DUFF & PHELPS

Protect, Restore and Maximize Value

Regulatory Focus

Issue 119

INSIDE

A synopsis of the Financial Conduct Authority's (FCA) latest news and publications issued in October and November 2018

VOICE

SM&CR- under a year to go.

There is just under a year until the implementation of SM&CR, which will apply to all regulated firms from 9th December 2019. This follows the implementation to banks in March 2016 and to insurers this December. The conduct rules will apply to all Senior Managers and Certified Staff from this date and firms will have 12 months from commencement to complete fitness and propriety checks and the certification process.

The new regime replaces the current Approved Persons Regime and has a three-tier approach so that SM&CR is applied in a proportionate way:

Core regime: a standard set of requirements will be applied to all FCA firms except for Limited Scope Firms. The requirements comprise of Senior Managers Regime, Certification Regime and Conduct Rules.

Enhanced regime: the core regime plus additional requirements will be applied to significant or complex firms, e.g. asset managers with AUM of over £50 billion, including responsibilities maps, document handover procedures and confirming that a senior manager has overall authority for each area of the business.

Limited Scope Regime: a reduced set of requirements will be applied to a small proportion of firms such as internally managed AIFs and sole traders.

Given that there is now under 12 months to go until implementation, we recommend that firms start to plan for implementation and educate their governing bodies. If you would like assistance with SM&CR, please contact us.

To read more visit our website here.

Brexit

As the uncertainty around Brexit continues, there have been a number of publications, consultation papers and speeches about the FCA's approach to Brexit. Please refer to our section on Brexit over the following pages.

Common Supervisory Culture

On a separate note, ESMA has taken an active role in creating a common supervisory culture by promoting a common supervisory approach and practices. The updated version of ESMA's supervisory briefing now considers the new ESMA guidelines that were published in May 2018. The supervisory briefing has been implemented to provide guidance for supervisors on the correct suitability approaches that need to take place in line with MIFID II and the areas where supervisory work needs to be focused on.

FCA telephone survey

A number of firms have been contacted by the FCA stating that, as the regulator is bringing in new rules that will affect the way in which it regulates firms, it wants to check whether firms know about the changes. It has asked an independent research agency to help them undertake this research by conducting a telephone survey.

D&P EVENTS

On 1st November Duff & Phelps held a European Alternative Investment Conference at the Landmark in Marylebone, which was a very successful whole day event which covered mainly valuation issues, but also included a session on the senior managers and certification regime presented by Jane Stoakes.

On 13th November Duff & Phelps held a Brexit Breakfast Briefing, chaired by Andrew Lowin, with Greg Sachrajda, Head of International Delivery at the FCA, as the keynote speaker, Mark Shaw, a Partner at Wildgen Luxembourg Law Firm, Marie Barber, MD, Regulatory Tax and Business Services and Killian Buckly, MD, Head of Management Company Solutions, both from Duff & Phelps. The session covered:

- the FCA's approach to Brexit,
- distribution of funds and delegation of investment management post Brexit,
- tax implications including jurisdictions, people, transferring assets and fee flows, and
- an insight into what we are seeing in Ireland and Luxembourg, the main message being that firms setting up offices there need substance.

The event was held at Grocer's Hall due to the large number of attendees.

On 4th December Duff & Phelps Paris held a Brexit briefing where Ian Manson and Marie Barber attempted to explain the UK and FCA's approaches in case of a soft or hard Brexit.

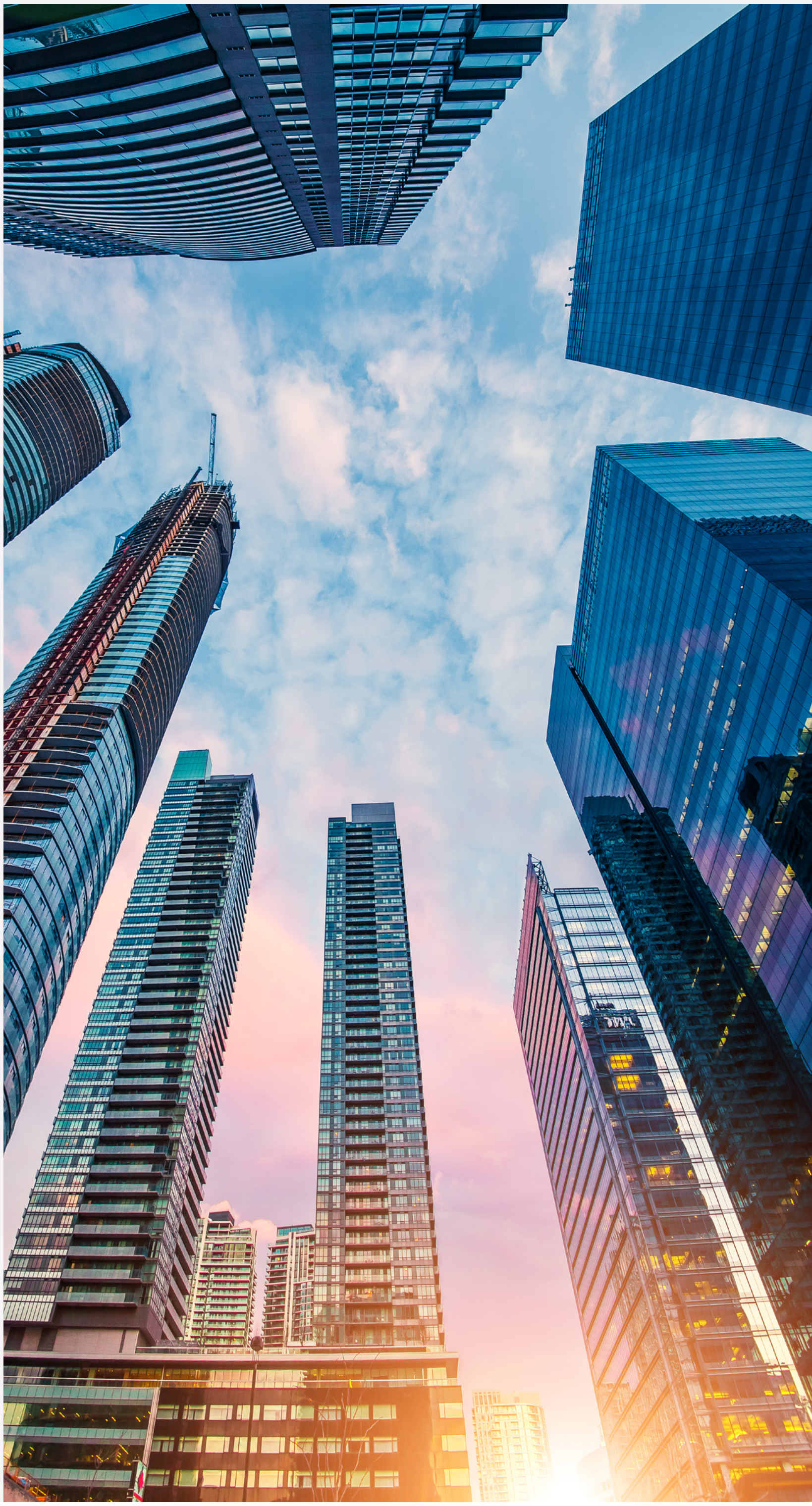
EU Withdrawal Agreement and Impact Assessment

The Government issued a draft agreement, dated 14 November 2018, on the arrangements that will take place in light of the UK ceasing to be a member of the European Union in March 2019. In summary the agreement states there will be a transitional period until 31 December 2020, which could potentially be extended to a yet undefined date by a joint committee of UK and EU representatives. During the transitional period all EU laws will continue to apply in the UK, with passporting rights between the UK and EU remaining the same. Other regulatory bodies, such as ESMA and European Services Authority ('ESA'), will retain their regulatory powers during this period.

On 29th November 2018, the FCA published its EU Withdrawal Impact Assessment, as requested by the Treasury Select Committee. The Assessment sets out the impact of the Withdrawal Agreement, as well as the future framework on the FCA's objectives. The Committee asked the FCA to assess the impact of the UK's exit of the EU across three areas:

- The UK leaves the EU without an agreement either on 29 March 2019 or after the transitional period on 31 December 2020. This can be found in section 2 of the Assessment.
- The draft Withdrawal Agreement. This can be found in section 3 of the Assessment.
- The outline of the political declaration on the framework for the future relationship between the EU and the UK. This can be found in section 4 of the Assessment.

The full EU Withdrawal Impact Assessment can be found at the following link.



