2018 Regulatory Bulletin Issue 7

> ***"We're not equipped for this, it feels kind of apocalyptic."***
>
> ***Lucy Thornton***

As the UK prepared for 'Furnace Friday', what some forecasters predicted to be the hottest ever July day, the Brexit discussions also heated up. On **24 July 2018** the Government published the draft Statutory Instrument that will form the legislative basis of the temporary permissions regime for inbound passporting EEA firms and funds.

UK Government issues draft statutory instrument on Temporary Permissions Regime

As part of new powers established under the EU Withdrawal Act, the UK Government issued a draft statutory instrument (SI) setting out a Temporary Permissions Regime (TPR) to apply in the event of a 'no deal' Brexit for EEA firms first announced in December 2017.

The TPR is designed to minimise the disruption faced by EEA firms and UK businesses and consumers due to the loss of passporting rights arising from EU withdrawal and will ensure that:

- firms can continue to carry out business as before, writing new contracts and servicing existing contracts entered before exit day for a temporary period post-Brexit;
- firms have appropriate time to prepare for and submit applications for UK authorisation and complete any necessary restructuring to keep operating in the UK post-Brexit;
- the PRA and the FCA can manage the expected applications for UK authorisation from EEA firms that were previously operating in the UK via a passport in a smooth and orderly manner.

Firms currently passporting financial services into the UK from the EEA will not automatically benefit from the TPR. Instead, to enter the TPR firms will either need to submit an application for UK authorisation, or a notify the FCA of their intent to enter the TPR, as set out in Chapter 4 of Part 3 of the SI prior to 'exit day'.

Extension of the Senior Managers and Certification Regime

SMCR

- SMCR will apply to solo regulated firms and branches from **09 December 2019**.
- The near final rules are subject to commencement regulations to be made by HM Treasury but the FCA do not expect to make any significant changes.
- Senior managers will need a statement of responsibility for each senior manager function they hold.
- The FCA also does not intend to issue prescriptive guidance on the assessment of fitness and propriety on the basis that it considers firms are best placed to decide how their internal employee assessments should be carried out.
- The FCA will contact firms ahead of implementation to confirm the FCA's indicative assessment of the firm's tier status.
- Firms will have to identify and train Senior Managers and Certified staff by **09 December 2019.**
- There will be a transitional 12 month period to complete their initial certification process and train all other staff.

FCA Final Guidance on the duty of responsibility

- The statutory duty is to be brought within in **December 2019**.
- It empowers the FCA to take action against a Senior Manager where there was misconduct in a firm's activities for which that Senior Manager was responsible and the FCA can prove that the Senior Manager did not take reasonable steps to avoid the misconduct occurring or continuing.
- Firms should look to the existing DEPP guidance when considering the duty of responsibility and reasonable steps on the part of their senior managers.
- Failure to comply may result in FCA action.
- The burden of proof lies with the FCA, so it is for the FCA to prove that the Senior Manager did not take reasonable steps.

FCA Consultation on the proposal to introduce a new public register for checking the details of key individuals working in financial services.

The FCA is separately consulting on a proposal to introduce a new public register for checking the details of key individuals working in financial services as the CF30s currently held on the FCA register would no longer be held there under SMCR.

- The FCA proposes to introduce the Directory: a new public register and user interface that will make information public on additional individuals carrying out a wider range of roles (including Certification staff, non-Senior Manager Function Directors (executive and non-executive) and those who the FCA does not approve, such as financial advisers, pensions and mortgage advisers, traders, portfolio managers and additional managers), as well as presenting information on the Senior Managers that the FCA continues to approve.

The Directory would include information such as:

- Workplace location: list of individuals active in specific areas.
- Qualifications: list individuals who hold appropriate qualifications where relevant.
- Regulatory sanctions and prohibitions: facility to check which individuals are prohibited by the FCA and PRA or have limitations on the activities they are permitted to undertake.

If the FCA introduces the Directory:

- Firms would need to provide the FCA with the information outlined above on all Directory Persons who work on their behalf, by the end of an individual's first business day performing a relevant role.
- For existing staff, firms would have until the end of the SMCR transition period (9 December 2020) to certify relevant employees and report to the FCA accordingly.

