DUFF & PHELPS

REGULATORY FOCUS

A synopsis of the Financial Conduct Authority's (FCA) latest news and publications issued in August and September 2017.

ISSUE 110

Countdown Until MiFID II: Less Than 40 Business Days

MiFID II topics and challenges

Legal Entity Identifiers (LEIs)

The FCA has updated its website in relation to Legal Entity Identifiers (LEIs). It states that from 3 January 2018, firms subject to transaction reporting under MiFID II will not be able to trade for clients that are eligible for LEIs if they do not have one. We recommend that all firms subject to transaction reporting check that all clients have LEIs, where relevant.

To view the FCA webpage please click here.

Best execution - Disclosure of execution quality by Execution Venues

Execution venues will have to publish information on execution quality under Regulatory Technical Standard 27 (RTS 27). This allows investment firms (including brokers) to monitor the quality of execution they are obtaining more effectively, and to help them choose the execution venue that will provide the best results for their clients on a consistent basis. This information should be published quarterly. Execution venues are defined as regulated markets, Multilateral Trading Facilities (MTFs) and Organised Trading Facilities (OTFs), but may also be market makers and other liquidity providers.

OUR RECENT AWARDS

BEST COMPLIANCE CONSULTING TEAM
Women in Compliance Awards 2017

BEST GLOBAL REGULATORY ADVISORY FIRM
Hedgeweek Global Awards 2017

EUROPEAN SERVICES - BEST CONSULTANCY FIRM 2016
CTA Intelligence

BEST EUROPEAN OVERALL ADVISORY FIRM 2016
HFMWeek

BEST OVERALL ADVISORY FIRM IN THE U.S. 2014*
HFMWeek

BEST ASIAN ADVISORY FIRM FOR REGULATION AND COMPLIANCE 2014*
HFMWeek

BEST EUROPEAN ADVISORY FIRM FOR REGULATION AND COMPLIANCE 2014*
HFMWeek

BEST ADVISORY FIRM REGULATION AND COMPLIANCE 2014
*HFMWeek**

BEST SEC REGISTRATION TEAM - HONG KONG 2014*
Acquisition International

*Awarded to Kinetic Partners, which was acquired by Duff & Phelps in January 2015

Supervision Matters

Regulator consults on client money

1 August 2017

The FCA recently published Consultation Paper 17/29: *Client money and unbreakable deposits*, in which the Regulator consults on amendments to the CASS sourcebook. The changes are driven by feedback from various investment firms which have had trouble in placing client money at banks in accordance with CASS requirements, and has in turn, led to the FCA's concern of the potential harm caused to consumers. Here, the root cause is CASS 7.13.13R (3) (the '30 day' rule) and the liquidity requirements which apply to banks and other relevant deposit holders offering such accounts. Currently such accounts are subject to the Liquidity Coverage Ratio (LCR) requiring banks to hold highly liquid assets to cover 100% of potential cash outflow over 30 days. The proposed extension of the '30 day' rule would mean accounts would not attract the same LCR treatment and banks would therefore, potentially, have more appetite to offer client money accounts with a longer term.

The FCA asks firms for feedback; specifically it seeks views on:

- Permitting firms to deposit an appropriate proportion of client money in an unbreakable deposit of a maximum of 90 days
- Where a firm deposits client money in an unbreakable deposit of 31-90 days and it must comply with certain conditions and
- Requiring CASS medium and large firms to report client money in an unbreakable deposit of 31-90 days in their client money and asset return (CMAR)

The deadline for feedback is 1 November 2017. The regulator will then publish a policy statement, along with finalised rules.

If you would like to read the CP in full, please click here.

Financial Advice Market Review (FAMR): Implementation Part II and insistent clients

1 August 2017

The FCA has published Consultation Paper 17/28 to consult on guidance which relates to recommendations made by FAMR in its final report.

The consultation will be of interest to firms providing advice on, or distributing, retail investment products and financial instruments to retail clients.

