



regulatory focus

Issue 86

A synopsis of the Financial Conduct Authority's (FCA) latest news and publications issued in June 2015.

Welcome to Kinetic Partners' latest issue of *regulatory focus*, our regulatory newsletter for the financial services community.

Principle 11: Co-operating with the Regulator - Hot topic

Further to recent enforcement cases, the FCA has highlighted in its regulatory round-up publication that it is vital for all firms to co-operate with the regulator under Principle 11. Principle 11 states that a firm must deal with its regulators in an open and co-operative way, and must disclose to the appropriate regulator anything relating to the firm of which the regulator would reasonably expect notice.

Heavy penalties have recently been levied in two cases, showing that the FCA takes Principle 11 very seriously:

- Bank of Beirut was fined £2.1m for repeatedly providing the FCA with misleading information regarding its financial crime systems and controls, and
- Deutsche Bank was fined £227m for LIBOR and EURIBOR related misconduct.

Both fines were especially large due to the repetitively misleading behaviour by the banks.

As such, the FCA has deemed it important to remind firms to get in contact at the earliest opportunity when identifying any potential or actual misconduct, significant risks or anything that might affect the firm's ability to comply with the FCA's rules and regulations. Co-operating in an open and honest way with the FCA also implies co-operating during investigations, answering requests for information in a timely manner and volunteering any useful information. During the last year the FCA has also cancelled the permissions of a number of small firms for not co-operating as they failed to respond to repeated requests for financial information and failed to discuss concerns about their businesses.

Firms are therefore encouraged to cooperate with the FCA's requests and to be proactive in promptly communicating notifiable events under Principle 11. A failure to do so may have regulatory and financial repercussions.

Update on FCA's Connect system

Until now, firms were still required to submit their passporting applications through the ONA system but the FCA has advised that from the end of July, Connect users will be able to submit the following notifications via Connect:

- UK firms "passporting out" into the EEA under the MiFID, IMD, AIFMD, UCITS and PSD directives;
- Adding, amending and removing PSD UK Agents.

Firms should be aware that these new notifications will be added to their accounts, however the Principal User of the firm will still have to assign these new permissions to Advanced User Management profiles.

CoRep returns

When completing their CoRep returns firms may have come across an issue when converting base capital requirements from Euros to Sterling whereby they have been asked to resubmit their returns. The system uses tolerance levels based on the Bank of England published spot rate, and triggers a resubmission alert when the conversion amount is calculated outside of such tolerances. We therefore encourage firms to use the Bank of England spot rate to complete their returns to avoid any inconvenience.

Regulatory Update

We also provide regulatory updates on key developments as and when these arise. For further information, including recent updates, please visit [here](#).

- [FCA's Market Watch newsletter](#)
- [SEC's proposed rules to enhance information reported by investment companies and investment advisers](#)
- [Anti-Money Laundering Directive and Wire Transfer Regulation](#)

OUR RECENT AWARDS

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ACCREDITATION
2015
Best Companies UK

BEST OVERALL
ADVISORY FIRM IN THE US
2014
HFMWeek

BEST ASIAN ADVISORY FIRM
FOR REGULATION
AND COMPLIANCE
2014
HFMWeek

BEST EUROPEAN ADVISORY
FIRM FOR REGULATION
AND COMPLIANCE
2014
HFMWeek

BEST ADVISORY FIRM
REGULATION AND COMPLIANCE
2014
HFMWeek

BEST SEC REGISTRATION
TEAM - HONG KONG
2014
Acquisition International

UCITS FUND ADVISOR OF
THE YEAR - IRELAND
2014
Acquisition International

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Enforcement Matters

Operation Cotton obtains eight convictions for roles in unauthorised collective investment scheme

1 & 19 June

In June 2015 the courts sentenced eight individuals to imprisonment for a total term of 32 years and nine months, in respect of a fraudulent land banking scheme. This is the longest total sentence imposed to date as a result of an FSA or FCA prosecution. Five of the individuals were subject to 26 years immediate imprisonment.

In a case which demonstrates FCA's strengthening criminal prosecutions capability, FCA secured convictions in early June against eight individuals for their parts in the operation of an unauthorised collective investment scheme. This prosecution has been named Operation Cotton and it is one of the largest investigations undertaken by the FCA to date. The FCA used its civil powers against two of the companies through which the scheme was operated. The regulator then went on to take criminal action to close the scheme when it became apparent the defendants were continuing to pursue their fraudulent activities through a third company.