- Firms would be responsible for the timely and accurate reporting of this information on an ongoing basis (with a £250 administrative fee for late or inaccurate data).

The FCA's approach to Brexit

Nausicaa Delfas, Executive Director of International at the FCA delivered a speech at the Bloomberg/TheCityUK event in London on he FCA's approach to Brexit and how they are preparing for a smooth transition.

Key highlights included:

- The focus is on meeting the FCA's three statutory objectives, to: secure an appropriate degree of protection for consumers; protect and enhance the integrity of the UK financial system; and to promote effective competition in the interests of consumers.
- The FCA are preparing for all scenarios, including the possibility of a 'no-deal' or 'hard' Brexit at March 2019.
- The FCA are participating in a technical group set up by the Bank of England and the European Central Bank which is taking account of potential Brexit risks, including contract continuity.
- The EU (Withdrawal) Act will transfer and convert existing EU law at the point of exit into UK law. It also gives powers to ministers to make secondary legislation to amend this legislation to ensure it functions effectively when the UK leaves the EU.
- The Temporary Permissions Regime (TPR) will allow EEA firms and funds using a UK passport to continue to operate, without needing to apply for authorisation at this stage.
- Markets will remain highly integrated whatever the outcome of Brexit, and the FCA think working to promote common global standards, alongside their work to onshore a rulebook that is equivalent to the EU on day one, provides a solid basis for cross border business to take place.

GDPR

The Information Commissioner (IC) has acknowledged that firms should be actively implementing GDPR and will stamp on those firms who ignore the requirements (Brexit has no impact on GDPR implementation for the UK). This invariably involves completion of GDPR risk assessments across business units, identifying and addressing gaps, as well as updating data protection procedures with GDPR requirements, including staff training and other processes.

Don't underestimate the time and resources this has and will continue to take. The IC has confirmed GDPR compliance should be viewed as an evolutionary process for the organisation, recognising the need for firms to identify and address emerging privacy and security risks going forward.

Several important areas for asset managers hold and process personal information, including:

- Investors
- Marketing
- Staff
- Data protection officers
- Contracts
- Privacy notices
- Data subject access requests
- Monitoring/audit
- Policies and procedures
- Training of staff.

How can we ensure that Big Data does not make us prisoners of technology?

Charles Randell, Chair, Financial Conduct Authority and Payment Systems Regulator delivered a speech at the Reuters Newsmaker event, London.

Key highlights included:

- Three factors could come together to make an algocracy more than just science fiction: Big Data, artificial intelligence and machine learning, behavioural science.
- The power of Big Data corporations and their central place in providing services that are now essential in our everyday lives raise significant questions about the adequacy of global frameworks for competition and regulation.
- We need to anticipate the fundamental questions which Big Data, artificial intelligence and behavioural science present, and make sure that we innovate ethically to shape the answers.

FCA policy statement on final 2018/19 regulatory fees and levies

The FCA published a policy statement on regulated fees and levies for 2018/19. The policy statement sets out the final 2018/19 fees and levies for the FCA, the Financial Ombudsman Service, the Money Advice Service, the Pension Wise service, the Single Financial Guidance Body and HM Treasury's illegal money lending levy expenses. The total 2018/19 annual funding requirement (AFR) remains unchanged from CP18/10 at £543.9 million (representing an increase of 3.2%). The AFR includes the FCA's ongoing regulatory activities budget costs, the costs it needs to recover for changes to its regulated activities, and the costs of EU withdrawal.

Alongside the policy statement, the FCA has published the instruments making the rules for the 2018/19 fees and levies. These instruments were made by the FCA Board on 28 June 2018 and came into force on 2 July 2018. The FCA advises that firms can use its online fees calculator to work out their individual fees based on the final rates. It will invoice fee-payers from July 2018 onwards for their 2018/19 periodic fees and levies.

MiFID II and the fight against financial crime

Mark Steward, Director of Enforcement and Market Oversight at the FCA, delivered a speech on the fight against financial crime at the Duff & Phelps Global Enforcement Review 2018.

