DUFF & PHELPS

REGULATORY **FOCUS**

A synopsis of the Financial Conduct Authority's (FCA) latest news and publications issued in January and February 2018.

ISSUE 112

Looking back on January and February, the first couple months of 2018 have not paved the way for any post-MiFID II relief. Although the regulator kicked off the year by handing the London International Financial Futures and Options Exchange (LIFFE) and the London Metal Exchange (LME) a 30-month extension to comply with MiFID II requirements, 1 January 2018 also saw the EU benchmark regulation come into force.

Financial Reporting

As new regulations swept in, the regulator continued to press on and highlight new issues. In February, CEOs of IFPRU and BIPRU firms should have received a letter from the FCA stating that the quality of prudential regulatory returns has fallen below the appropriate standard, with some data being incorrect and/or incomplete. Additionally, the FCA disclosed that they will be scrutinising a sample of firms' returns. In anticipation of this, our clients will have received a regulatory alert from us to encourage them to examine their own data.

AIFMD Survey

From a European perspective, firms subject to AIFMD will have also received an opportunity to complete a survey designed to collect feedback on the implementation of AIFMD (commissioned by The Directorate General for Financial Stability, Financial Services and Capital Markets Union of the European Commission (DG FISMA)). KPMG have been contracted to assess how the directive has worked in practice and to what extent its objectives have been met. We issued a regulatory alert regarding this, encouraging all our clients to complete the survey by the deadline of 15 March as this may influence the likely implementation of AIFMD II.

RTS 28 Disclosures

However, as new tasks arise, we would also like to remind our readers that new MiFID II deadlines are approaching, with respect to best execution venues. RTS 28 disclosures (such as top-five execution venues) must be made by 30 April 2018. Given that these requirements are new, these disclosures may lack the intended granularity, so we point our clients to the ESMA guidance on this topic (please refer to question 6 on page 20). In brief, whilst some of the disclosures may be incomplete, firms should endeavour to provide as much data as possible.

Cayman Islands Monetary Authority Anti-Money Laundering (AML) Guidance

Finally, we point our readers to the guidance issued by the Cayman Islands Monetary Authority. New money laundering regulations came into force on 2 October 2017. The expanded requirements necessitate the appointment of a money laundering reporting officer (MLRO) and a deputy MLRO, or delegation of this role to a third party. Please note that these requirements will apply to unregulated funds from 31 May 2018.

General Data Protection Regulation (GDPR)

As the deadline of 25 May approaches fast, Duff & Phelps has developed a GDPR toolkit to help firms prepare for and ensure compliance with the regulation. This was presented by Latha Balakrishnan at our quarterly breakfast briefing, held on 22 February 2018 at the Savile Club, and is now available for purchase. Please contact Ian Manson, Katy Karpasitis or Matteo Basso for further details.

Supervision Matters

FCA statement on proposals to introduce a public register

26 February 2018

The FCA has made a statement regarding the public FCA register, in light of feedback concerning its potential decreased value, as a by-product of the proposed Senior Management and Certification Regime (SMCR).

As a reminder, once the SMCR comes into force, under the current proposals only senior managers will appear on the register, as they are the only category the FCA will be actively approving. As a result, a significant number of individuals won't appear on the register, despite the fact that they will have roles that are able to impact the market and customers (for example, nonexecutive directors, financial advisors and portfolio managers).

The FCA has stated that it has listened to this feedback and will consult on proposals to address this issue and widen the scope of the public register, alongside other matters relative to the regulation, by summer 2018.

FCA and PRA publications on algorithmic trading supervision

12 February 2018

The FCA published a report on 12 February regarding the supervision of algorithmic trading in wholesale markets. The report provides examples of good and bad practices within the sector.

The report also highlights the regulator's focus points in the algorithmic trading space, specifically identifying five key areas:

- defining algorithmic trading,
- development and testing,
- risk controls,
- governance and oversight and
- market conduct.

The FCA notes that whilst automated technology brings various benefits to investors, such as increased execution speed and reduced costs, it also has the potential to increase risks. As such, the regulator considers it imperative that key oversight functions (such as compliance and risk management) keep pace with technological advancements.

Megan Butler, Director of Supervision - Investment, Wholesale and Specialist at the FCA, said, 'This report is relevant for all firms developing and using algorithmic trading strategies in wholesale markets. Firms should consider and act on its content in the context of good practice for their business'.

The report can be read in full here.

The PRA also published on the same day a consultation paper setting out a draft supervisory statement outlining the PRA's expectations regarding a firm's governance and risk management of algorithmic trading.

The consultation period closes on 7 May. The PRA proposals can be found here.