FAMR was launched by FCA and HM Treasury in August 2015 with the aim of exploring ways in which government, industry and regulators could develop a market that delivers affordable and accessible financial advice and guidance to consumers.

The guidance contained in CP17/28 proposes the following:

- Changes to the FCA Handbook reflecting amendments to the Regulatory Activities Order. These were agreed in February 2017 (following HM Treasury consultation), and will come into force on 3 January 2017. As a result, most authorised firms will be exempt from the regulated activity of 'advising on investments' unless the firm is providing a personal recommendation
- Updating Perimeter Guidance (PERG) to give firms more clarity on what amounts to a personal recommendation
- Creating guidance to address common areas of uncertainty which were identified from the FCA's Advice Unit experiences. The FCA set up its Advice Unit in May 2016 in response to FAMR's recommendation that a team was dedicated to assisting firms develop mass-market automated advice models
- Issuing guidance on ways in which to treat insistent clients has also been drafted to provide support to firms, especially in light of legislative requirements that consumers must receive regulated advice for any defined benefits where the value of the fund transferred exceeds £30,000

The FCA is inviting responses to this consultation by 2 October 2017. It is anticipated that a Policy Statement will be published in December 2017.

If you would like to read the CP, please click here.

Enforcement Matters

FCA Regulation Round up
September 2017

In its September edition of Regulation Round up, the FCA has chosen to focus on the topical items of MiFID II, anti-Money Laundering (AML), recovery plan submissions for IFPRU 730k firms, commodity derivatives and structured deposits.

AML and Sanctions
It is clear the Regulator has an increased focus on AML. Its revised approach to AML supervision and oversight will include annually reviewing the AML and sanctions controls within 100 randomly selected firms. This will provide the FCA with a clearer picture of AML risks within the various sectors the FCA regulates. The Regulator comments that the results of the review completed in 2017 are positive, and that the process of assessment has been useful in helping firms focus on and improve their AML and sanctions frameworks. The FCA goes on to say the new programme is just one aspect of its approach, and makes reference to a new annual data return. More details will be provided in a future 'Regulatory Round up' edition.

Given the enhanced strategy and potential 'annual data return', all firms should consider their overall approach for AML and sanctions and ensure the risk-based approach set out in policies and procedures are fit for purpose and are updated for the Fourth Money Laundering Directive.

MiFID II
Commodity derivatives: the FCA published a list of commodity derivative contracts where a bespoke position limit will be set. The FCA also updated its website in relation to the application for position limit exemptions and notification requirements.

Structured deposits: the Treasury has created a new investment type for structured deposits to support the implementation of MiFID II regulation. Firms wishing to perform certain regulated activities in relation to structured deposits after 3 January 2018 can update their permissions during 2017 through a simplified process. From 3 January 2018 firms will need to make a formal application for a variation of permission.

Approved Publication Arrangements (APA): MiFID II expands obligations for post trade reporting. Reports are made by trading venues through a firm authorised as a Data Reporting Service Provider to provide APA's. As such, the FCA has authorised the first batch of APAs and a list of the entities can be found on the FCA webpage.

Recovery plan submissions for IFPRU 730k firms: The FCA stated that many firms need to strengthen the quality of their scenario analysis. Any IFPRU 730k firms should review comments made by the FCA ahead of their 2018 submissions of recovery plans to ensure they understand and implement FCA feedback.

Upper Tribunal upholds FCA's decision to fine and ban individual, a former CEO of an advisor network
8 August 2017

The Upper Tribunal has upheld the FCA's decision to ban an individual, a former CEO, from performing significant influence functions. The Tribunal also upheld the FCA's decision to impose a financial penalty of £86,691.

The banned individual was the majority shareholder and CEO of a regulated firm, as well as a director and de facto CEO of the advisor network. The national network at its peak consisted of 397 appointed representatives and 516 registered individuals, which collectively provided advice to 40,000 customers.