FCA consults on its approach ahead of the UK's exit from the EU

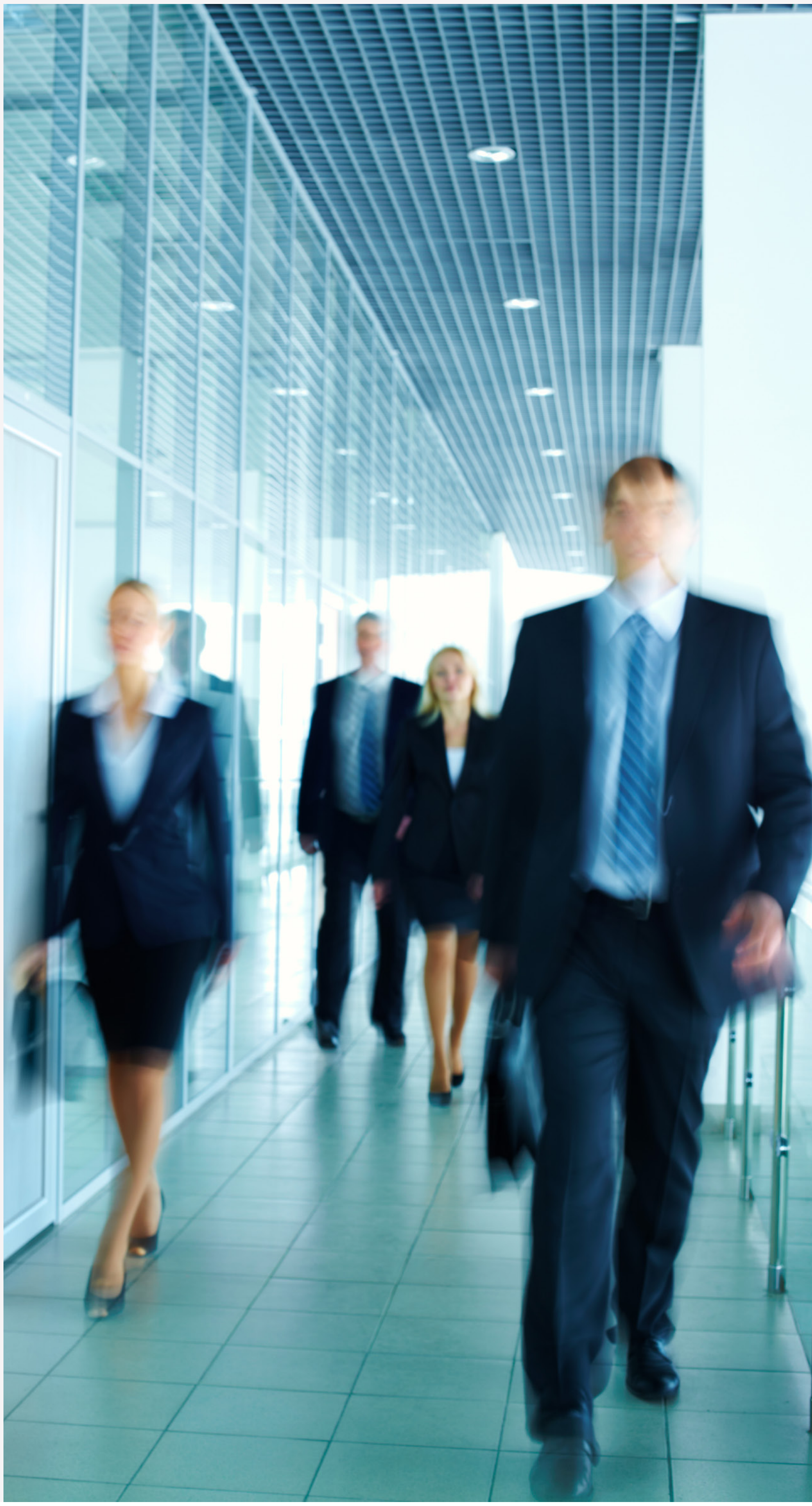
10th October

The FCA published two consultation papers setting out its proposals in the event of a Hard-Brexit, following the UK's departure from the European Union on 29 March 2019. The consultations also set out the FCA's approach to the regulation of Credit Agencies, Trade Repositories and Data Reporting Service Providers.

1. CP18/28: Brexit: proposed changes to the Handbook and Binding Technical Standards
2. CP18/29: Temporary permissions regime for inbound firms and funds

Nausicaa Delfas, Executive Director of International at the FCA, said that "we are publishing two consultation papers to ensure that in the event the UK leaves the EU in March 2019 without an implementation period, we have a robust regulatory regime from day one".

The FCA is keen to hear whether compliance with the changes to the regulatory requirements by March 2019 will pose a particular challenge for firms. The FCA does not expect firms to implement any new technical requirements, at this stage. However, the FCA does anticipate that firms are reviewing what changes they may need to make to their business, in addition to how they might present information surrounding these changes to their customers in a fair, clear and not misleading way.



FCA launches further consultation ahead of the UK's exit from the EU

23rd November

The FCA published a further consultation on its approach to the UK's exit from the European Union, setting out additional proposals in case the UK leaves the EU on 29th March 2019 without an implementation period.

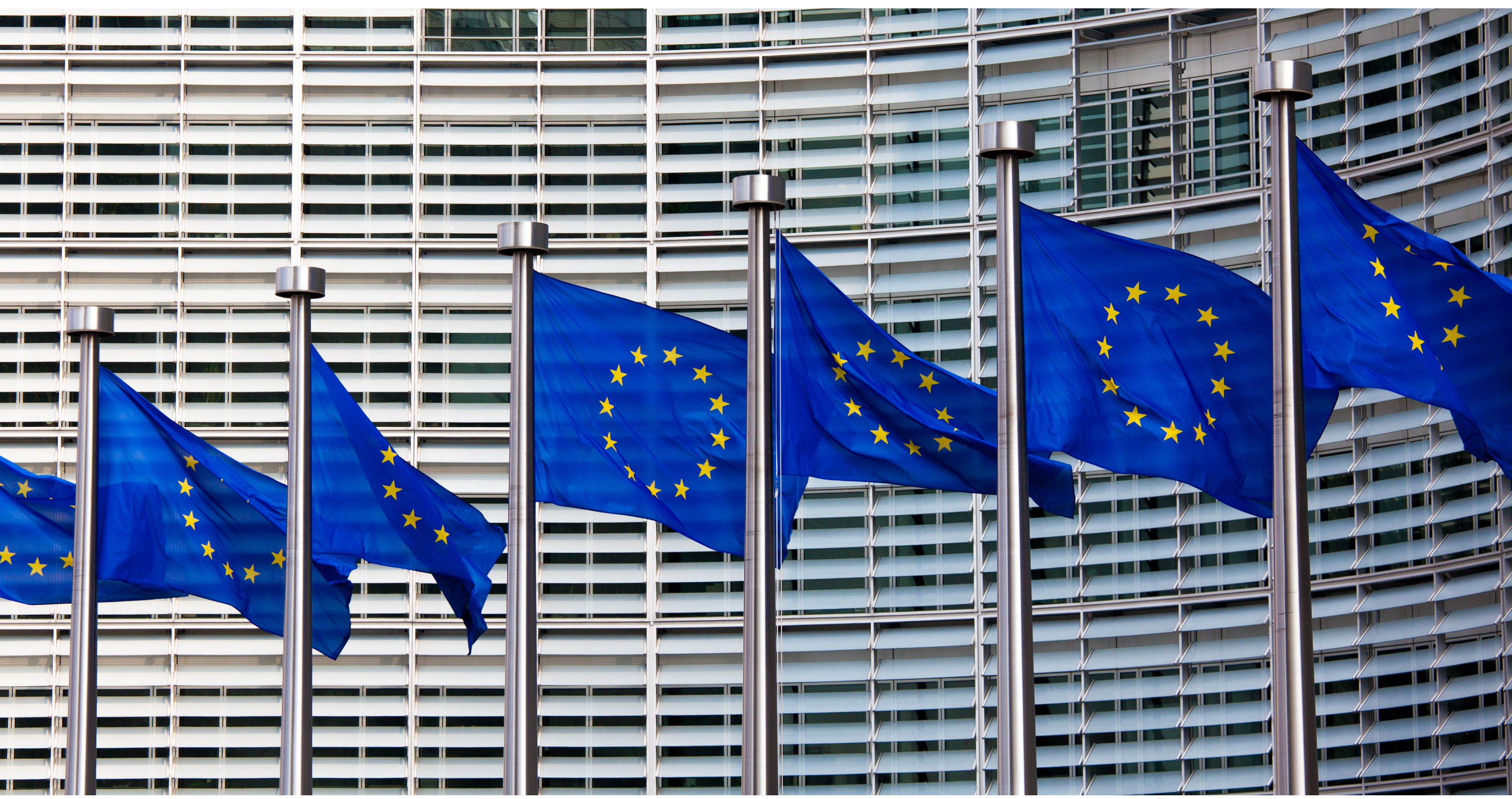
The FCA has been working throughout the year to ensure a smooth transition for the UK as it prepares to leave the EU, with one consultation earlier this year setting out the FCA's role and further consultations published in October 2018, found here.

However, this consultation paper covers a range of Handbook and EU Binding Technical Standards ("BTS") amendments. As well as this, it consults on:

- additional amendments to the Handbook regarding the Temporary Permissions regime;
- changes to the Handbook that reflects the new Credit Rating Agency and Trade Repository regimes;
- the FCA's approach to non-Handbook guidance and their approach to forms appearing in the Handbook.

The paper does not consult on any proposals of policy changes unrelated to Brexit.

The FCA stated that this consultation is relevant to all stakeholders, and is keen to hear from the widest possible range of stakeholders across sectors regarding it. Responses to the consultation can be submitted via the FCA's online form, by email or in writing, until 21st December 2018.



Brexit and financial services- where has the FCA got to?

25th October

The Chief Executive of the FCA, Andrew Bailey, delivered a speech focusing on Brexit and financial services. Bailey used the speech to make clear that the FCA is prepared for a "hard Brexit", and has the resources in place for such an eventuality.

Mr. Bailey stressed the importance of retaining a close relationship with the EU post-Brexit, stating: "One broad outcome is to seek to stay closely aligned to the EU. There are good reasons for doing this: our markets are closely integrated, and we have developed much of the EU financial services acquis together". He added "we need to find a way to create the effective voice and practical involvement for the UK authorities when it comes to the shape and form of that future alignment".

