DUFF & PHELPS

Protect, Restore and Maximize Value

Regulatory Focus

Issue 121

INSIDE

In this edition of Regulatory Focus, the experts in Duff & Phelps' UK Compliance and Regulatory Consulting team, provide a detailed synopsis of the latest news and publications issued by the Financial Conduct Authority during January 2019.

Dear CEO letter- Financial Promotions

9 January 2019

The FCA issued a letter on its website addressing the CEOs of all FCA regulated firms. The letter serves as a reminder of firms' responsibilities when issuing financial promotions.

A financial promotion is an invitation or inducement to engage in investment activity. Any form of communication, including through websites and social media, is capable of being a financial promotion. All financial promotions must be fair, clear and not misleading.

The FCA has recently become aware of firms issuing financial promotions that state their activities are regulated by the FCA and/or PRA, when this is not the case. The regulator specifically mentions occasions where a firm names the FCA and/or the PRA as its regulator in a financial promotion that refers to aspects of its business which are not regulated by either regulatory body. The promotion should make clear which aspects are not regulated.

The letter reminds firms' senior management of the guidelines that should be followed when producing financial promotions.

Jonathan Davidson, executive director of supervision, states: "It is completely unacceptable for firms, which are regulated for some of their business, to market unregulated investments by implying to customers that all their business is regulated. We are committed to stamping out this misleading practice and recommend that customers should ask firms whether what they are buying is really regulated by the FCA".

The FCA has encouraged firms to read this letter so that they understand the financial promotion rules.

Firms are also reminded that the FCA actively monitors adverts across the media and has the power under section 137S of FSMA to direct a firm to withdraw an advert, or to prevent it from being used in the first place.

To read the letter in full, click here.

MiFID II Product Governance and Research: FCA Review

16 January 2019

At a House of Commons Treasury Committee hearing, Andrew Bailey, FCA Chief Executive, and Charles Randell, FCA Chairman, gave evidence on the work of the FCA. The published transcript shows that, during the course of his evidence, Mr Bailey confirmed that the FCA has been carrying out supervisory work on costs and charges, the conclusions to which the FCA will publish in the next month or two. In addition, Mr. Bailey stated that the FCA will undertake supervisory work during 2019 on new product governance and research unbundling.

FCA Issues Further Consultation Clarifying and Amending Elements of the Senior Managers and Certification Regime (SM&CR)

25 January 2019

The FCA issued further consultation on certain elements of the SM&CR, including the client dealing function, the Head of Legal and the person responsible for systems and controls. Please read our client alert on this matter here.

ESMA provides standards on supervisory co-operation under the securitisation regulation

8 January 2019

The European Securities and Markets Authority (ESMA) issued its Regulatory Technical Standards (RTS) regarding cooperation under the Securitisation Regulation between the Competent Authorities (CAs) and European Supervisory Authorities (ESAs) to the European Commission.

The need for the RTS arises because originators, sponsors, original lenders and Securitisation Special Purpose Entities can be established in different Member States and supervised by different CAs. Good collaboration and harmonisation endorses best practice, helps to remedy non-compliance, enables CAs and ESAs to fulfil their obligations and ensures that securitisation transactions in the European Union are well supervised.

ESMA's proposal focuses on, inter alia, the following key areas:

I. the necessary cooperation between CAs and ESAs, who should liaise closely and share information and reports in relation to supervision, investigations and enforcements.

II. the requirement that CAs notify each other where a supervised entity is in breach of the Securitisation Regulation. Notification is required in cases of both suspected and actual infringements. The CA of the entity or entities must receive notification in a timely manner and take any necessary action to address the breach. Where another CA disagrees with the approach taken and a resolution is not reached within 3 months, the matter will be referred to ESMA.

III. the procedure and documentation that should be used by CAs and the ESAs when sharing relevant information. ESMA has drafted specific forms that should be used when making a request for cooperation and exchange of information and when replying to such a request.

The European Commission has three months to adopt ESMA's RTS, which will become law once published in the Official Journal of the European Union.

To read ESMA's announcement and the final RTS in full, please click here.

Crypto-assets need common EU-wide approach to ensure investor protection

9 January 2019

ESMA published its advice on initial coin offerings (ICOs) and crypto-assets. The advice provides an overview of the existing EU rules that are likely to apply to crypto-assets that qualify as financial instruments. It also provided ESMA's position on a number of gaps and issues identified in the current EU financial regulatory framework with respect to these asset classes.