Between July 2008 and November 2011 the defendants were involved in the operation of an unauthorised collective investment scheme through three companies: Plott Investments Ltd (which later changed its name to Plott UK Ltd), European Property Investments (UK) Ltd, and Stirling Alexander Ltd.

Salesmen for the companies cold-called potential investors to sell them agricultural land that the companies had either bought for minimal amounts or did not own at all. Using sales scripts, misleading promotional material and high-pressure sales techniques they misled potential investors about the current and future value of the land. People were persuaded to purchase land at a vastly inflated price, on the false promise of a substantial profit. The scheme extracted over £4.3 million from 110 investors and none of them have seen a return.

Sentences ranged from 8 years to 4 months. Of particular note were the sentences of Daniel Forsyth, whose 9 month sentence was increased to 2 years because he lied to FCA in a compelled interview, and Ross Peters who received an additional 6 months for breaching an FCA restraint order by disposing of cash, Rolex watches and two racehorses without permission. Confiscation proceedings are now underway and six of the individuals were disqualified as company directors.

Later in the month, Adam Hawkins was sentenced to 6 years and 9 months imprisonment for his role in the scheme. Mr Hawkins' actions were described by the judge as a "very substantial and deliberate fraud on the public" which was "subtle and cruel" in nature.

For further details please see [here](#) and [here](#) for the full press releases.

Former director banned from conducting regulated activity

9 June

Kevin Allen was this month banned from performing any function related to a regulated activity following FCA enforcement proceedings. Mr Allen was the sole shareholder of NMB, a New Life mortgage intermediary, whilst simultaneously holding controlled functions at another regulated entity offering equity release mortgage products.

Over a four year period, Mr Allen made illegitimate transfers totalling £1,000,000 from New Life to NMB without the knowledge of the other New Life directors. He was also found to have fabricated email exchanges between himself and another director, in order to provide legitimacy to one of the transactions and went on to falsify bank statements in an effort to mislead New Life's auditors.

32 years and nine months is the longest total sentence imposed to date as a result of FSA or FCA prosecution.

The FCA's acting director of enforcement and market oversight, Georgina Philippou, highlighted Mr Allen's failure to act with honesty and integrity. Mr Allen would have been fined £248,500. However, he provided evidence that a financial penalty of any kind would cause him serious financial hardship, and as a result the fine has been waived.

The press release can be found [here](#).

The Final Notice can be found [here](#).

Court of Appeal upholds sentence against Raj Von Badlo

19 June

Raj Von Badlo, who was sentenced in January 2015 to two years imprisonment for offences in connection with a fraudulent investment scheme, has had his appeal against the sentence dismissed by the Court of Appeal.

In July 2014 Mr Von Badlo pleaded guilty to an offence of recklessly making false representations to investors and a further offence of promoting a collective investment scheme without authorisation. His actions caused over 75 investors to invest £4.29 million into a scheme that was fraudulent. In January 2015, he was sentenced to a total of two years imprisonment for these offences.

The FCA has initiated confiscation proceedings. The outcome of these proceedings and any other financial orders are yet to be determined.

Please see [here](#) for the press release.

Policy Documents

CP15/20: Investing in authorised funds through nominees

22 June

The FCA has proposed that it will revoke rules and guidance relating to notifications to beneficial owners about short reports, unitholder voting rights and other fund information as contained in COBS 14.4.1R to 14.4.9R.

In 2011 the FSA proposed rule amendments to allow consumers who invest in authorised funds via an intermediary to have the same rights as those investors who invest directly. Implementation of these rules was delayed from the end of 2012 to the end of 2013 due to operational complexities identified. The latest delay of implementation was extended to 31 December 2015 and now, given the short time for implementation, it has been proposed that these rules will be revoked.

The rationale for revoking the rules and guidance is that the FCA is now intending to undertake two new pieces of work, one of which will be a discussion paper and the other a market study on asset management (which will be launched later this year). The discussion paper will focus on the effectiveness of disclosures to consumers and will in part look at whether consumers using third party service providers should be given the same information and rights as those who access products directly. It is believed that the outcomes of these two projects will impact the rationale for the proposed new rules under COBS 14.4.

The Consultation Paper will be of particular interest to 'intermediate unitholders' i.e. certain firms that hold units in authorised investment funds on behalf of consumers who are the beneficial owners, such as platform service providers and wealth managers.