The Tribunal agreed that the individual failed to act with due skill, care and diligence in carrying out his role as director and CEO of the firms. He failed to take reasonable steps to ensure that business was organised so it could be controlled effectively, in relation to oversight and monitoring of appointed representatives and registered individuals during a time of increased expansion.

The individual can still appeal to the Court of Appeal if he chooses to do so.

Other publications

FCA - Review of property funds and liquidity rises
20 July 2017

The FCA has published findings from its review on the impact on customers of deal suspension and price adjustments by property funds following the UK's vote to leave the EU. The findings will be considered alongside the responses to DP 17/1 (illiquid assets and open-ended investment funds). The review focused on daily-dealt UK authorised property funds, and linked life assurance contracts which use property-backed contracts. The reason for focusing on these types of investments is that these both invest in illiquid assets which, by their very nature, make it difficult for them to realise assets quickly. The FCA wanted to understand, if this would place customers in an unfair position, what measures fund managers took to tackle the situation and avoid market uncertainty from escalating.

Overall, the FCA found that the use of suspensions was effective in preventing market uncertainty from escalating further, and the use of other liquidity management tools, such as deferred redemptions, helped reduce the risk of market uncertainty escalation. Whilst property funds which invest in illiquid assets will always have difficulty in realising assets quickly, liquidity management tools can reduce the risk.

However, the FCA noted that firms could enhance their communication to their customers following significant market events and should review their policies and procedures for dealing effectively with similar market disruptions.

To read the FCA's Review of property funds and liquidity rises, please click here.

GC 17/7: Proposed guidance on a sourcebook for professional body supervisors on anti-money laundering supervision
24 July 2017

The Government announced in March 2017 that a new Office for Professional Body Anti-Money Laundering Supervision (OPBAS) would be created at the FCA. As a result, the Regulator has published its consultation on its approach to OPBAS supervision and has also published text for a specialist sourcebook for professional body supervisors.

If you would like to read the consultation paper in full please click here.

FCA publishes occasional paper on the implications of dark trading on market quality
1 August 2017

The FCA has published Occasional Paper No.29, which looks at evidence surrounding the potential implications dark trading could have on aggregated market quality, across the UK and Europe.

As an increasing percentage of UK exchange trades are executed within "dark pools", the FCA felt that it was vital to understand how these affect overall market liquidity and investor protection, as well as reviewing competing arguments surrounding their impact against that of "lit" transactions.

Questions have arisen regarding the process for securing price quality, as trades, or "dark orders" executed within these dark pools are not subject to any pre-trade transparency requirements. Therefore, other market participants will be unaware of the trade prior to execution, or that the reason trades are placed here is due to their lack of overall quality. However, arguments have been put forward to suggest that the reduction of trades within lit venues would lead to a reduction in "noise" and an overall enhancement within the price discovery process. If these prices are used as reference for trades within dark venues, then this will ultimately increase market quality.

The key findings within this paper outline that from the study of data from 288 of the largest stocks within the London equity market conducted across a five-year period (June 2010 - June 2015), no evidence could be found that dark trades had any detrimental effects on the market, until the trading value (as a proportion of the total trading value) exceeded 15%. The results also indicated that dark trading can reduce adverse selection risk and issues within the price discovery process, up to a total attainment of 16% and 11% respectively of total trading value and that when adjustments were made to allow for increased trading environments, the threshold could rise to as high as 17%.

Post MIFID II implementation, the overall value of trades permitted within dark pools will be limited to a maximum of 8% for each stock traded. From the sample taken by the FCA, it was evidenced that current daily trade levels are at approximately 8.35% and no indications were given that there would be any negative effect on market quality at this level.

For further information, the full text of Occasional Paper 29 can be found here.