For crypto-assets that meet the definition of MiFID financial instruments, ESMA identified areas that require further interpretation or re-consideration of specific requirements to allow for an effective application of existing regulations. ESMA noted that because the existing rules were not designed with these instruments in mind, National Competent Authorities faced challenges in interpreting the existing requirements and certain requirements were not suited to the specific characteristics of crypto-assets.

It was also found that the crypto-assets that fall outside the regulatory framework pose a substantial risk to investors who have limited or no protection when investing in those assets. ESMA argued that at a minimum, Anti Money Laundering (AML) requirements should apply to all crypto-assets and activities involving crypto-assets. There should also be appropriate risk disclosure in place, so that consumers can be made aware of the potential risks prior to committing funds.

ESMA's work highlighted several issues that are beyond ESMA's legal remit, but the advice allows the EU Institutions (such as the European Commission) to consider possible ways in which the identified gaps and issues may be addressed and subjected to further analysis.

FCA proposes new measures to encourage effective stewardship

30 January 2019

The FCA published two papers proposing new measures and gathering views on how to encourage effective stewardship in the interests of investors. Most UK consumers hold investments, through their pensions for example, which are looked after by asset managers; who in turn have a duty to oversee these investments in their clients' interests.

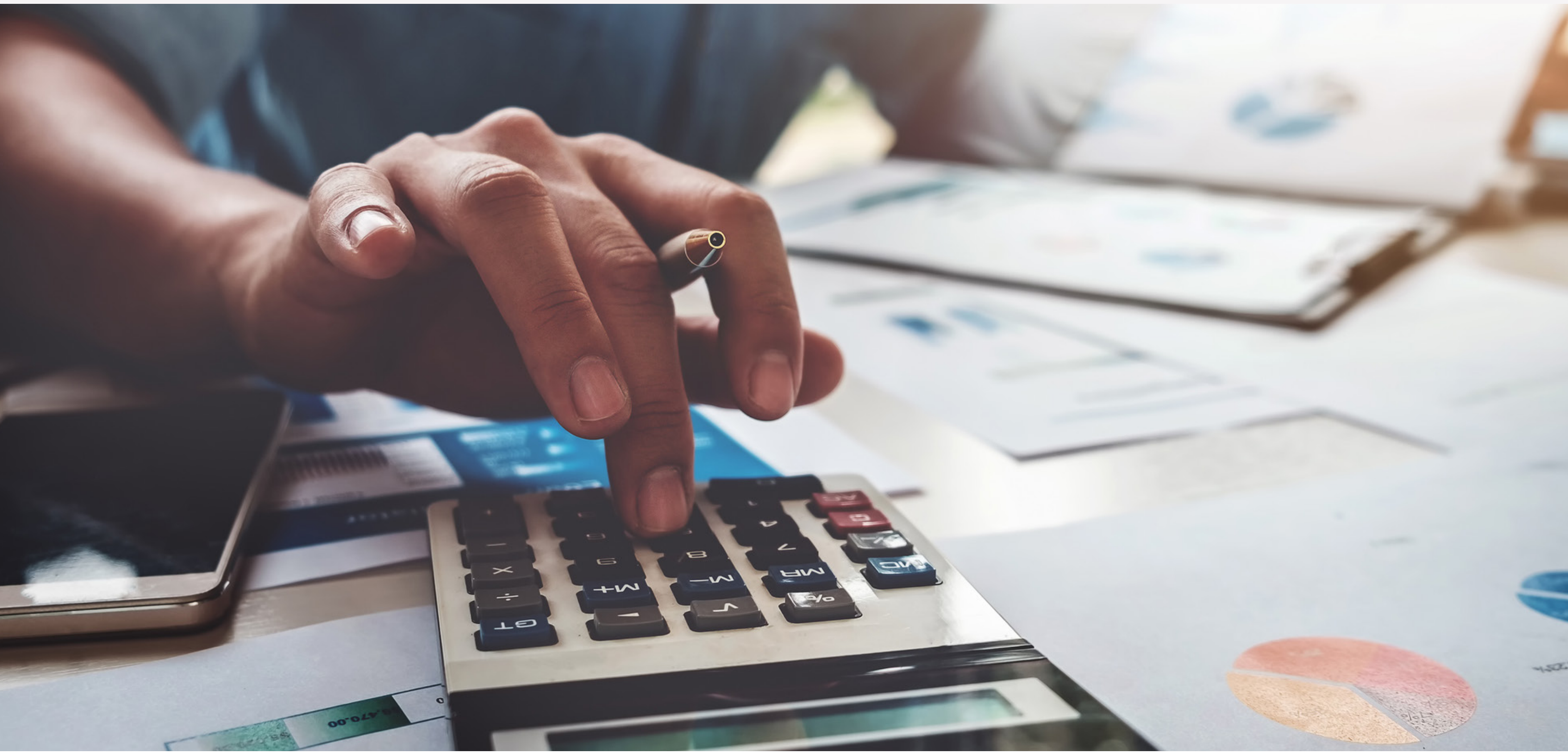
To deliver long-term effective stewardship, the FCA is working with the Financial Reporting Council (FRC) to find out how asset managers can be encouraged to closely monitor the companies they invest in, actively engage with them and hold them to account on material issues.