For the full Policy Statement please see [here](#).

PS15/15: FCA regulated fees and levies 2015/16

23 June

The FCA published "PS15/15: FCA regulated fees and levies 2015/2016" which sets out the final rules for periodic regulatory fees and levies. It also includes the regulator's responses to comments and criticism arising from CP15/14: FCA regulated fees and levies: Rates proposals 2015/16.

The most pertinent chapters of the Policy Statement are:

- Chapter 2, which confirms the FCA's annual funding requirement for 2015/16 and allocations to fee-blocks. It also contains feedback on the responses to Chapters 2 and 3 of CP15/14 consultation on the draft fees rates rules for authorised firms (the 'A' fee-block), and;
- Chapter 4, which sets out the final rules on how financial penalties will be applied.

The FCA will invoice fee-payers from June 2015 onwards in respect of their 2015/2016 periodic fees.

The full Policy Statement can be found [here](#).

The FCA has proposed that it will revoke rules and guidance relating to notifications to beneficial owners about short reports, unitholder voting rights and other fund information.

Supervision Matters

Regulation - supporting vibrant markets

2 June 2015

In this speech delivered at the Futures of Financial Services event in London, Martin Wheatley, CEO of the FCA spoke of the importance of supporting vibrant financial markets. Mr Wheatley commented that the existential crisis of survival that dominated financial services in 2007 to 2009 has been replaced by a focus on growth. Regulators cannot continue to define activity solely in terms of its capacity to respond to crisis - there should be an attempt to speak to societal ambitions for the next five to 15 years. The question should be, not just how do we restore faith in the financial services sector; but how do we ensure that London and the UK aren't perceived as hostile to business? The importance of effective regulation in the city is now more broadly accepted as a means to create sustainable growth as well as for dispensing justice. Core conditions for achieving that ambition are deemed to be: effective policy and supervision and supporting vibrant markets. Mr Wheatley's speech considers two key themes linked to the latter: competition and financial innovation.

Competition

Mr Wheatley comments that a key question here is: how do regulators have a more telling impact on competition today than in the past? FCA priorities in this area have aimed at reducing the barriers to entry, for example, in banking there have been initiatives that have seen the emergence of genuine alternatives in this area.

Despite signs of significant progress, there needs to be a mechanism for ensuring that competition plays out in the interests of both market and consumers. Consumers, when faced with the "black box" of finance, must be given sufficient information to enable them to make rational decisions and to ultimately to discipline the market. To achieve this, the FCA has led global work to look at the adequacy of information presented to clients, as well as allocation transparency and potential issues around bundling. The basic question will be, however; whether the landscape is competitive.

Innovation

Two competing visions are presented in terms of innovation. Firstly, a "pessimistic" view: that lower product value may reduce the incentive for incumbents to offer differentiated products and also raise the risk of other issues such as cyber-crime. Secondly, a more optimistic perception of the potential for innovation to solve problems that are yet to be envisaged. The latter view points to the increasing vitality of financial innovators, such as the UK's alternative finance market. Nevertheless, the FCA has a responsibility to ensure that excitement over potential is tempered by consumer protection principles.

In its drive not to create an environment unhelpful to innovators, the FCA is using a number of initiatives to support innovators and to consider how the regulatory regime might be adapted to provide this support. It is also using its engagement with firms to identify processes or policies in need of change, for example, in areas such as digital currency.

Mr Wheatley concludes the speech by affirming that sustainable growth must be pursued on the basis of positive outcomes for both clients and consumers, with regulation playing a crucial role in this equation.

Please see [here](#) for the full transcript of the speech.

Capital Markets Union - a regulator's perspective

4 June

On 27 May 2015 David Lawton, the Director of Markets, Policy and International at the FCA, delivered a speech on the Capital Markets Union ("CMU"). The CMU is a European Commission ("EC") initiative which is in the early stages of development. The initiative is driven by multiple priorities, including fostering well-regulated and integrated capital markets throughout the EU, strengthening the single market and growing economies. According to Mr Lawton, the CMU will be a key component of the EC's agenda over the next five years. The FCA, along with other European Securities and Markets Authority ("ESMA") members, will play an important role in the discussions on the path that should be followed to achieve the initiative's objectives.