FCA and ICO publish joint update on GDPR

8 February 2018

The implementation date for the EU's General Data Protection Regulation (GDPR) is fast approaching and will apply in the UK from 25 May 2018. The Financial Conduct Authority (FCA) and the Information Commissioner's Office (ICO) are working closely together to prepare for GDPR. The FCA and ICO have had a Memorandum of Understanding in place since 2014, which demonstrates their joint commitment to co-operation and co-ordination with regards to their activities.

Although the GDPR will be regulated and enforced in the UK by the ICO, compliance with the GDPR requirements is something that the FCA will consider within their rules - for instance, with regards to Systems and Controls (SYSC) and the Senior Management Arrangements. The FCA has stated that compliance with GDPR is now a board-level responsibility in which firms will need to evidence the steps that they have taken to achieve compliance. The FCA does not consider that the requirements under GDPR are incompatible with the Handbook rules, but considers that there are several common requirements - for example, with regards to the requirement to treat customers fairly, which is central to both the FCA and the new GDPR regime.

To read the full article, please click here.

FCA speech on building cyber resilience

26 January 2018

The Head of Technology, Resilience & Cyber at the FCA, Robin Jones, delivered a speech on building cyber resilience at the PIMFA Financial Crime Conference on 25 January 2018. He announced that cyberattacks were on the increase. There were 69 material attacks reported in 2017, an increase on the 38 reported in 2016 and 24 from 2015.

The FCA's ambition was to raise the awareness and capability of firms to have good cyber hygiene, a good security culture and good governance. This translated into an expectation for firms to understand their key assets and their backup arrangements and constantly assess where they are vulnerable. Firms must also create a good security culture with their staff, for example, for staff to be able to spot phishing emails, ensure password discipline and maintain data controls. Finally, the FCA expects firms to implement effective governance around this area, namely that business leaders must understand what a cyberattack could do and how to respond and recover. A cyberattack needs to be understood as a significant risk to a business's operation, its consumers and to the wider market.

Mr Jones concluded by emphasising that firms can learn key lessons from cyberattacks that have already happened:

'The first lesson is addressing the basics... Attacks often exploit well-known vulnerabilities... so addressing basic hygiene factors such as vulnerabilities in old systems or patching on a regular cycle is important.

The second lesson is to detect attacks, stop them from spreading and have in place robust contingency plans.

The third lesson is to ensure any contingency plan includes a communications plan; for example, [in the event of a cyberattack, firms should] know how to get hold of key people, [whether they are staff, consumers or the authorities]'.

The full speech can be accessed here.

Enforcement Matters

FCA secures Serious Crime Prevention Order (SCPO) for serial breaches
8 February 2018

The FCA has secured its first Serious Crime Prevention Order (SCPO) against an individual who was sentenced to three and a half years' imprisonment on 8 February 2018 at Southwark Crown Court. Between 2012 and 2016, the individual provided loans to vulnerable customers without a licence from the OFT or authorisation from the FCA. During this time, he received approximately £2 million in payments from customers by securing loans against their property. He then threatened customers with court action for failing to make a payment, even though he knew the loans could not be enforced.

This behaviour was compounded by the individual taking deliberate steps to evade FCA regulations, which involved inventing complex structures that disguised the nature of the loans. In addition, a prior action was taken by the FCA in 2016, as a result of which the individual was found to be in contempt of court and was sentenced to 18 months' imprisonment and subjected to a restraining order. He was, however, released early and went on to commit additional breaches, which led to the current FCA action and the SCPO.

The terms of the SCPO will begin when the individual is released from custody and will place additional conditions on his conduct, such as his being prohibited from conducting any business relating to credit and having restrictions on the number of banking facilities he is able to operate. Proceedings have also now begun to confiscate the proceeds of this criminal activity.

Mark Steward, the Director of Enforcement and Market Oversight at the FCA, said, 'The court is sending a very clear message that deliberate and repeated offending will lead to long periods of imprisonment. Today's decision also imposes the FCA's first Serious Crime Prevention Order which will severely inhibit the individual's ability to reoffend and should protect consumers in the future. The FCA will continue to take whatever action is necessary to bring offenders to justice and protect consumers'.

The full article can be found here.

FCA fines online broker £1,049,412 for poor market abuse controls and failure to report suspicious client transactions
25 January 2018

The FCA has fined an online broker for a breach of Principle 3 (Management and Control).

In the period between February 2014 and February 2015, the firm failed to detect and report potential instances of market abuse. As a result, the firm did not submit suspicious transaction reports (STRs), and, later in the investigation, the regulator identified three instances in which the firm should have done so.