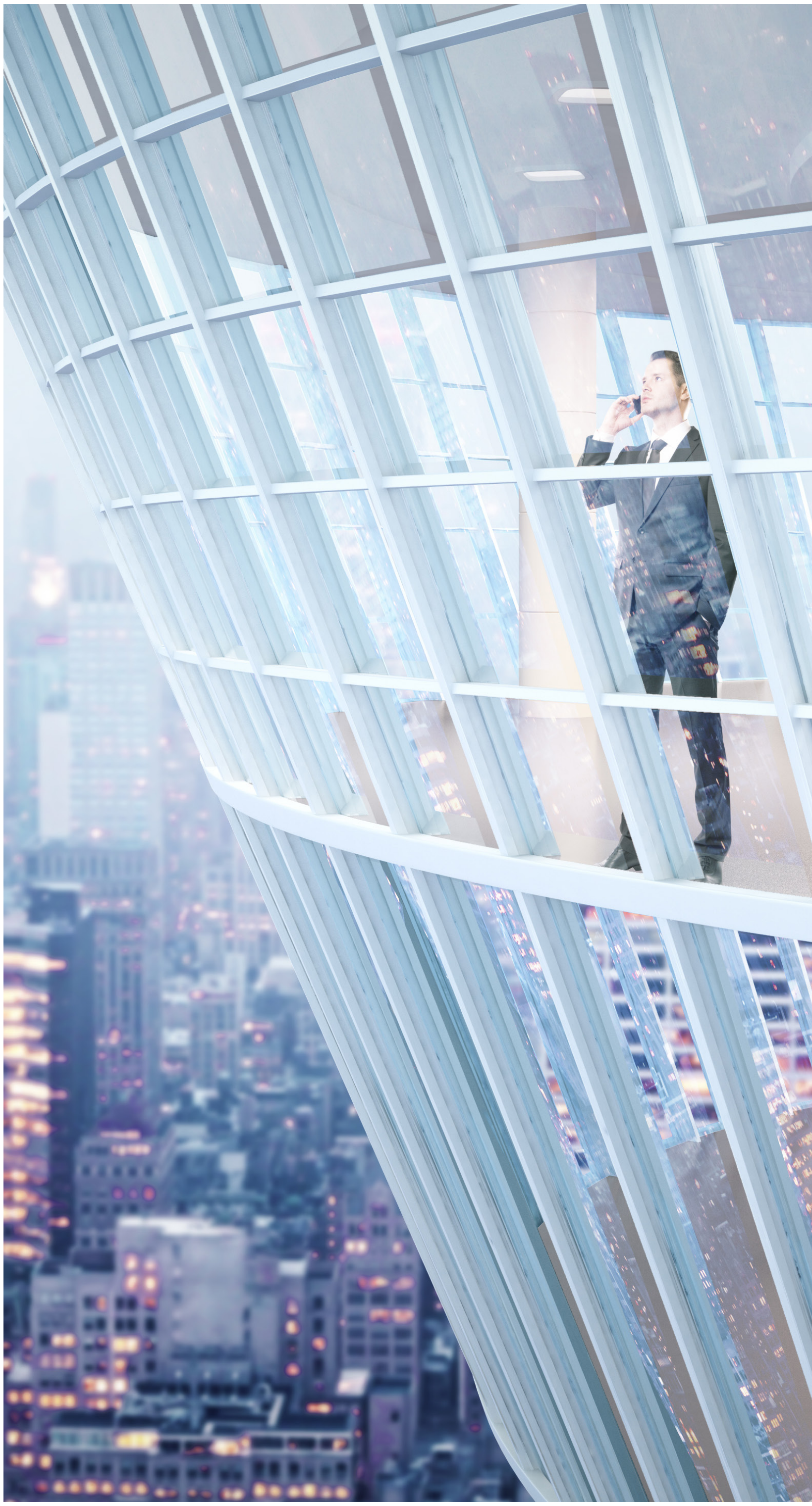
Mr. Bailey specifically emphasised how important cooperation with regulators across the EU currently is, as well as how crucial it will become in the event of a no-deal Brexit. He highlighted the need to take "reciprocal equivalence decisions" on each other's regimes: "Our work to onshore the EU rulebook, as outlined in our consultation, demonstrates that on day one, the UK will have the most equivalent framework to the EU of any country in the world."

The FCA Chief Executive added that this should be achieved via a new framework in which the UK has a significant role in shaping regulations – rejecting the idea that in the future the UK will merely be a "rule taker".

Mr. Bailey also called on banks not to relocate away from the UK unless it could clearly be shown to be in clients' best interests, stating "This is not a matter of being willfully disruptive; it's what our objectives mean. It's about treating customers fairly. Brexit does not override these objectives given to the FCA in statute by the UK Parliament."

Mr. Bailey concluded by outlining the regulator's future aim of ensuring that their approach is more nimble and readily adaptable to changing markets. Mr. Bailey used the Packaged Retail and Insurance-based Investment Products Regulation ("PRIIPS") as an example of an area where the EU's approach lacked "the ability to amend and adjust and recognise" the need to do so quickly, as events unfold.

To read the speech in full, please click here.



An update on the FCA's approach to authorisation and its Brexit preparations

30th October

Sarah Rapson, Director of FCA Authorisations, delivered a speech on 2 October 2018 at the Association of Professional Compliance Consultants Autumn Conference, on the FCA's approach to authorisation and Brexit preparations.

Ms. Rapson discussed how the FCA is taking a "harder line" on applications for authorisation and refusing firms' authorisations earlier where they believe a firm is not "ready, willing and organised" to operate in the regulated financial services market. This has reduced the average time taken for an authorisation by 35%.

Ms. Rapson highlighted that improvements to the Financial Services Register have been made so that it is easier to use and understand. Recent changes include making it clearer when certain requirements such as suspensions apply to an entry as well as improvements being made to the search facility.

Ms. Rapson discussed how Brexit and preparing for "Day 1" outside the EU was a key priority for the FCA. The key piece of legislation to prepare for "Day 1" was the EU Withdrawal Act, which provides that if there is no implementation period after 29 March all EU laws will have no effect in the UK, and any existing EU legislation will be converted to UK law. This is to ensure continuity that the same laws that applied before 29 March would continue to apply the day after. The FCA has been working closely with the Treasury and Bank of England to determine if any legislation retained would then need to be amended.

Ms. Rapson discussed the temporary permissions regime that will be implemented, the aim of which is to allow EEA firms that currently passport into the UK to continue to do so for a temporary period whilst they seek full FCA authorisation. The regime will also be available to investment funds who currently have passporting rights to continue to market in the UK whilst they seek full authorisation. Firms will be required to notify the FCA that they want to use the temporary regime. The notification window will be opened from early 2019 until prior to exit day. There is therefore only a small window for firms to notify the FCA if they need to use the temporary permissions regime. Once firms and fund managers are in the regime they will be allocated a landing slot where they will be required to submit their application for UK authorisation. During their time in the temporary regime they will be allowed to undertake the regulated activities under their passporting rights existing before "Day 1" of Brexit.

Ms. Rapson concluded her speech by highlighting the scale of the challenge which Brexit brings. She encouraged firms to help by completing the online surveys which were aimed at EEA firms and fund managers, asking how likely they were to use the temporary permission regimes. She also encouraged firms to make sure their UK passport notifications were up to date as it would make the notification process smoother if all details were fully accurate.

To read the speech in full click here.

Maintaining Market confidence- an update on Brexit

5th November

Nausicaa Delfas, FCA Executive Director of International, delivered a speech at the City and Financial Brexit Summit, providing an update on Brexit and maintaining market confidence.

Ms. Delfas began her speech by stating that although the FCA, among other scenarios, is preparing for the UK leaving the EU in March 2019 without a withdrawal agreement (or a 'hard exit'), they are hopeful of achieving a better outcome and will do everything possible to support this. No matter what the scenario is, the FCA will aim to provide as much certainty and confidence as possible for firms operating in the UK and their consumers.

The FCA has been working closely with the Government and Bank of England to ensure there is a robust regulatory framework on exit day if the UK leaves the EU without an implementation period, and is also looking to ensure a smooth transition for EEA firms and funds currently passporting in the UK. Potential alterations have been set out that may need to be made to the Handbook and Binding Technical Standards, which will be transferred to the FCA from the European Supervisory Authorities. In line with the wider Government approach, there will be no substantial policy changes, only consequential amendments. For example:

- Replacing Handbook references to EU institutions with the UK equivalent;
- Treating the EU as a third party in the FCA rules, although there are some cases where this can be deviated from, as the Government has done. An example of this is the FCA proposing to allow UK UCITS schemes to maintain their freedom in investing in EEA assets as they do now;
- Publishing a consultation on the proposed temporary permission regime, which can be found here.

Any amendments to the Handbook and the temporary permissions regime will only come into force in March 2019, if there is no implementation period when the UK leaves the EU.

Ms. Delfas further stated that the FCA will be taking on new regulatory responsibilities relating to Credit Rating Agencies (CRAs) and Trade Repositories (TRs). Statements have been released on how CRAs (click here for more information) and TRs (click here for more information) can register with the FCA before exit day.

In response to questions presented in the past on the FCA's approach to supervision and enforcement if there is a hard exit in March, Ms. Delfas referenced the publication from the Treasury on its proposal to give financial services regulators the power to phase in changes "that are made as part of the onshoring process". Without a withdrawal agreement or implementation period, the FCA would have the power and flexibility to temporarily waive or modify regulatory obligations on exit day. Not only will this help firms to "adjust to the post-exit regulatory framework in an orderly manner", but the integrity of UK markets will also be protected.

In the event of a no-deal Brexit, the FCA is expecting firms:

- To take their own legal advice on the consequences for both them and their consumers, as well as how to manage these impacts;
- To continue meeting FCA rules when implementing plans for Brexit;
- To understand the consequences of Brexit for customers, while continuing to provide full and fair service, communicating in a timely manner.

Despite progress being made in avoiding cliff-edge risks within the UK, risks do remain, particularly in areas requiring action from the UK and EU authorities, such as contractual continuity, data adequacy and clearing. Ms. Delfas believes the time to resolve these types of issues and provide certainty to markets is now, with the aid of EU counterparts being vital in achieving this. For example, urgent action is needed from EU counterparts in facilitating the transfer of personal data from the EU to the UK in the event of a no-deal scenario. There also needs to be a conclusion in Memorandums of Understanding (MoUs) and other practical arrangements, "to support cross-border supervision of firms and data sharing as soon as possible".

The FCA is determined to preserve the UK and EU's history of promoting free trade and open markets, as it will help in diversifying risk, increasing efficiency, reducing fragility in the financial system and helping UK companies to access deeper pools of capital. The FCA will continue its work to ensure a regulatory framework is in place which preserves "high standards of conduct and governance while incentivising new issuances and vibrant secondary markets" and will also work with global counterparts to create and put into place strong and flexible standards, enabling competition and innovation. The FCA's contingency planning for a hard exit will also make sure there is continuity of access to the London market.