The two papers published, which were developed with the help of the Department for Business, Energy and Industrial Strategy, Her Majesty's Treasury, the Department for Work and Pensions and the FRC, are:

- A Consultation Paper on regulatory measures to implement the provisions of the amended Shareholder Rights Directive (SRD II) for FCA-regulated life insurers and asset managers, as well as for issuers of shares in respect of related party transactions, which will come into effect in June 2019. If a transition period for EU Withdrawal is agreed, it will need to be transposed in the UK. This paper can be found here.
- A joint Discussion Paper (DP) by the FCA and the FRC on the importance of effective stewardship, which can be found here.

The FRC has sought to advance high standards in stewardship through its Stewardship Code and has published a separate Consultation Paper, setting out proposed revisions to the Stewardship Code. With these revisions, the FRC aims to consolidate the UK's strong international reputation on stewardship. This paper can be found here.

To read the full article click here.



Notification window for the temporary permissions regime now open

7 January 2019

The temporary permissions regime will enable EEA-based firms that passport into the UK to continue to provide regulated business in the UK for a limited period of time while they apply for full FCA authorisation, if the UK leaves the EU without an implementation period in place. It will also allow EEA-domiciled investment funds that market in the UK under a passport, to continue temporarily marketing in the UK.

The notification window for entering the temporary permissions regime is now open and will remain open until 28th March 2019.

Firms that have not submitted a notification by this date will not be able to use the regime.

Firms will need to submit a notification by using the FCA Connect system. Fund managers will also need to notify the FCA via Connect which of their passported funds they wish to continue to market in the UK temporarily. To aid with this, the FCA has published a guide for using Connect covering the notification process for firms and investment funds.

Firms and fund managers should not wait for confirmation as to whether there will be an implementation period before submitting their notification. The FCA has also confirmed that there is no fee for notifying for the regime.

Firms that do not notify the FCA that they wish to use the temporary permissions regime will, where they meet the relevant conditions, be subject to the financial services contract's regime.

Fund managers that fail to submit a notification for a fund during the window will be unable to use the temporary permissions marketing regime for that fund, meaning they will be unable to market that fund in the UK on the same basis as they did before exit day. The only exception to this is for new sub-funds of EEA UCITS that are in the temporary permissions marketing regime on exit day, who are able to enter the temporary permissions marketing regime after exit day.

Firms should take note of the following directions:

- Firms which have passports under Schedule 3 to FSMA or Treaty firms under Schedule 4 to FSMA with or without a top-up permission
- EEA authorised payment institutions and EEA registered account information service providers which before exit day are entitled to offer payment services in the United Kingdom in the exercise of a passport right
- EEA authorised electronic money institutions which before exit day are entitled to offer electronic money issuance, redemption, distribution or payment services in the United Kingdom in the exercise of a passport right

Funds should take note of the following:

- Temporary marketing permission regimes
- Draft direction under regulation 64(1) of the Collective Investment Schemes (Amendment etc.) (EU Exit) Regulations 2019
- Draft direction under regulation 78A(6) of the Alternative Investment Fund Managers Regulations 2013 (as amended, in particular by the Alternative Investment Fund Managers (Amendment etc.) (EU Exit) Regulations 2019

More information on the temporary permissions regime can be found here.

Brexit planning continues as the FCA opens advance applications for credit rating agencies (CRAs) and trade repositories (TRs)

7 January 2019

As the 29th March 2019 moves closer, uncertainty about the final Brexit outcome remains. In preparation for this the FCA has said it is preparing for a range of Brexit scenarios.

One such scenario involves the UK leaving the EU without a deal and without entering an implementation period.