New technologies and anti-money laundering compliance report
2 August 2017

The FCA has published a report detailing findings from a three month study into new technologies in anti-money laundering ("AML") compliance. The Report highlights respondent's views on the following questions:

- What new and emerging technologies are available regarding AML compliance, and which are considered by regulated firms?
- What challenges do firms face in introducing new technologies, particularly regarding innovation in AML compliance?
- What are the FCA's views regarding new technologies in AML compliance?

As part of the study, 40 interviews were held with a range of regulated firms, technical providers as well as other bodies. The Report contains information on emerging themes, such as how new technologies have the potential to deliver cost reductions as well as enhance current AML, terrorist financing and fraud controls. It notes, however, that the attractiveness of such technologies varies from firm to firm, particularly when considering level of support, cost and understanding of individual business activities. In addition, the study uncovered that some regulated firms felt unwilling to use unproven technologies due to the perceived level of risk.

Areas reviewed as part of the study include AML technology decision making considerations, customer onboarding and maintenance, client screening, as well as reporting and management information. It provides information around perceived barriers to the development and use of compliance technology, and the response from technology providers. It also details industry views on the FCA's approach to new technologies within the AML compliance space as well as a brief overview of key differences between the UK and other jurisdictions in their approach to AML and know your client innovation.

The FCA believes the report will be of interest to firms that are considering employing new AML compliance technologies.

If you would like to read the Report in full please click here.

Overview of competition at the FCA

24 July 2017

Ms Mary Starks, Director of Competition and Economics has given a speech, focusing on the FCA's competition mandate, why it exists and how it is pursued. She began by commenting that she arrived at the FCA in 2013, alongside co-director Deborah Jones and their peers, to promote competition and financial services in three ways:

(1) Market Studies

(2) Competition Law Enforcement

(3) Pro-Competition Regulation

1. Market Studies

Under FSMA and the Enterprise Act 2002, the FCA has authority to carry out a comprehensive analysis of a market and how it operates; enabling it to identify any issues of concern or "Theories of harm". These theories suggest how competition in a particular market can be improved and describes the adverse effects of the current situation on that market.

In conducting market studies the FCA will produce various publications and consultations on an issue and ultimately publish a final report setting out the way forward.

There are no restrictions determining which market the FCA should focus its studies on, but it will look for indicative factors showing a lack of competition compliance.

2. Competition Law Enforcement

The FCA, in partnership with the Competition and Markets Authority (CMA), can investigate alleged or suspected breaches of competition law. Breaches of competition law can be varied but generally fall within one of the following two categories:

1. Failure to maintain strategic independence, i.e. firms that enter agreements or other practices that involve cooperating with firms that should be their rivals
2. Abuse of dominant position

Either the FCA or the CMA will take a case forward, depending on which body is best placed to do so, but ultimately the CMA has the power to decide.

3. Pro-Competition Regulation

A firm must be authorised by the FCA before it can sell financial services and products. Thus, the FCA acts as a 'gateway' function to the financial market and can determine the impact a firm will have on the competition within it.

The FCA has worked with the PRA to review its authorisation process and requirements for new firms so whilst it is easier to become authorised, the standards expected remain. The FCA has also established its 'Innovation Hub' and 'Sandbox' schemes to aid new and innovative firms to gain an awareness of the regulatory implications of their innovations. This also allows the FCA to understand where and how their regulations may be hindering that innovation.

The speech concluded with Ms Starks highlighting that with all competition, there are losers, and unfortunately some firms fail to remain valid competition and cease to function. The FCA acknowledges that this is a side-effect of maintaining a competitive market, but by carrying out market studies, competition law enforcement and pro-competition regulation, the FCA has made it easier for new and innovative firms to challenge the dominant and keep the market fair, creating better offerings to consumers and preventing firms from becoming complacent.

Enforcement - non-public outcomes

August 2017

The FCA's August Regulatory Update contained a section on the enforcement action undertaken by the FCA's Threshold Conditions Team (TCT) against firms which fail to comply with basic regulatory requirements (such as requirements to submit FCA returns and fees due). These can result in the FCA cancelling the regulatory status of those firms, which means they can no longer conduct regulated business.