Although a lot has been achieved, Ms. Delfas recognised that there is a lot more to do in the coming months and beyond, and expressed that everyone should continue to work together and prepare for a range of scenarios.

To read the speech in full, please click here.

FCA consults on new laws to improve the approach to open-ended funds investing in liquid assets

8th October

The FCA is consulting on new rules and guidance to reduce the potential harm to investors in open-ended funds that hold illiquid assets. The FCA is particularly concerned with the effect of stressed market conditions on such funds, where a significant number of investors simultaneously withdraw their money at short notice, as was the case following the BREXIT vote in June 2016.

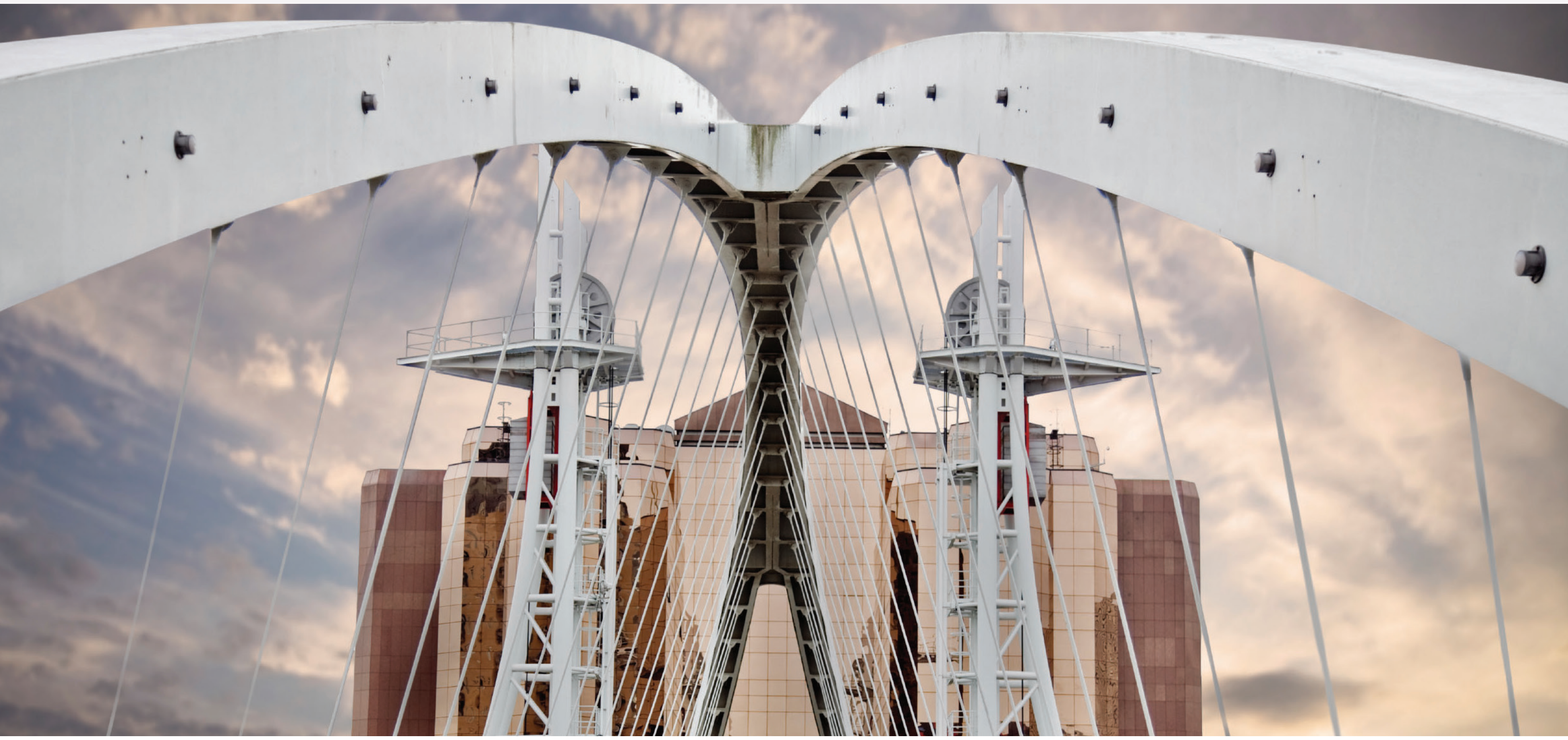
Following an earlier FCA Discussion Paper (DP17/1) and subsequent supervisory work, the FCA confirmed that a major overhaul of the regulatory framework in this area was not needed but has identified the following improvements:

- Funds which are significantly made up of 'immovable' assets, such as commercial property, should suspend trading where the independent valuer expresses uncertainty about the value of those assets.
- Fund Managers who mainly invest in illiquid assets should produce contingency plans in case of a liquidity risk arising.
- Liquidity management process in the funds should be overseen by depositaries.
- More information to be disclosed about the liquidity risks in these funds, the liquidity management tools available to the fund manager, the circumstances in which they may be used and what impact they may have on investors.

Christopher Woolard, Executive Director of Strategy & Competition at the FCA, said: "As well as better protecting consumers, these changes should help to protect and enhance the integrity of the UK financial system. They will increase investors' understanding of, and confidence in, how funds holding illiquid assets are managed".

The consultation remains open to responses until 31 January 2019. Following this, the FCA will consider feedback and issue a Policy Statement with its final rules and guidance.

To read the consultation paper in full or to provide a response, please click here.



FCA and SFC sign MoU on United Kingdom/Hong Kong Mutual Recognition of Funds

8th October

The FCA announced it had entered into a Memorandum of Understanding on Mutual Recognition of Funds (MoU) with the Securities and Futures Commission (SFC). This will create a streamlined process that allows both eligible Hong Kong public funds and UK retail funds to be distributed in each other's market.

The MoU also provides several other benefits, as it establishes a framework for:

- exchange of information
- regular dialogue
- regulatory cooperation (regarding the cross-border offering of eligible Hong Kong public funds and UK retail funds)

Andrew Bailey, Chief Executive of the FCA, said that the FCA is very pleased to have agreed this framework, because it will lead to greater choice for consumers and diversification in their investments. Mr. Bailey also believes it reflects "the UK's commitment to open financial markets supported by effective regulation which delivers equivalent outcomes".

Ashley Alder, Chief Executive Officer of the SFC, also spoke about the benefits that the new cooperation framework will bring to the asset management industries in the UK and Hong Kong, as well as the increased investment choices that will be on offer for investors in both markets. Mr. Alder recognised the importance of expanding the mutual recognition of funds framework in making Hong Kong an international asset management centre.

Both the FCA and SFC are looking forward to their continued close work together in this area and "in wider areas of mutual benefit". For more information on the mutual recognition of funds scheme, this can be found in the 'SFC circular' and the 'FCA circular', issued on 8th October 2018.

Importance of international co-operation

9th October

Megan Butler, Executive Director of Supervision, delivered a speech at The Pan Asian Regulatory Summit 2018, on the importance of international co-operation.

Ms. Butler began her speech by mentioning the value of international co-operation and how the FCA strongly supports open markets in financial services in addition to the cross-border co-operation of institutions. She was keen to emphasize that having such an approach was vital to economic stability, growth, customer protection, effective competition and efficiency.

Ms. Butler was keen to acknowledge that we are currently facing a “complex period” for global policy making considering events such as Brexit. This reiterates the point that the current geo-political environment is becoming less predictable. However, this does not mean that international authorities need to conform to a model of fragmented regulation. Ms. Butler mentioned how the foundations of international engagement already exists and it is now important to build on previous engagements to further promote economic security. The FCA is keen to show its active nature on international co-operation by being participants in the International Organisation of Securities Commissions (IOSCO) alongside the SFC. This has seen important strides being taken to ensure a global framework is constructed to create more safe and resilient markets.

The FCA and SFC have continued to show the importance of co-operation after announcing a memorandum of understanding around the mutual recognition of funds. This now allows funds in Hong Kong to market to UK customers and vice versa, as mentioned in the article above. Ms. Butler pointed out the importance of this agreement on customers who now have greater options to be involved in a more dynamic market, as well as investors who now have increased diversification in their portfolios. Secondly it promotes more qualifying funds to gain easier access to the UK and Hong Kong markets. This agreement is an important example, to show recognition of each other’s rulebooks and supervision. Ms. Butler said that open markets are the key way to ensure increased competition for the future.

Ms. Butler went on to emphasise the importance of how the FCA has applied its consumer protection and competition mandates very thoroughly when it came to regulating funds. Observations from the final asset management market study showed how portfolio managers work hard to ensure clients get their expected returns, but aspects of profits and pricing did not necessarily align with the best interest of customers. The important challenge now facing the industry is that all firms should live up to the highest professional standards.

This ensures that clients are well looked after, and portfolio managers are making money because of the expertise that the firm has to offer.

The second point raised by Ms. Butler was around “value for money”, referring to the time when portfolio managers were considered failures if they could not produce double digit figures. However, times have changed, with low interest rates and ageing populations there is a lot more emphasis on delivering best possible returns for customers who are looking to enjoy long retirements. However, the strongest financial centres, including UK and Hong Kong, do still deliver returns, as demonstrated in the growth of assets under management of firms authorised by the FCA.

Ms. Butler concluded her speech by clarifying that the FCA objective is not to increase competition in the UK, but to create a market that works well for all customers by increasing international co-operation. Ms. Butler said that ‘high functioning, clean, safe, global markets do tend to create an environment that is attractive to investors and the best firms’. Therefore, it is vital for financial centres such as London and Hong Kong to work together so everyone can reach their common goal.

Please click here to read the speech.