Mr Lawton opened his speech by commenting on the value of the CMU initiative and its alignment with the FCA's statutory objective of ensuring that markets function well. He discussed the CMU's potential benefits and stated that "deepening capital markets, enhancing investor choice, and diversifying financing opportunities for companies beyond bank finance, are all valuable aims" and that "breaking down barriers to cross-border capital flows will help diversify risk, create larger economies of scale and thereby enable more efficient allocation of capital".

Mr Lawton continued by setting out the following perspectives which he thinks are essential to making the CMU as successful as possible:

- 1. Action needed through the investment chain:** Mr Lawton emphasised that macroeconomic principles cannot be forgotten when crafting the initiative. Moving the distribution of finance from banks to capital markets will require an increase in finance to achieve long-term significant economic growth. To this end, and to create a successful CMU, he argued that action must be taken on three linked fronts: "to increase the supply of investor finance into capital markets, to ensure competitive, fair and effective intermediation at a proportionate cost, and to facilitate increased use of capital market finance by corporates and others".
- 2. More capital market finance needs investor protection:** Mr Lawton highlighted that capital markets have instruments and products that are more complex, more illiquid and often less well protected or with more complicated protection arrangements. He stated that investors would be more poised to invest in these markets: if products are sufficiently explained; if investors believe products align with their needs and risk tolerance; and if products have sufficient safeguards and are offered within "a robust but proportionate regulatory framework".

The existential crisis of survival that dominated financial services in 2007 to 2009 has been replaced by a focus on growth.

3. **Focus on effective implementation of existing and already planned legislation:** Europe has already taken important strides to develop a capital market through legislation intended to encourage a single market in Europe. Mr Lawton stated that the first stage of the CMU should be focused on finalising the most recent round of legislation, which includes among other pieces of legislation MiFID 2, CSDR and MAR.
4. **Consistent supervision:** Mr Lawton is of the opinion that uniform supervision should occur within the current regulatory framework. He believes it could have a substantial positive impact on the single market as supervision within the EU would be more efficient and would offer an equal level of protection to both markets and consumers. He expressed his hope that part of the EC's plan is to have European Supervisory Authorities work together with national competent authorities to encourage "effective and consistent supervisory outcomes throughout the EU".
5. **Legislate only where necessary:** Mr Lawton highlighted the importance of only putting forward new legislation that is essential. New legislation should be created in line with Better Regulation disciplines. Before passing new legislation, he stated that the EC will need to determine if its goals can be obtained through market-led solutions or whether national solutions should be pursued, with the latter sometimes the more appropriate option to achieve greater scale.
6. **Promoting effective competition:** Mr Lawton emphasized the need for the CMU to recognise the importance of competition in economies. Competition should be taken into account when considering how to approach the CMU, as competitive markets "establish the right incentives for firms, help deliver the best outcome for consumers, and result in lower prices and higher levels of service and innovation". Mr Lawton commented on the FCA's market studies which have been implemented to assess the competitiveness of UK markets.
7. **European Markets need to be embedded in a globally competitive landscape:** Lastly, Mr Lawton discussed the importance of seeking capital from outside the EU by making EU markets attractive to foreign investors. He stated that efforts to do so would benefit foreign and EU investors as well as borrowers.

Before concluding his speech, Mr Lawton talked about some steps which the FCA considers would help to develop a successful CMU. A suggested action was to have MiFID 2 product governance requirements extended to cover additional products including credit, lending and insurance products, so as to encourage direct retail participation in capital markets. Another action proposed is to make pooled investment vehicles open to a greater variety of investor types. Other steps discussed by Mr Lawton included attracting more investors to a more competitive fund sector and reviewing the Prospective Directive to focus on admitting securities to the stock market.

In conclusion, the CMU initiative has the potential to bring significant benefits to the EU that stand to help capital markets, foreign and EU investors, consumers and borrowers. Mr Lawton made clear to his audience that the FCA stands poised to assist EU authorities implement this programme over the coming years.

The speech can be found [here](#).

Confidence to crisis and back

17 June

Martin Wheatley delivered the key note speech at the International Organisation of Securities Commissions (IOSCO) conference, which was hosted by the FCA in London. His speech is of interest to all regulated firms because it discusses the stages involved in the regeneration of the financial sector and how regulation plays a part in that process.