Furthermore, since the broker had delegated its post-trade monitoring to another company within its group, the FCA found that the firm had failed to do the following:

- have adequate policies and procedures in place during the relevant period;
- provide adequate input into the design and calibration of those systems;
- test the operation of those systems;
- provide effective oversight of the review of the post-trade surveillance reports, which were generated by those systems; and
- provide adequate guidance or training to those carrying out that review.

The serious shortfall in monitoring and testing of systems and reports, together with the failure to report STRs, led the FCA to judge the firm's standard as 'below appropriate' and highlighted the additional risk this has brought to counterparties and the market as a whole.

The full article can be found here.

FCA fines and bans former bank trader
8 January 2018

The FCA has fined a former interest rate derivatives trader £250,000 and banned him from carrying out any regulated function in the financial services industry.

The FCA uncovered that the trader was knowingly involved in the bank's failure to comply with proper standards of market conduct and considered that, by acting recklessly and without integrity, he was not a fit and proper individual.

Mark Steward, Director of Enforcement and Market Oversight at the FCA, said that the penalties imposed would reinforce the message that 'turn[ing] a blind eye... to laws and regulations' and applying one's own 'lower standards' have no place in the financial services community.

The FCA found that between February 2007 and November 2010, the trader

- made routine requests to the bank's primary submitters with the intention of benefitting from the trading positions he was responsible for,
- took those trading positions into account when acting as a substitute submitter,
- attempted to manipulate the Japanese yen LIBOR submissions of other banks with the assistance of a broker and
- entered into 28 wash trades, with no 'legitimate commercial rationale', to facilitate payments to brokers to acknowledge hospitality that he had personally received.

Despite the trader being issued a warning notice in June 2014, proceedings were stayed owing to the Serious Fraud Office's continuing criminal investigation into certain persons who worked at the bank. The FCA concluded by asserting that the penalties imposed on the trader were an affirmation of their commitment to protecting the integrity of the UK financial system.

Other publications

2018 SEC examination priorities
15 February 2018

The SEC's Office of Compliance and Examinations (OCIE) announced its 2018 Examination Priorities. The priorities should be viewed as a 'floor', not a 'ceiling', in assessing risk and focus areas for Duff & Phelps clients. Common exam areas relating to conflicts, risk disclosures, safety of client assets, fees and expenses, compensation, valuation, liquidity, best execution, microcaps, suitability, marketing and performance claims, supervision, recidivists and cybersecurity are still very much on the examiners' target list. This year marks a new focus on cryptocurrencies and initial coin offerings, even as the debate continues over whether these can be fairly classified as securities. Clients whose businesses have an impact, either directly or indirectly, on retail investors, retirees or seniors will continue to be under scrutiny.

More specifically, the OCIE's examination priorities include:

- **Cybersecurity**. Each of the OCIE's examination programmes will prioritise cybersecurity, with an emphasis on, governance and risk assessment, access rights and controls, data loss prevention, vendor management, training and incident response.
- **Disclosure of the costs of investing**. The OCIE will continue to focus on proper disclosure of fees, expenses and other charges, with an emphasis on incentive/sales-based compensation arrangements, changes in fee structures and private funds with a high concentration of retail, nonprofit and pension plan investors.
- **Cryptocurrency, initial coin offerings, secondary market trading and Blockchain**. To address the influx of investment advisors and broker-dealers engaged in the cryptocurrency and initial coin offering space, the examiners will closely monitor the sale of digital products and assess the adequacy of antifraud safeguards and disclosure concerning risk of loss, liquidity, price volatility and potential fraud.
- **Compliance and risks in critical market infrastructure**. The OCIE will continue to examine clearing agencies, national securities exchanges and transfer agents and other entities that provide services critical to the proper functioning of capital markets.
- **Anti-money laundering (AML) programmes**. Examiners will review for compliance with applicable AML requirements, including whether firms are appropriately adapting their AML programmes to address their regulatory obligations and making timely filings.
- **Electronic investment advic**e. The OCIE will continue to examine 'robo-advisors' to assess the adequacy of their compliance programmes, including the oversight of algorithms that generate recommendations, marketing materials, investor data protection and disclosure of conflicts of interest.
- **Never-before-examined investment advisors**. The OCIE will focus on investment advisors who either are newly registered or who have not been examined for some period of time (typically 7 to 10 years or more). Generally, these are limited-scope exams that focus primarily on safety of client assets, code of ethics and the advisors' compliance programme.
- **FINRA and MSRB**. The OCIE will continue its oversight of FINRA by focusing examinations on FINRA's operations and regulatory programmes and the quality of FINRA's examinations of broker-dealers and municipal advisors.
- **Fixed-income order execution**. Examiners plan to conduct examinations to assess whether broker-dealers have implemented best execution policies and procedures for municipal and corporate bond transactions.