FCA confirms greater access for SMEs to the Financial Ombudsman Service

16th October

The FCA published a statement confirming its intention to grant more small and medium-sized enterprises ("SMEs") access to the Financial Ombudsman Service ("FOS"). The statement coincided with the release of Policy Statement PS18/21, which provides the FCA's near-final rules on the expansion and allows for approximately 210,000 additional UK SME's to complain to the FOS. The eligibility criteria that SMEs must meet to make a complaint has been amended, with SMEs with £6.5 million or below in annual turnover and fewer than 50 employees, or with an annual balance sheet below £5 million, now eligible to complain. SMEs currently must meet all three criteria to be eligible to seek redress. With the FCA's near-final rules published, the FOS can now take steps to implement the extension, which will require, among other actions, the hiring of additional staff with relevant experience. The final rules are currently expected to take effect on 1 April 2019. Speaking on the extension, Andrew Bailey, the Chief Executive of the FCA, noted that the FCA understands that it is critical for SMEs to have a way to resolve disputes other than via the costly legal route.

In addition to this statement and PS18/21, the FCA also released on 16 October 2018 Consultation Paper 18/31 on increasing the maximum amount of compensation that the FOS can require firms to pay. The FCA has proposed that the amount increase from £150,000 to £350,000.

The FCA's statement is available here.

Cryptoasset Taskforce publishes report on UK approach to cryptoassets

20th October 2018

The FCA published a report on the UK's policy and regulatory approach to cryptoassets. This was as part of a Treasury (HMT) led Cryptoasset Taskforce.

The Taskforce Report considered the policy and regulatory impact of distributed ledger technology (DLT) and cryptoassets. At a higher level, the report also set out some opportunities and risks presented by DLT and cryptoassets. In the FCA's view, cryptoassets have no intrinsic value, meaning investors should be prepared to lose all the money that they invest.

Although the Taskforce had taken note of the potential benefits that cryptoassets can bring to markets, firms and consumers, there are still many risks that the HMT, Bank of England and FCA will look to mitigate. Key risks include:

- Harm to consumers and market integrity;
- The use of cryptoassets for illicit activities; and
- Potential future threats to financial stability.

The Taskforce committed to several actions to mitigate these risks, including consulting on:

- Perimeter guidance by the end of 2018, making it clear which cryptoassets are within the current regulatory perimeter and which are not;
- A possible extension of the regulatory perimeter, so that cryptoassets (currently outside the perimeter) which have comparable features to specified investments are included;
- A possible prohibition of the sale to retail consumers of derivatives which refer to certain types of cryptoassets;
- Further exploring whether and how exchange tokens (such as Bitcoin), and related firms such as exchanges and wallet providers, could be regulated effectively; and
- Implementing a comprehensive global response and going further than the fifth EU Anti-Money Laundering Directive in response to cryptoassets being used for illicit activities.

The authorities will continue monitoring market developments, as well as working with international counterparts, to consider the most appropriate domestic and international responses.

You can find the Taskforce Report at https://www.gov.uk/government/publications/cryptoassets-taskforce

Cryptoassets Taskforce

20th November
Christopher Woolard, Executive Director of Strategy and Competition at the FCA delivered a speech at The Regulation of Cryptocurrencies event in London.

The event, organised by City and Financial Global, was designed to be a forum on all aspects of cryptocurrency regulation and took place shortly after the Cryptoassets Taskforce final report was published at the end of October. The taskforce announced by the Chancellor of the Exchequer as part of the government's FinTech Sector Strategy brought together the FCA, HM Treasury and the Bank of England to investigate the impact of cryptoassets and distributed ledger technology (DLT) in financial services.

Mr. Woolard stressed the importance of the lessons learnt since the events of 2008, specifically the importance of understanding new and complex products and their wider impact. He took time to detail some of the work of the FCA including its Regulatory Sandbox initiative – noting that nearly half of the technologies tested in its fourth Sandbox cohort used some form of DLT or cryptoassets.

He acknowledged that in this area getting a clear explanation isn't always straightforward and explained the FCA's definition of a cryptoasset: it is a cryptographically secured digital representation of value or contractual rights that uses some type of DLT and can be transferred, stored or traded electronically.

He explained that the Cryptoasset Taskforce has categorised cryptoassets into three broad types:

- Exchange tokens- cryptoassets, such as Bitcoin that are often referred to as 'cryptocurrencies'. The FCA prefers the more neutral term "exchange tokens" as they do not function as money.
- Security tokens- Tokens that amount to a 'specified investment'. These may provide rights such as ownership, repayment of a specific sum of money or entitlements to a share in future profits.
- Utility tokens - Tokens which can be redeemed for access to a specific product or service that is typically provided using a DLT platform. These tokens typically fall outside the FCA's regulatory perimeter.

Mr. Woolard also deliberated on the benefits and harms of this technology, explaining that the taskforce had identified three major harms associated with cryptoassets:

- Harm to consumers- who may buy unsuitable products, face large losses, be exposed to fraudulent activity, struggle to access market services or be exposed to the failings of service providers;
- Harm to market integrity- opaque practices and misconduct that could damage confidence in wider market functioning; and
- Risk of financial crime- where cryptoassets have been used as part of illicit activity such as money laundering and fraud.

The planned next steps were also outlined and included the following:

- The FCA consulting on perimeter guidance by the end of 2018 to help clarify which cryptoassets fall within the FCA's existing regulatory perimeter and then HM Treasury to consult on whether the regulatory perimeter needs extending;
- The FCA also to consult on whether there should be limits on the sale of certain derivatives to retail consumers;
- The Treasury to consult on how to combat financial crime taking into account the fifth EU Anti-Money Laundering Directive; and
- The Treasury to also investigate the challenges of exchange tokens and if further regulation is required in this area.

Mr. Woolard concluded his speech by stressing the importance to head off risks in this area before pondering how the work of the taskforce will be perceived in ten years' time. He hoped that it would be seen to have encouraged innovation as well as combatting financial crime, safeguarding market integrity and protecting consumers from harm.

To read the full speech click here.

The role of regulation in encouraging good culture

6th November

Andrew Bailey, Chief Executive of the FCA, delivered a speech about the role of regulation in encouraging good culture within the asset management sector at the Investment Association Culture Conference.

The speech opened with the premise that to achieve good culture in the financial services industry, it cannot be expected that a single rule to this effect will result in success. Rather, for good culture to prevail, it requires two core items to exist. Firstly, a detailed set of rules and principles is required as this can help shape good actions from regulated firms and individuals. Secondly, it is important that firms and individuals are encouraged, and feel empowered, to exercise strong judgement based on their own professional competence, integrity and honesty.

Mr. Bailey continued by considering the responsibility that the asset management industry has in overseeing the wealth of institutions and individuals alike such as the management of long term savings which individuals are relying upon to provide them with a comfortable retirement or meet their long-term financial goals. For more context, given the current flexibility afforded to individuals when taking income from their pension plans, it's imperative that good culture is embedded within firms so that it allows advisers and investment managers to provide sound recommendations to individuals who need advice. This is particularly the case given the high stakes involved for the individuals whose financial trust has been placed in these professionals.

The speech then progressed onto another important and relevant aspect involving good culture; the issue surrounding the transparency of fees and charges. Transparency needs to be coupled with effective communication. For example, a transparent fees and charges disclosure needs to be presented in manner which can reasonably be comprehended by the recipient and not merely manufactured in a way that only the firm understands.

Mr. Bailey discussed the FCA's approach to supervision and furthermore their organisational culture in adapting to change most notably by embracing innovation and technology such as Project Innovate and Sandbox.

Mr. Bailey concluded by discussing a "very powerful example of an area of activity for investment management which I have no doubt will have an important impact on trust in the sector and thus on culture". The issues raised by Mr. Bailey were in relation to the clear shift within the industry towards passive investing, more ethical and socially responsible investing, and an interest in encouraging longer-term patient capital investment.

To read the speech in full, please click here.

Artificial Intelligence (AI) and financial crime: silver bullet or red herring?

20th November

Rob Gruppetta, Head of the Financial Crime Department at the FCA, delivered a speech on AI and Financial Crime. The speech focussed on the increasing significance of AI, especially machine learning, in FCA's work such as learning models to help supervise the way FCA supervises firms – 'supervised supervision' as the FCA call it. Financial crime risk supervision is an area where supervised supervision through machine learning could be extremely useful. He mentioned that while machine learning has helped monitor information more cheaply compared to human monitoring, effective supervision has to be combined with actual human expertise as well. He also said that as a regulator, FCA wants to take a balanced approach, being open-minded but appropriately sceptical about how it keeps pace with innovation. Mr. Gruppetta gave an example: *"Just to give you a glimpse of what's possible – post-Markets in Financial Instruments Directive (MIFID) II, our market data processor is processing 30 million transaction reports per day – that's a transaction for every person in London, New York and Tokyo combined. Deploying machine learning algorithms over this data gives us the ability to detect things that were previously impractical, like suspicious activity across different markets and venues. In this way, we're squeezing the space that criminals can operate in."*

Further, he also indicated some of the practical difficulties of using AI – "financial crime doesn't lend itself easily to statistical analysis – the rules of the game aren't fixed, the goal posts keep moving, perpetrators change, so do their motives and the methods they use to wreak havoc. Simply turning an algorithm loose without thinking isn't a suitable approach to tackling highly complex, dynamic and uncertain problems in financial crime."

Overall, the report highlights that FCA is embracing machine learning and artificial intelligence in a fair and balanced way with human expertise and traditional analysis methods. Simply put, the algorithms improve, rather than replace, supervisory judgment. The results so far look promising: year on year, this has helped improved risk targeting in FCA's AML supervision work by over 65%. The report also cites the last FCA publication on financial crime analysis with results based on financial crime data returns in 2016.

The read the speech in full, please click here.

EU Securitisation Regulation

What is it?

EU Securitisation Regulation (Regulation (EU) 2017/2402) will apply from 1 January 2019. It will create new rules for the issue of simple, transparent and standardised ("STS") securitisations and will also amend the existing UCITS Directive and the Alternative Investment Fund Managers Directive ("AIFMD)".