Mr Wheatley reflected on the changes that have occurred since he last hosted IOSCO in 2006. He described 2006 as the final year in a period of "Great Moderation" in which stable economic growth, high rates of employment and low inflation had been achieved. Stability brought with it a rising demand in the financial community for light touch regulation. However, in 2007 and 2008 there was an abrupt move from confidence in the financial industry to a code red crisis situation, from which the industry is still recovering.

There are several areas which have been the focus of the wholesale repairs required following the 2008 financial crisis:

- The prudential regulators have worked on repairing the functional failings in banks and it is Mr Wheatley's view that this stage is almost at completion;
- The culture of financial institutions is another area which is on the way to being restored, however, it is a complex and time consuming process which is likely to take a number of years, and;
- The third phase of rebuilding involves returning innovation and competition to financial services. Although this has already begun, the completion of the first two stages will act as a catalyst to this stage allowing innovative ideas (which are beneficial for consumers and the market alike) to enter the sector. The FCA demonstrated its support for innovation when it launched its Innovation Hub to facilitate the communication of new ideas from start-ups, regulated and unregulated industries and to provide assistance with the regulatory process. Competition will also ensure that the industry remains healthy by creating space for new entrants, assisting successful companies to thrive and ensuring that poor businesses exit the market. Mr Wheatley is of the opinion that in order for this stage to be successful it requires "confidence from consumers, but it also requires bravery from regulators." The way in which he proposes that global regulators nurture competition is by supporting consumer demand in order to empower consumers and ensure that supply is effectively disciplined.

Consequently the question is: how do regulators fit into the trend towards growth that is emerging in the UK and around the world? Mr Wheatley argued that the role of regulators was more accepted than in the past and stated that it has become apparent that effective regulation is "no longer seen as antithetical to growth, but as a necessary precondition for it." He proposes that, in addition to the financial markets actively welcoming useful innovation and encouraging competition, there also needs to be a stable culture of positive conduct. Culture is a topic which is high on the agenda of policy makers at both national and global levels as this is the factor which will restore investor and consumer confidence.

The CMU initiative has the potential to bring significant benefits to the EU that stand to help capital markets, foreign and EU investors, consumers and borrowers.

Effective regulation is "no longer seen as antithetical to growth, but as a necessary precondition for it."

Mr Wheatley made it clear that the responsibility of culture and conscience rests squarely with firms and individuals. However, he does recognise that there are governance issues for firms which will always exist because culture and integrity are difficult to measure in statistical terms. He spoke of the new Senior Managers Regime which the FCA is introducing in 2016. The aim is for banks, building societies, credit unions and PRA designated firms to clearly set out how responsibilities are distributed within the organisation and the areas for which individual members of senior management will be personally accountable. Although asset managers will not immediately be subject to the regime, it is expected that this reprieve will be short-lived.

Mr Wheatley concluded that regulation can, and should be, a positive part of the new frontier of competitive and innovative financial markets. Consequently, the FCA will be judged on how it facilitates growth over the next ten years as the financial landscape evolves.

Please see [here](#) for the full transcript of the speech.

Other Developments

FCA appoints new Director of Enforcement and Market Oversight and Director of Risk

5 June

The FCA recently announced the appointment of two key executive roles:

- Mark Steward, currently the Head of Enforcement at the Hong Kong Securities and Futures Commission, has taken on the role of Director of Enforcement and Market Oversight.
- Barbara Frohn, Managing Director at Banco Santander and on secondment to the Institute of International Finance in Washington D.C., has taken on the role of Director of Risk and Compliance Oversight. Both are expected to take up their new roles in the early autumn.

The Chief Executive of the FCA, Martin Wheatley, stressed the importance of these new hires and talked positively of the FCA's ability to attract such 'high calibre candidates'.

The FCA also took the opportunity to announce details of three internal appointments; Marc Teasdale was named Director of Market Oversight within the Enforcement and Market Oversight division, Jo Hill has become Director for Markets Intelligence, Data and Analysis and Andrew Whyte is now Director of Communications within the Strategy and Competition division.

These appointments represent the next stage in the implementation of the FCA's new strategic approach and associated leadership structure which was first announced in December 2014. Mark Steward's role will see him responsible for the newly created Market Oversight Division, which incorporates the UKLA and Market Monitoring functions of the FCA. For the first time, the new Risk and Compliance Oversight Division provides a strategic approach to the management of internal and external risk and a direct link between the Chief Executive and the risk function.

The press release can be found [here](#).

The FCA Interim Organisation Chart can be found [here](#).

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