Key highlights included:

- From 3 July, firms require Legal Entity Identifiers (LEIs) before they can trade on behalf of their clients. A LEI is a unique code, included in a global data system, which allows every legal entity or structure that is a party to a relevant financial transaction to be identified, no matter where it is located.

- Since the second Markets in Financial Instruments Directive (Mifid II) commenced on 3 January 2018, the FCA's market data processor has ingested nearly 3.5 billion transaction reports, averaging over half a billion reports per month.
- Using software developed in-house to normalise and ingest disparate order book data-sets from the main lit and dark UK trading venues, it is now possible to track potentially related trading activity on different venues and detect cross-market manipulation.
- The FCA have commenced a small number of investigations into firms' systems and controls where, for the first time, they have indicated to those firms that they are looking at whether there has been any misconduct that might justify a criminal prosecution under the Money Laundering Regulations.

New AML Requirements for Cayman Funds & Investment Entities - Deadline of September 30th 2018

On 6 April 2018, CIMA published a notice which confirmed that natural persons need to be appointed to the following three AML officer roles:

1) money laundering reporting officer (MLRO);
2) deputy money laundering reporting officer (DMLRO); and
3) AML compliance officer (AMLCO and together, AML Officers).

In practice it seems likely some funds will appoint one individual to the dual roles of AMLCO and MLRO and a separate individual as DMLRO. The good news is that CIMA's notice introduced a grace period with respect to such AML Officer appointments such that with respect to funds in existence prior to 1 June 2018, the appointments must be made by **30 September 2018.**

From 1 June 2018, new funds are expected to have appointed such designated AML Officers. In the case of CIMA regulated funds such as hedge funds and mutual funds, notification of the designated AML Officers must be made to CIMA by the applicable deadline. With respect to private equity funds, unregulated funds and SPV's, whilst AML Officers must be appointed by the deadline, there is currently no stipulated notification procedure for such vehicles.

The AMLCO must have AML oversight of an investment entity's activities, and the role includes taking measures to develop Cayman AML and compliance systems and controls, reporting issues to the Board and dealing with mandatory reporting and enquiries from regulatory bodies.

The DMLRO and MLRO will be the key points of contact for reporting suspicious activity, and they will take responsibility for reporting such activity to the relevant regulatory authorities. These roles can be fulfilled by directors of the fund or employees of the investment manager, administrator or service providers but they must be named and designated individuals with the appropriate knowledge, expertise and autonomy to carry out the function.

FCA revised version of payment services and e-money approach document

On 6 July 2018, the FCA published version 2 of its approach document on payment services and electronic money) to reflect the requirements on operational and security risk under the revised Payment Services Directive. In summary, the FCA is requiring all payment services providers to comply with the EBA's guidelines on operational and security risk under PSD2, and to report to the FCA at least annually on their operational and security risk management frameworks.

ESMA consults on extending the derogation for EU to third-country EMIR intragroup clearing exemptions

On 11 July 2018, ESMA published a consultation paper on the clearing obligation under EMIR. In the Paper, ESMA proposes a draft amending the Regulatory Technical Standard relating to the treatment of intragroup transactions between EU and third country group entities. As no third-country equivalence determination has been made in relation to the EMIR intragroup clearing exemption regime, ESMA proposes to extend to December 2020 the current derogation provided for these transactions in the absence of the relevant equivalence decisions. The consultation is open until **30 August 2018**.

Draft Finance Bill 2019 legislation published

HMRC has published draft legislation for the Finance Bill 2019. Among other things, the draft legislation extends corporation tax to the property income of non-resident companies, and extends capital gains tax and corporation tax on property gains to non-residents. The government has also amended various corporate tax provisions, including those relating to exit charges, controlled foreign companies and hybrids and other mismatches to be compliant with the EU's Anti-Tax Avoidance Directive.

The consultation on the draft provisions generally closes on 31 August 2018 and the government will introduce the Finance Bill 2019 into Parliament following the Budget in the autumn.