What types of securitisations are in-scope?

EU Securitisation Regulation applies to a transaction or scheme, whereby the credit risk associated with an exposure or a pool of exposures is tranched, having all of the following characteristics:

a. payments in the transaction or scheme are dependent upon the performance of the exposure or of the pool of exposures;

b. The subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme;

c. the transaction or scheme does not create specialised lending exposures (i.e. exposures which possess all the characteristics listed in Article 147(8) of the Capital Requirements Regulation (EU No 575/2013)).

STS designation

The EU Securitisation Regulation creates a "STS" or "simple, transparent and standardised" designation for short term asset-backed commercial paper securitisations and for term securitisations.

After 1 January 2019 securitisations may opt-in to this designation, if they meet the following criteria:

- the originator, sponsor and securitisation special purpose entity is established in the EU;
- it meets all the criteria set out in Chapter 4 of the EU Securitisation Regulation;
- ESMA has been notified; and
- ESMA has added the securitisation to a list maintained on its website.

Selling of securitisations to retail clients

The EU Securitisation Regulation imposes conditions on the selling of securitisation positions to retail clients, such as conducting a suitability test and restricting the aggregate investment of that retail client in certain circumstances.

Establishment of securitisations structures

There are now restrictions on where securitisation special purpose entities can be established. Countries listed as a high-risk and non-cooperative jurisdiction by the FATF are excluded; as are countries that have not signed up to agreements to exchange information for tax purposes (i.e. fully comply with the standards provided for in Article 26 of the Organisation for Economic Cooperation and Development (OECD) Model Tax Convention on Income and on Capital or in the OECD Model Agreement on the Exchange of Information on Tax Matters).

Due-diligence requirements for institutional investors

The EU Securitisation Regulations require an institutional investor, other than the originator, sponsor or original lender, prior to holding a securitisation position, to verify that:

- Unless the originator or original lender is an EU credit institution or investment firm, that an EU originator or original lender:
  - grants all the credits giving rise to the underlying exposures on the basis of sound and well-defined criteria and clearly established processes for approving, amending, renewing and financing those credits; and
  - has effective systems in place to apply those criteria and processes to ensure that credit granting is based on a thorough assessment of the obligor's creditworthiness in compliance with article 9 of the EU Securitisation Regulation;
- Where the originator or original lender is established in a third country, that the originator or original lender:

  - grants all the credits giving rise to the underlying exposures on the basis of sound and well-defined criteria and clearly established processes for approving, amending, renewing and financing those credits; and
  - has effective systems in place to apply those criteria and processes to ensure that credit granting is based on a thorough assessment of the obligor's creditworthiness;
- The originator, sponsor or original lender:
  - retains, on an ongoing basis, a material net economic interest of not to be less than five per cent; and
  - the risk retention is disclosed to the institutional investor; and
- The originator, sponsor or securitisation special purpose entity has, where applicable, made available the information required of it under the transparency requirements in Article 7 of the EU Securitisation Regulation.

The institutional investor, other than the originator, sponsor or original lender, must also carry out a due diligence assessment prior to holding a securitisation position to consider:

- the risk characteristics of the individual securitisation position and of the underlying exposures;
- all the structural features of the securitisation which could materially impact the performance of the securitisation position;
- for a securitisation notified as STS, the compliance of that securitisation with the requirements in the EU Securitisation Regulation.

There are also due diligence requirements for institutional investors, other than the originator, sponsor or original lender, holding a securitisation position to:

- establish appropriate and proportional written procedures to monitor compliance with the due diligence procedures mentioned above, the performance of the securitisation position and of the underlying exposures (for example monitoring of the exposure type, the percentage of loans more than 30, 60 and 90 days past due, default rate, prepayment rates, loans in foreclosure etc.);
- perform regular stress tests on the cash flows and collateral values supporting the underlying exposures or, in the absence of sufficient data on cash flows and collateral values, stress tests on loss assumptions, having regard to the nature, scale and complexity of the risk of the securitisation position;
- ensure internal reporting to the management body so that the management body is aware of and adequately manages the material risks arising from the securitisation position; and
- be able to demonstrate to its competent authority, on request, that it has:
  - a comprehensive and thorough understanding of the securitisation position and its underlying exposures; and
  - it has implemented written policies and procedures for the risk management of the securitisation position and for maintaining records of the verifications, due diligence and of any other relevant information.

The definition of institutional investor includes a UCITS management company and an AIFM that manages and/or markets alternative investment funds in the EU. Non-EU AIFMs who market into the EU and sub-threshold AIFMs are now caught by this provision if they are investors holding a securitisation position and are not the originator or sponsor.

Transparency Requirements

The originator, sponsor and securitisation special purpose entity of a securitisation, must make certain information available to holders of a securitisation position, to the competent authorities and, upon request, to potential investors. The three parties may designate amongst themselves one entity to fulfill the following information requirements:

- information on the underlying exposures on a quarterly basis, or, in the case of asset-backed commercial paper, information on the underlying receivables or credit claims on a monthly basis;

- all underlying documentation that is essential for the understanding of the transaction (including for example: the prospectus together with the closing transaction documents, asset sale agreement, assignment, novation or transfer agreement, the trust deed, security deed, agency agreement, account bank agreement etc.)

Conclusion

From 1st January 2019 the EU Securitisation Regulation will provide the general requirements for all securitisations in the European Union as well as specific requirements for STS securitisations.

The intention of the EU Securitisation Regulation is to make the European securitisation market work more effectively by increasing the information disclosed to investors. The EU Securitisation Regulation also amends the AIFMD and UCITS Directive to provide that, where such AIFMs/UCITS management company are exposed to a securitisation which no longer meets the requirements in the EU Securitisation Regulation, they shall "in the best interests of the investor in the relevant AIFs / UCITS act and take corrective action, if appropriate."

FCA fines Bank £16.4m for failures in 2016 cyber attack

1st October

The FCA has fined a large retail bank (the Bank) £16.4million following a cyber-attack which identified significant weaknesses in the Firm's processes for exercising due skill, care and diligence in protecting its personal current account holders.

The cyber-attack, which took place in November 2016, exploited deficiencies in the Bank's debit card design, its financial crime controls and its financial crime operations team, allowing the attacks to profit £2.26million.

Mark Steward, Executive Director of Enforcement and Market Oversight at the FCA, stated that: "The fine the FCA imposed on the Bank today reflects the fact that the FCA has no tolerance for banks that fail to protect customers from foreseeable risks". The FCA found that the Bank failed to comply with Principle 2, exercising due skill, care and diligence, because it failed to:

a. Design and distribute its debit cards

b. Configure specific authentication and fraud detection rules

c. Take appropriate action to prevent the foreseeable risk of fraud

d. Respond to the November 2016 cyber-attack with sufficient rigour, skill and urgency.

If the FCA had not granted the Bank 30% credit for mitigation and 30% discount, the overall total fine would have been £33,562,400. The FCA reiterated the importance of remaining resilient to cyber-attacks and that responsibility ultimately lies with the Firm's board to ensure that its cybercrime controls are sufficient to withstand such attacks in the future.

To read the press release, please click here.

Upper Tribunal upholds the FCA decision to fine and ban former investment services executives

6th November

The Upper Tribunal has decided to uphold the FCA's decision to fine and ban two former executives of an investment services company.

The Tribunal ruled that both executives involved had not acted in an open and co-operative way and had failed to act with integrity when dealing with the FCA's predecessor, the FSA. Both former executives have received fines of £76 million and £3,240,847 respectively and both will be prohibited from performing any future roles in financial services.

Mark Steward, Executive Director of Enforcement and Market Oversight at the FCA, stated that the investment services company, "sold complex structured products backed by life settlements based on misleading brochures and without properly assessing whether the products could meet what was promised".

It was stated that the CEO extracted fees from the investment structure totaling some £73.3 million over a three-year period but offered no services whatsoever in return. The Tribunal therefore ruled that the fees received could not be justified commercially.

The Tribunal also ruled that the company's sales director had received £2,540,787 in undisclosed commission from the CEO. It was claimed by both executives that this payment was in relation to unrelated loans, but it was brought to the attention of the Tribunal that this was in fact "fabrication". This false claim further enabled the Tribunal to rule that both individuals showed a lack of integrity.

Despite being aware of the concerns surrounding the products being sold, both individuals failed to notify such concerns either directly to investors, to IFAs who were advising on the products or the regulator. Furthermore, the Tribunal referenced that both individuals produced false statements when being interviewed by the FCA and had failed to instruct the firm's compliance officer not to mislead the authorities.

To read the enforcement action, please click here.