UK Finance releases CFA 2017 guidance
2 February 2018

UK Finance have published final guidance for the financial services sector on the UK's Corporate Criminal Offence of Failing to Prevent the Facilitation of Tax Evasion. The offence is part of the continued global and local impetus towards tax transparency, reporting and cracking down on tax evasion. From 30 September 2017, the Criminal Finances Act 2017 introduced two new criminal charges:

- The failure to prevent the facilitation of the evasion of UK tax.
- The failure to prevent the facilitation of the evasion of foreign tax.

The offences are committed by incorporated bodies (companies and partnerships) when they fail to prevent persons associated to them from committing tax evasion. Persons associated with the business must be examined on a case-by-case basis but will include employees, agents, contractors or subsidiaries of the business. It is not necessary that the business is aware of the tax evasion. If the business cannot prove that it took proportional steps to prevent the evasion in the first place, it will still be liable. Tax evasion is the dishonest and deliberate act of not paying taxes, and not the lesser act of tax avoidance, which is the arrangement of one's affairs to minimise tax liability within the law, or unintentional non-compliance. A defense exists where businesses can prove that they have reasonable prevention procedures in place to prevent the facilitation of tax evasion or that it is not reasonable or proportionate to put such a procedure in place.

The government published general (non-sector-specific) guidance in September 2017, but the new sector-specific guidance provides greater in-depth analysis for the sector and examples to the application on the new legislation.

To view the press release, please click here.

ESMA's call for evidence on temporary product intervention measures applicable to contracts for difference and binary options sold to retail clients
18 January 2018

On 18 January 2018, ESMA issued a consultation paper on the possible use of its product intervention powers on contracts for differences (CFDs) and binary options (BOs) sold to retail clients, under Article 40 of Markets in Financial Instruments Regulations (MiFIR).

ESMA's consultation states that several national competent authorities (NCAs) have conducted studies showing that between 74% to 89% of clients trading in these products lose money. This is due to the increase in aggressive marketing and the offering of incentives to clients. ESMA is also concerned with the increased exposure to loss for retail investors due to the complexity of these products and lack of transparent information at the point of sale. As a result, ESMA is considering prohibiting the marketing, distribution and sale of binary options to retail clients and restricting the same activities in relation to CFDs on cryptocurrencies and rolling spot forex for retail clients. ESMA is also proposing to restrict the gearing limits on these products and other measures to reduce the losses to retail clients.

ESMA is inviting responses from investors and firms on the impact of the measures under the consultation. To read the consultation, please click here.

Changes to the 4th Anti-Money Laundering Directive

The European Union has published a fact sheet detailing the proposed changes to the 4th Anti-Money Laundering Directive. The aim is to further strengthen the fight against money laundering and terrorist financing. The main changes are as follows:

Improving transparency on the real owners

Beneficial ownership information for legal entities will be available on a public register.

Improving transparency on trusts

Competent authorities, financial intelligence units and entities subject to AML rules will have unrestricted access to data detailing the beneficial owners of a trust. Furthermore, any person or entity who can demonstrate a legitimate reason for access to the information will be able to request it.

Better connection of the beneficial ownership registers

There will be cross-sharing of national registers on beneficial ownership information between European Member States. Furthermore, additional verification mechanisms will be implemented by the Member States to ensure accuracy of the information provided in the registers.

Lifting the anonymity on electronic money products, in particular when used online

Anonymity will be preserved only if a prepaid instrument is used directly in a shop for a maximum of 150 EUR or if it is an online transaction using a prepaid instrument for a purchase that is below 50 EUR.

Extending anti-money laundering and counterterrorism financing rules to virtual currencies, tax-related services and works of art

All those who are in scope of the rules will have to follow 4th Anti-Money Laundering Directive rules and report any suspicious activity to financial intelligence units.

Improving checks on transactions involving high-risk third countries

The list of checks that companies will have to carry out has now been aligned across all Member States.

Setting up centralised bank account registers or retrieval systems

This will be implemented to ensure that holders of bank accounts can be identified.

Enhancing the powers of EU financial intelligence units and facilitating their co-operation

There will be greater collaboration between the financial intelligence units of different Member States, and they will also have access to more information (as a result of the centralised registers).

Enhancing co-operation between financial supervisory authorities

The directive will allow deeper and wider co-operation between supervisory authorities.

The fact sheet can be found via this link.

Duff & Phelps Announcements

We are pleased to announce some promotions on the team:

Nick Thomas
Compliance and Regulatory Consulting Practice
Director

Paul Winter
Compliance and Regulatory Consulting Practice
Director

Tom Bevan
Compliance and Regulatory Consulting Practice
Vice President

Rory Jevon
Compliance and Regulatory Consulting Practice
Senior Associate

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