In the year ending 30 June 2017, the TCT canceled the authorisation of 207 firms for these (and other) failings.

The FCA also highlights that following referral to the TCT, whilst many firms do comply late and retain their authorisation, other firms volunteer to give up their authorisation. During the same period as mentioned above, 1.387 referrals were received by the TCT, 824 managed to retain authorisation and 122 applied to cancel permission altogether.

To view the page please click here.

30 Day Notice - Revised Version of Form ADV

Firms are advised that if they are registered as an Exempt Reporting Advisor, or fully registered with the SEC, they may receive an automated email from the SEC about a revision to the ADV form.

From 1 October 2017, all investment advisors filing Form ADV must use a revised version of Form ADV which is designed to enhance the reporting and disclosure of information by investment advisors.

All investment advisors filing an initial Form ADV or a Form ADV amendment (annual updating amendment or other-than-annual amendment) will be required to provide responses to the form revisions adopted in the rulemaking (including all new and amended questions), beginning on October 1, 2017.

Completeness checks in the IARD system will not allow the submission of filings with incomplete responses.

If you would like to review the amended forms please click here or the list of FAQ's.

Initial Coin Offerings (ICOs)

12 September 2017

The FCA has published a warning to consumers about the risks of ICOs partly due to the increased popularity of investing in cryptocurrencies which has been supported by concern and an increasing struggle to regulate and identify their associated risks.

ICOs are an alternative form of raising capital. Like an Initial Public Offering, it allows an organisation to raise funds from numerous sources. Rather than selling shares in a company, the issuer sells newly issued digital currency called 'coins' or 'tokens'.

Investors use established cryptocurrencies, such as Bitcoin or Ether, to purchase units of these new digital coins. These coins relate to an individual company or project, which publish a white paper outlining how they will use the cryptocurrency to fund the development of their phone application, software, business operation or any other enterprise. The coin can represent almost anything; a share in a company, voting rights, a prepaid voucher for services not yet rendered, or it may have no obvious value at all. The investor's hope is that the project is successfully launched and that its popularity generates demand for the new unit of coins, thereby increasing their value and allowing investors to sell the coins at a profit on cryptocurrency exchanges.

There are various benefits to participating in ICOs; the democratised access allows almost anyone from any geographic location to invest in them, their liquidity grants investors the opportunity to trade coins in the secondary market and the potential for fast and significant returns is a major lure.

But ICOs should be approached with caution. The FCA considers them to be "very high-risk, speculative investments". It warns consumers to be cognisant of the risks involved in buying digital coins, and to conduct detailed research before investing funds. It advises consumers to only part with their money if they have the relevant investment experience, can afford their losses and have confidence in the project's business plan, technology and key individuals.

The FCA highlighted the following risks associated with ICOs:

- The majority of ICOs are unregulated by the FCA and many are based outside the UK
- It is unlikely that consumers will be able to seek compensation or remedial action through the Financial Services Compensation Scheme or the Financial Ombudsman Service
- Due to their price volatility, coins are susceptible to significant fluctuations in value
- The possibility of fraud may see consumer's funds being utilised for a different purpose to that which was originally marketed to them
- Consumers are generally provided with a white paper rather than a regulated prospectus. Such papers may be misleading or inadequate and as such, the coin's characteristics and its associated risks may only be appreciated by experienced investors with technical knowledge
- ICO projects and business models are usually in the preliminary stages of development which may increase the likelihood of consumer's losing their whole investment sum

The regulation of an ICO is evaluated on a case by case basis and is largely dependent on its structure. The FCA advises promoters and firms involved in ICOs to assess whether their activities amount to regulated activities, and advises digital currency exchanges to consider whether they require FCA authorisation.

The FCA requests any suspected scams to be reported to them and provides links to further information regarding the technology behind ICOs.

The FCA's full press release can be found here.