Financial Conduct Authority responds to Environment Audit Committee recommendations on green finance

On 6 July 2018, the FCA published its response to the recommendations the Environment Audit Committee made to it in its June 2018 report, Greening Finance: embedding sustainability in financial decision making. The FCA's comments include that it will:

(i) consult on rule changes requiring independent governance committees (IGCs) to report on their firm's policies on evaluating environmental, social and governance (ESG) considerations and take account of members' ethical concerns;
(ii) highlight to issuers the need to make adequate disclosure on materially important information, including on ESG, however, it will not amend the listing rules to require climate-related financial disclosures; and
(iii) publish its approach on climate-related issues and green finance later in 2018.

MiFID II cases – Inducements and research

Under the Markets in Financial Instruments Directive II (MiFID II), research is allowed not to be treated as an inducement provided that it is paid for:

- directly by the firm from its own resources; or
- via a separate research payment account, funded by specific research charges to the client.

This has meant that most large asset managers have added the costs of research to their profit and loss reports, which means now much less research is being approved. This has put pressure on research houses' margins and business models. Larger asset managers and banks have been able to absorb these new pressures, but a consultant quoted in the FT has said: "Tier 2 players are struggling to monetise their research offerings".

The result is there is increasingly less research available, but given that under MiFID II, client interactions are more closely tracked, it's easier for analysts to track how much their research is worth. Estimates are that investment research numbers are likely to halve, with the result that a 'star analyst' culture is emerging.

Enforcement cases

Four former directors of online consumer credit broker banned for misleading customers

The firm took fees of over £7.2 million from approximately 124,000 online customers by duping them into believing they had been approved for short term loans. Customers searching for loans online were informed on arrival at the websites they had been 'approved'. They were shown details of a sample loan and were asked to enter their payment card details in order to 'verify their account'. Customers were not pre-approved for a loan and there was no such account verification, instead their cards were charged between £39 and £69.

Mark Steward, Executive Director of Enforcement and Market Oversight, said:

"These four individuals consistently misled vulnerable customers into paying money for worthless services and into believing their company had found them a loan, in addition to selling on their data. They showed complete disregard for the consequences of their actions. We have taken the strongest action possible to prevent them from working in financial services again."

The FCA found that between November 2013 and July 2014 all four lacked honesty and integrity as they had deliberately misled often vulnerable customers, in relation to fees and services provided through web-based brands.

The Insolvency Service, with assistance from the FCA, disqualified all four individuals as directors last year for periods of between 5-8 years. The FCA's bans remain in place for life or for as long as necessary for consumer protection.

Wealth management boss jailed over £14.5m Ponzi fraud

A former boss of a wealth management firm has been sentenced to six years in jail for defrauding 55 people out of £14.5m in a Ponzi scheme.

A City of London Police investigation found that between 2005 and 2017 the managing director was running the Ponzi scheme through the Financial Services firm. The FCA referred the case to the police after it became suspicious of the company's accounts.

According to the police, the former director would convince the investors, some of whom he knew personally as friends, their funds were being held in a high-interest bank account offering between four and eight per cent annual interest. The investigation revealed money was being transferred into his personal account for his own use as well as being used to pay investors "monthly interest". He used the money for gambling, holidays and his children's school fees.

Between January 2005 and November 2017, he spent £15.6m on gambling websites and £240,000 in one day alone.

FCA enforcement and market oversight executive director Mark Steward adds: "He abused the position of trust he had as managing director at a regulated firm to run this appalling fraud."

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- Related Training

FMConsult Contacts

Dallas J. McGillivray
Group Managing Director & Authorisation Services
Tel: 020 7220 9073
dmcgillivray@fmconsult.co.uk

Andrew (Andy) Hicks
Director, Head of Monitoring Services
Tel: 020 7220 9074
ahicks@fmconsult.co.uk

Ross Revell
Director
Tel: 020 7220 9078
rrevell@fmconsult.co.uk

Colette Panebianco
Director, FMConsult USA
cpanebianco@fmconsult.us

John Clare
General Manager, FMConsult Ireland
Tel: +353 87 2599510
jclare@fmconsult.ie

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