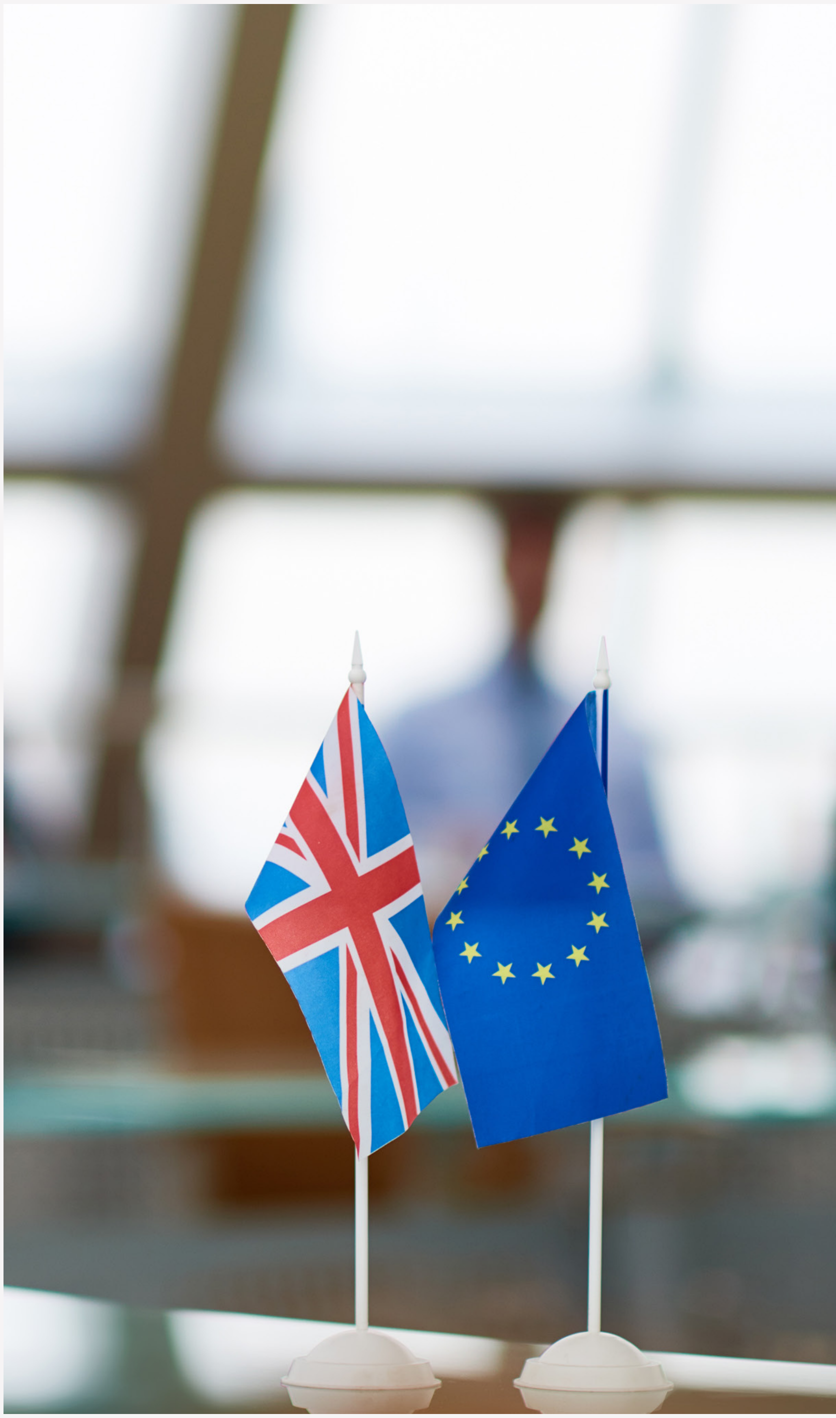
For this reason, the FCA has opened advance applications for CRAs and TRs looking to offer services in the UK after 29th March 2019.

The window is now open for EEA data reporting services providers (DRSPs) who are authorised under MiFID to let the FCA know if they wish to continue providing data reporting services after exit day. If so, they have until 15 February 2019 to let the FCA know.

The FCA's CRAs, TRs and DRSPs can find information on how to submit an advance application on its website.

Links

1. www.fca.org.uk/firms/credit-rating-agencies
2. www.fca.org.uk/firms/trade-repositories
3. www.fca.org.uk/markets/data-reporting-services-providers/brexit-eea-drsp



FCA's new consultations on Brexit

8 January 2019

The FCA published two further consultation papers in preparation for the UK's exit from the EU.