FCA Update: MiFID II applications for authorisation and variations of permissions

18 September 2017

The FCA issued a statement regarding the need to submit applications for authorisation and variation of permission (VoP) prior to MiFID II which comes into effect on 3 January 2018. The Regulator has previously warned that failure to do so before 3 July 2017 may mean that the new permissions will not be in place for when MiFID II comes into effect.

Given that the initial deadline set by the FCA has already passed, firms should submit their application for authorisation/VoP as a matter of urgency, if they haven't already done so. This particularly applies to proprietary traders who use direct electronic access ('DEA') provided by a regulated firm as they will have a duty to carry out due diligence on prospective DEA clients. The FCA application and notification user guide can help you assess whether you require authorisation or new permissions, in addition to those currently held, under MiFID II. This can be found here.

Firms should also ensure that adequate contingency plans are in place if the new permissions are not approved prior to 3 January 2018.

If you have already submitted your application for authorization or VoP and have been contacted by the FCA then you must respond to their requests without delay, as any delay will hold up the application being approved.

Click here to read the full statement by the FCA.

ESMA

ESMA Updates Q&A on MAR

The Markets Abuse Regulation (MAR) came into effect in June 2016 with the objective of creating a level playing field for all financial operators within the EU. However, as with all legislation, some areas have remained unclear and questions raised.

As the European legislature for MAR, The European Securities and Markets Authority (ESMA), is responsible for clarifying any such questions and ensuring that common application of the regulations is achieved. One way of managing this is by regularly updating its Q&A 'tool' to provide practical answers to frequently asked questions.

The scope of the September 2017 update focuses on clarifying

(1) The detection and reporting of suspicious orders and transactions (Question 6)

(2) The scope of the financial instruments subject to the market sounding regime (Question 9)

(3) The persons' subject to the insider list requirements (Question10)

Central to MAR is the issue of insider dealing. Under MAR an insider is any person that has access to inside information. This is not limited to the issuer of the information but also includes all persons acting on behalf of the issuer that have access to inside information.

Additional questions on MAR can be submitted to ESMA through the Q&A tool on its website.

To read the ESMA's Q&A tool, please click here.

EBA/EIOPA/ESMA Joint Guidelines on Controllers

20 September 2017

The Joint European Supervisory Authorities (ESAs) combining the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) has issued its Final Report on Guidelines for how Acquisitions and Increases of Qualifying Holdings (Changes in Control) should be assessed.

The report, dated 20 December 2016, under reference JC/GL/2016/01 was finally published in all EU official languages in mid-July 2017, and gives Competent Authorities two months within which to confirm if they will comply or not with the Guidelines which will apply from 1 October 2017.

Within the Guidelines a *Qualifying Holding* is defined as a direct or indirect holding in a relevant Undertaking that represents either 10% or more of the capital or voting rights, or which makes it possible to exercise a significant influence over the management of that Undertaking. In summary, the main aim of the Guidelines is to bring about consistency between Competent Authorities when assessing these circumstances with four main objectives to achieve this. These are:

- Agreeing the circumstances for when a Competent Authority should be notified of a proposed change in Qualifying Holdings from Institutions within the Credit Institution, Insurance and Investment Firm's sectors
- Providing clear direction on how holdings can be acquired or changed, as well as providing a timeframe for when the request will be dealt with
- Explaining how each request will be considered
- Listing all necessary documentation required with requests

It had previously been noted that there was a lack of consistency between Competent Authorities of Member States in considering the effect of indirect shareholders on potential acquisitions, and therefore if acquisitions of this nature needed to be reported. Section 6 of the Guidelines covers acquisitions of indirect holdings and Annex II provides worked examples showing how to identify circumstances when an indirect holding has been acquired.

In the UK, the FCA and the PRA have stated they will comply with these Guidelines, apart from those in relation to the identification of indirect holdings. They instead require firms to continue to apply the procedures set out in Part XII of FSMA.

The FCA's full Article can be found here.

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