Individual sentenced to 5 years' imprisonment in FCA prosecution of £3m investment fraud

29th November

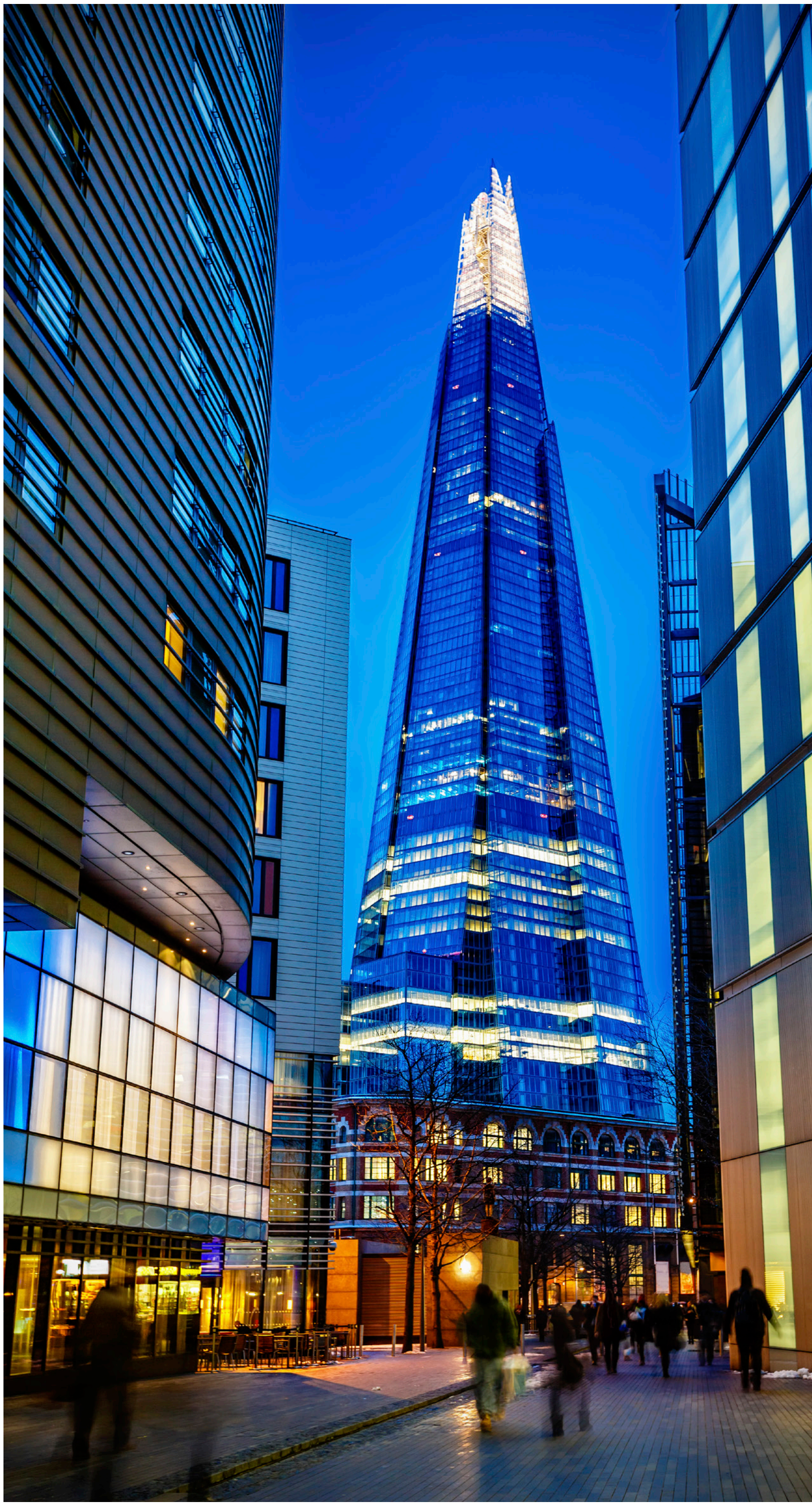
An individual has been sentenced to 5 years' imprisonment following a successful FCA prosecution for defrauding investors of nearly £3 million in relation to unauthorized investment schemes operated between 2008 and 2017. The individual was never authorised to hold a controlled function or carry out any regulated activity.

The individual claimed to manage three investment funds and described himself as a 'proprietary futures trader', despite having little to no experience of working within the futures market. The defendant traded just £8,000 of the £3 million invested with him, on which he made a loss of nearly £2,500. He also spent over £1 million maintaining his own lifestyle.

Mark Steward, Executive Director of Enforcement and Market Oversight at the FCA, said the defendant's *"sophisticated and dishonest masquerade has caused substantial losses to innocent investors. The FCA is committed to ensuring that criminals who operate unauthorised investment schemes are brought to justice and our quick action here has prevented losses from becoming much worse".*

Whilst this case concerns investments from retail clients (the defendant's friends and acquaintances), it is a good example of how the FCA continues to enhance integrity within the UK financial system.

To read the press release in full, please click here.



Trust and ethics – a regulator's perspective

16th October

Andrew Bailey, Chief Executive of the FCA delivered a speech at the launch of the St Mary's University School of Business and Society on trust and ethics from a regulators perspective.

Mr. Bailey began his speech by stating how important the topic of trust has become in the modern world, especially after what has happened over recent times and whether trust is viewed differently by individuals and institutions. He approached the concept of trust from the perspective of an economist, philosopher and psychologist, the economist viewing trust as rational self-interest, the psychologist viewing trust as a reciprocal altruism and the philosopher being more "touchy feely" about the subject. Mr. Bailey himself, views trust as having both a moral and ethical dimension which involves a considerable amount of commitment. In addition, he believes trustworthiness demands two things which are knowledge and skill, and good intentions and honesty. This lead to an important question of whether trust within the financial institutions has changed over time. Mr. Bailey highlighted the decline in trust by looking more into the history of senior executive remuneration in the US.

His starting point was from the end of the Second World War until the early 1970's which illustrated an era that emphasized a strong rejection of excessive executive remuneration due to the fear of moral outrage. This formed a foundation of trust and created an expectation of how future behavior should be conducted. Nevertheless, it was evident that changes to such a culture was on the horizon, as around the early 1980's the "Greed is Good era" began to change the concept of what was the social norm. This was the era when the agency theory came into practice, where corporate governance was used to change the way that managers operate. This emphasized of the interest of the owner led to the rapid increase in senior executive pay.

Coming back to the modern-day era it was clear that before the financial crisis, the culture towards public interest and ethical values was "permissive". It was clear that when there was limited regulation where firms were left to themselves, the assumption was made that as they succeeded, the public interest would also benefit. It was clear that this approach did not work in light of the financial crisis and now the approach has been changed to regulation in the public interest.

Mr. Bailey also touched upon the thoughts of philosopher Katherine Hawley which was how "confidence in the honesty of certain professions and their members is based on our confidence in the institutional structures, motives and risks which surround them". However as institutional structures differ from one institution to another, so do their purposes and objectives, therefore affecting their ability to make certain commitments.

In the wake of the financial crisis questions were posed such as, to what extent does FCA regulate firms, and to what extent does it regulate individuals and particularly senior management? The answer is both, but with a shift towards individuals. This has led to the introduction of the senior management and certification regime. This regulation highlights two clear concepts on responsibility and accountability. Mr. Bailey emphasised that applying both these two concepts would be vital in rebuilding trust. Public interest is embodied in the objectives of the Regulator but should also be pursued by firms and their staff.

Mr. Bailey concluded his speech by reiterating that we are on the correct route to restoring trust, but that the journey continues.

To read the full speech, click here.

CTI (cost transparency initiative) launched to continue work of Institutional Disclosure Working Group (IDWG)

7th November

The Cost Transparency Initiative ("CTI") was launched with the support of the Pensions and Lifetime Savings Association ("PLSA"), the Investment Association ("IA") and the Local Government Pension Scheme Advisory Board ("LGPSAB"). The FCA has also asked to join the CTI as an external observer. The CTI is an independent working group with the objective of implementing, promoting and encouraging the use of templates by asset managers to standardise costs and charges disclosures for the benefit of institutional investors.

The CTI's stated key aims will be to:

- Provide a clear voice for the interests of asset owners as it improves cost transparency.
- Run a pilot phase to test the new cost transparency templates and supporting technical and communications materials until January 2019.
- Following the pilot, roll-out the templates to the asset management and pensions industries to encourage fully transparent and standardised cost and charge information for institutional investors.

Firms wishing to participate to the pilot to test the templates should submit a request to the CTI (details can be found on the CTI's website).

The CTI has been set up to progress the work of the Institutional Disclosure Working Group ("IDWG"), an experts group created following the recommendations of the FCA's Asset Management Market Study ("AMMS"). The FCA welcomed the launch of the CTI and Christopher Woolard, Executive Director of Strategy and Competition, commented: "The CTI has the right experience, resources and market coverage, and will represent a broad and balanced range of suppliers and clients of the institutional asset management industry to deliver results in the market and continue to build on the momentum created by the IDWG."

New Settlement Internalisation reporting requirement

22nd November

Firms will have an obligation from July 2019 to report settlement internalisation to the Bank of England, under Article 9 of the EU Central Securities Depositories Regulation (CSDR), which can be found here.