The first consultation (CP19/1) sets out fee proposals for recovering the costs of regulating securitisation repositories after the UK leaves the EU. Securitisation repositories are authorised and supervised by ESMA under the UK's Securitisation Regulation but the FCA is expected to acquire these responsibilities following the UK's departure from the EU.

The second consultation (CP19/2) outlines proposals for implementing the financial services contracts regime ("FSCR"). This will allow EEA firms to fulfil their contractual obligations in the UK and to run off their UK regulated businesses. EEA firms which either do not enter the temporary permissions regime ("TPR") by 29 March or that exit the TPR without full authorisation in the UK will be able to rely on this regime. Importantly, firms relying on the FSCR will not be able to take on new business in the UK after 29 March.

The FSCR will not be available to EEA funds marketed in the UK and to asset managers, operators, depositaries and trustees of UK authorised funds. These funds and firms will have to rely on the TPR.

The aim of the proposals is to ensure that a functioning regulatory framework is in place where a smooth transition can be executed when the UK leaves the EU. This is to ensure there is certainty and confidence for firms who currently operate in the UK.

To read more click here.

Tax issues

Spring Statement

As previously reported, it is widely anticipated that the Spring Statement will see some major changes as the impact of Brexit becomes clearer. The date set for the Statement is 13 March 2019 and we wait to find out about the issues and how those will be addressed.

Making Tax Digital ("MTD")

MTD is an HMRC initiative to modernise and digitalise the tax record keeping and reporting process. It allows HMRC to capture information stored in the tax payers' software directly, thus reducing avoidable mistakes. It is hoped that with digitalisation, the tax gap (i.e. the amount the Government is due less the amount it receives), which currently costs the Government over £9 billion a year, will reduce significantly.

Businesses and individuals have different deadlines for adopting MTD. The first wave of those required to use MTD are VAT registered businesses (although those who voluntarily registered for VAT remain exempt). MTD for these businesses begins on 1 April 2019. There is an exemption for the digitally excluded i.e. those that do not use computers for religious reasons or because of age, disability or location and for businesses in insolvency procedures.

Other tax matters

- UK reporting funds – for accounting periods starting on or after 1 April 2017, performance fees are treated as capital and are therefore no longer an allowable deduction from the excess reportable income ('ERI') calculation. This will impact UK reporting funds with a 31 December 2018 year end for the first time. The effect of this is likely to be that funds that had ERI previously will find that it's ERI has increased. Where previously a fund did not have ERI, it may find that it will now have to report a figure to its investors, who may suffer a 'dry' tax charge in respect of this reported income.

- Tax Strategy – as a reminder, the tax strategy published by a company, partnership or group must be republished annually, by the earliest of:

  a) the end of the next financial year; or

  b) within 15 months of the previous strategy being published.

ESAs publish a joint report on regulatory sandboxes and innovation hubs

7 January 2019

The European Commission's "FinTech Action Plan", published in March 2018 instructed the European Supervisory Authorities (ESAs) to analyse innovation facilitators in the EU FinTech space and to determine industry best practices. Following this, the ESAs published a joint report on the two main categories of innovation facilitators; regulatory sandboxes and innovation hubs.

As at the date of the report, 21 Member States and three EEA States have established innovation hubs and five EU Member States have regulatory sandboxes in operation. The aim is that the best practices will harmonise the design and operation of innovation facilitators across the EU, encourage supervisory transparency and enhance cooperation and consistency between different regulatory bodies within Member States including consumer and data protection authorities. A comparative analysis of these national innovation facilitators is set out in the report and, based on this analysis, a set of best practices has been prepared. The general best practices include guidance on:

- Ensuring the existence of innovation facilitators are made public knowledge through adequate marketing and communication;
- Reviewing the functioning and resourcing of innovation facilitators to ensure they remain well suited for their intended purpose;
- Referring enquiries to the appropriate body where they fall outside the scope of the body responsible for the innovation facilitator e.g. data protection matters.

To read the report in full please click here.

ESMA reports on accepted market practices under Market Abuse Regulation (MAR)

16 January 2019

The European Securities and Markets Authority (ESMA) published its annual report on the application of Accepted Market Practices (AMP) in accordance with the Market Abuse Regulation (MAR).

MAR's purpose is to guarantee the integrity of European financial markets and promote investor protection and confidence. Typical topics of market abuse cover insider dealing, unlawful disclosure of inside information and market manipulation. However, there are some exceptions. One of these is that MAR provides a defense against market manipulation, if the following applies:

- the transaction was legitimate and carried out in accordance with an AMP; and
- MAR describes the non-exhaustive factors that a Competent Authority, e.g. the FCA, should consider before deciding whether or not to accept a market practice.

AMPs are a defence against allegations of market manipulation. If dealings are carried out in financial markets for legitimate reasons and in conformity with an established AMP, this will not constitute market manipulation.

ESMA's report provides an overview on the establishment and application of AMPs in the EU, including how AMPs were established based on the Market Abuse Directive and which were still in force when MAR became applicable, as well as the AMPs which have been established under MAR.

The report also includes ESMA's views on the application of AMPs, together with recommendations to National Competent Authorities.

To read the full article click here.

LIBOR transition and contractual fallbacks

28 January 2019

Edwin Latter, Director of Markets and Wholesale Policy at the FCA, delivered a speech at the International Swaps and Derivatives Association (ISDA) Annual Legal Forum, acknowledging there is wide recognition that LIBOR will come to an end. Mr. Latter outlined how alternative benchmarks to LIBOR were performing in the transition away from it, most notably that the monthly cleared notional in Sterling Overnight Index Average (SONIA) swaps is now higher than that for LIBOR.

He explained the market had made a very significant step forward on the important task of calculating a fallback rate that could replace LIBOR in outstanding contracts. However, he was keen to point out that the FCA thought the best transition from LIBOR would be one where LIBOR is replaced or amended in contracts before fallback provisions are triggered. He predicted that it would be in the best interest of market participants to move away from LIBOR contracts before liquidity in LIBOR-referencing contracts significantly declined.

He highlighted that ISDA, at the request of the Financial Stability Board's Official Sector Steering Group (OSSG), had taken the lead in determining the fallback rate that could replace LIBOR. He outlined that ISDA had successfully established consensus on appropriate calculation of fallback rates that could substitute for sterling, yen and Swiss franc LIBOR in contracts. The fallback rate relies on the risk-free rates (RFRs) for these three currencies (i.e. SONIA, Tokyo Overnight Average Rate (TONA) and Swiss Average Rate Overnight (SARON).) Mr. Latter was hopeful that the work of ISDA would reduce the risk of widespread disorder in derivative markets when LIBOR does eventually come to an end.

Mr. Latter presented scenarios about how LIBOR will end and the potential pitfalls of what may happen; one being where LIBOR's administrator, ICE Benchmark Administration, announce in advance that it will cease the publication of certain currency-tenor combinations. This scenario may cause problems to those who have been slow or unable to transition away from LIBOR in their ongoing contracts. He noted the number of panel banks willing to contribute to LIBOR may decline meaning there may not be enough transactions underpinning the calculation of LIBOR.

Mr. Latter referred to the European Benchmark Regulation's requirement that a critical benchmark is assessed by the administrator and supervisor of the benchmark, to ensure it is representative of an underlying market and economic reality. He explained that, for this reason, another scenario may be the FCA, as supervisor of the benchmark, determine that not enough panel banks are submitting data for the calculated rate to be representative.

Mr. Latter was keen to clarify that the FCA would be clear in any future announcements about the precise date at which a particular LIBOR rate would no longer be capable of being representative, although he pointed out that it may be difficult to provide this far in advance.

Mr. Latter discussed the potential for continued publication of LIBOR for use in legacy instruments that do not have mechanisms to remove their dependence on LIBOR which could help to prevent unavoidable disruption in cash markets. Mr. Latter stressed the importance that the winding down of critical benchmarks does not unnecessarily disrupt markets.

Mr. Latter concluded his speech by urging those who were still creating new contracts that have a life beyond 2021 which reference LIBOR to use RFRs instead, whose continued publication can be relied on post 2021.

To read the full article click here.

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OUR RECENT AWARDS

BEST COMPLIANCE CONSULTANCY
CTA intelligence Awards 2018

ADVISORY AND CONSULTANCY: TAX
Drawdown Private Equity Services Awards 2018

BEST ADVISORY FIRM – REGULATON AND COMPLIANCE
HFM Week 2018

BEST GLOBAL CYBERSECURITY SERVICES PROVIDER
Hedgeweek Global Awards 2018

BEST COMPLIANCE CONSULTING TEAM
Women in Compliance Awards 2017

BEST GLOBAL REGULATORY ADVISORY FIRM
Hedgeweek Global Awards 2017

EUROPEAN SERVICES - BEST CONSULTANCY FIRM
CTA Intelligence 2016

BEST EUROPEAN OVERALL ADVISORY FIRM
HFM Week 2016

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