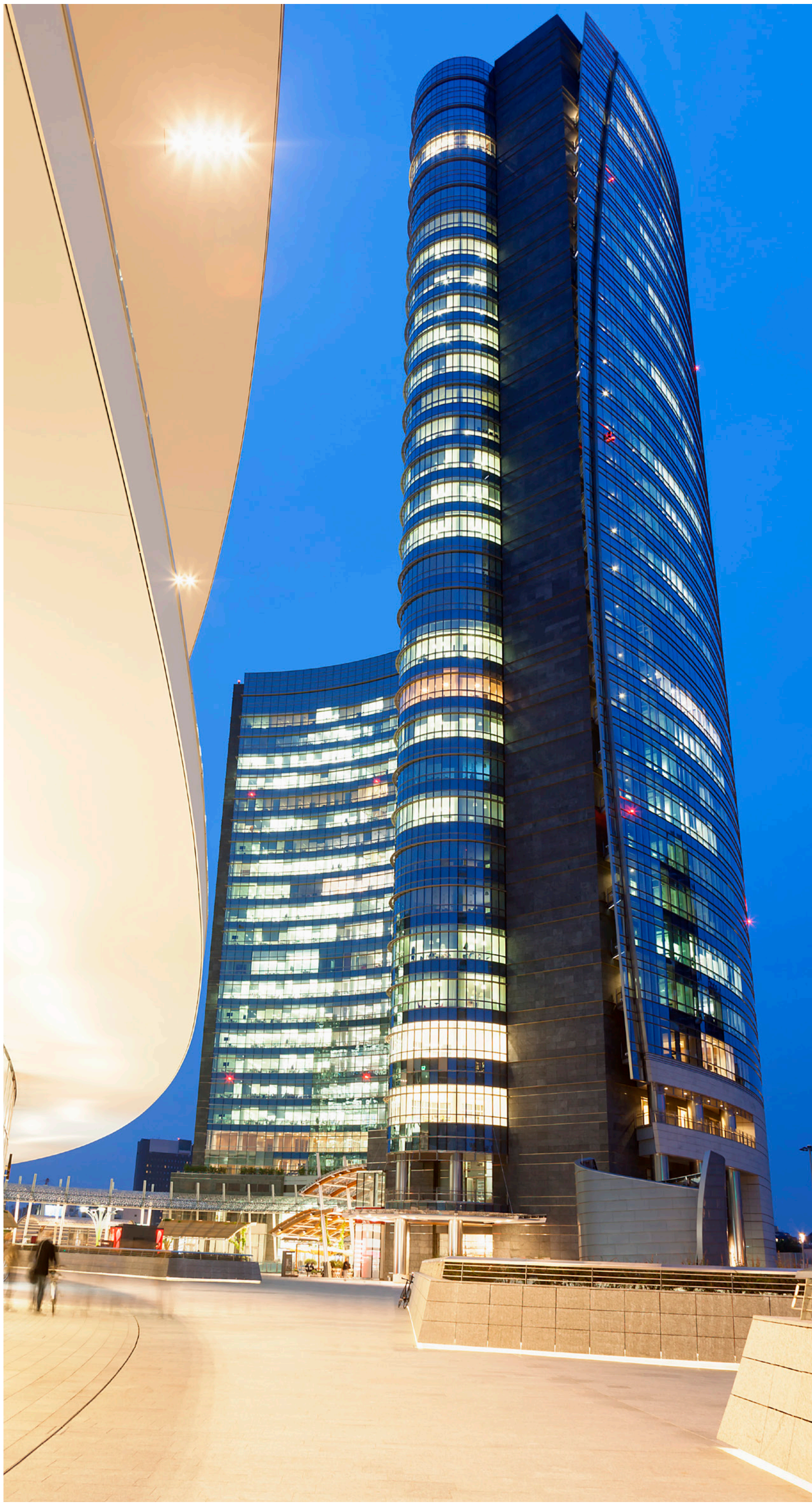
The CSDR states that an institution is considered to be a settlement internaliser if it settles transfer orders on behalf of its own account, as opposed to doing so through a Central Securities Depository (CSD). Transfer orders are defined separately in the Settlement Finality Directive (here), which refers in summary to any instruction by a participant to transfer money or securities by means of amending a book entry.

This applies potentially to firms who have the required regulatory permissions to carry out the following activities:

- arranging safeguarding and administration of assets;
- safeguarding and administration of assets (without arranging).

Reports must be sent to the Bank of England, with the first reports being due by 12th July 2019. This will cover the period from April 2019 until the end of June 2019.

More information on this can be found on the Bank of England's website. If firms think they will be captured by the reporting obligation they are also advised to complete the Bank of England's survey, with details of this provided in a letter to UK firms.



Megan Butler, Executive Director of Supervision delivered a speech at Bloomberg on Cyber technology and resilience in UK financial services

27th November

In a recent speech, Ms. Butler gave an overview of the FCA's perception on how well UK financial services are managing risks that come with the introduction of new technology. She also discussed the findings published in the FCA's recent report following its cross-sector survey on cyber and technology resilience conducted during 2017/2018.

The FCA has seen 138% increase in technology outages, with 18% of the reported incidents being cyber related. Ms. Butler was keen to stress that the true test of the resilience of the UK finance is not measured from having no incidents at all but in fact it is how well these incidents are managed.

The primary concern for the FCA were the number of technology incidents being reported and how a lot of the incidents originated around re-platforming and outsourcing failures. Firms seem overly confident about their ability to manage such flagship IT changes and keeping their systems up to date, and data collected by the FCA suggests 20% of reported incidents were linked to weaknesses in change management. Ms. Butler suggested that behavioural biases, such as humans' tendency to ignore negative information or to overestimate their abilities could be the root causes. She also pointed out how recruiting the right skills at the top level has also been a real problem with there being a high demand for CIO's and IT consultants but not enough supply.

Ms. Butler went on to explain how important it was to manage these issues. She explained how the FCA's observation was that the most effective risk management takes place in firms that employ a traditional "three lines of defense model". This ensures there is clarity and identifiable roles, as well as a natural check and challenge which promotes a healthy culture.

The second theme that was discussed by Ms. Butler was cyber-attacks. Sectors such as retail banking, payments and pensions all say that they have effective controls in place to manage cyber-attacks. However, some serious vulnerabilities are being seen across areas such as identification of key assets, information and detection. Cybercrime is developing as a low-risk, high reward activity with barriers to entry being continually lowered. It is still a major concern that the majority of firms are still looking to get the basics right on cyber security. A third of firms do not perform regular cyber assessments and whilst larger firms have automated systems to detect potential cyber threats, the smaller firms are still relying on out of date, manual methods which could cause a serious problem if they need to respond to a fast-moving incident.

Ms. Butler stressed that regardless of the firm's size or sector, cyber is not just a technological risk but also a human risk. Firms need to educate and support their staff and 90% of firms have a cyber awareness programme in place. Firms should create a positive security culture if they wish to build a resilient business.

Ms. Butler concluded her speech by emphasizing the FCA's ongoing work with international bodies and other regulators and the FCA's intention to provide assistance where it can.

To read the full speech click here.

Budget

On 29 October 2018 the Chancellor delivered his last budget before Britain leaves the EU. His Budget was for “hard working families” so that they can look “confidently to the future”. The main theme was that “Austerity is coming to an end”. Lower than expected borrowing enabled him to bring forward several proposed tax cuts and in addition, the widely touted changes to the rules on pension allowance and lowering of VAT threshold were not introduced. Many of the measures the Chancellor did introduce are seen as a “clean up” prior to an expected big Budget in Spring 2019, when the impact of Brexit is clearer.

Please find the client alert we sent out on 30 October 2018 here.

Finance Bill 2018

Following on from the 2018 UK Budget, the 2018 Finance Bill was also published. Arising from this, there were 3 areas particularly relevant;

- Introduction of the ‘Profit fragmentation’ legislation;
- Amendments to Entrepreneurial Relief; and
- Amendments to the Intangible Assets.

Profit Fragmentation

The Finance Bill contained legislation relating to ‘Profit Fragmentation’ which broadly aims to prevent UK taxable profits being diverted to an overseas entity, where the overseas entity is in a lower tax jurisdiction.

Profit fragmentation occurs when there is a ‘transfer of value’ from a UK entity to one overseas, there is a ‘tax mismatch’ between the tax payable in the UK and the overseas jurisdiction and where a UK resident can enjoy the benefit of the profit fragmented. An example of this could be where a UK entity carries out work for an overseas entity in Cayman Islands and the fees charged (or expenses claimed) are not at arm’s length, and the UK trader or professional (or related party) is able to enjoy the profits that have been diverted. Where this occurs, HMRC will require the ‘transferred profits’ to be added to the assessable UK income and taxed accordingly.

It is important to note that the requirement to notify HMRC if the tax payer fell within these provisions, contained in the draft Finance Bill, has been dropped from the final provisions. Also, the exemptions where the value is otherwise considered under Transfer Pricing, Controlled Foreign Company regime or Diverted Profits tax have also been removed. Exemptions now only exist for transfers of value where there is no tax mismatch, or where tax avoidance was not the main motive or one of the main motives for making the transfer of value.

Entrepreneur’s Relief

There was an extension to the Entrepreneur’s Relief (‘ER’) conditions for individuals who may previously have lost their entitlement to the relief due to a dilution of their holding following a restructuring of the company shares. As part of the Finance Bill, legislation was published which now allows individuals to bank ER on certain disposals before their 5% shareholding becomes diluted. As part of this change individuals will be able to make an election to make ‘notional disposal’ immediately prior to the share issue, which would result in their holding becoming diluted, which means that they would still be eligible for ER on any gains made up until that point. They would then be treated as reacquiring those shares at their current market value. In addition to this, a further election can now be made which defers the crystallization of the gain until an actual disposal of the shares has been made. It is important to note that there are anti-avoidance provisions in place which say that the share issue which results in the dilution should have been made for ‘genuine commercial reasons’ and not for the purposes of avoiding tax.

In addition to this, two additional tests will need to be met from 29 October 2018 for the definition of a ‘personal company’ to be satisfied, in addition to the 5% share capital and 5% voting rights which must be met. An individual must be entitled to:

- at least 5% of the company's distributable profits; and
- 5% of the assets available for distribution to equity holders in a winding up of the company.

In addition, new legislation was introduced to revise the minimum holding period requirement for individuals who dispose of all or part of their business, or individuals who dispose of shares in their personal company on or after 6 April 2019. Previously for an individual to qualify for ER, the period for which the qualifying conditions needed to be met was 12 months. This period will increase from 12 months to 24 months for any disposals from 6 April 2019. There are however grandfathering provisions where an individual's personal company ceased trading (or holding company of a trading group) or the individuals business ceased before 29 October 2018, in which case the existing one-year qualifying period will continue to apply. These revisions will be important when considering future group restructurings or allocations of partnership interests, as it may mean that additional rights need to be given to shareholders or members for a longer period to satisfy the tests for relief.

Intangible Assets

Draft legislation has been released to tax (at 20%) the amounts received by a foreign entity for intangible property where the amounts received relate to services or goods provided in the UK. This tax will apply from 6 April 2019.   There are a number of exemptions:

- Where the value of UK sales does not exceed £10million per annum;
- All the activity substantially occurs in the foreign jurisdiction and has not previously been transferred from the UK to that jurisdiction; and
- The amount of tax paid in the foreign jurisdiction is at least 50% of the UK tax which would have been levied.

These rules will impact businesses that hold intangible property such as "black box" trading strategies, investment management mandates and distribution agreements which are offshore in low tax jurisdictions without a tax treaty with the UK, where amounts are received in these jurisdictions relating to services performed in the UK. If you think you might be impacted, we can help you review your arrangements and determine what the filing position or disclosure is under the new rules.

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