



# regulatory focus

Issue 84

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

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

## FCA to contact all MiFID Investment Firms

The Investment Association has warned its members that the FCA is about to contact MiFID investment firms in order to collect certain information which will then be reported to ESMA. Certain directives like MiFID, CRD, UCITS or AIFMD, oblige ESMA to maintain an electronic register of firms operating within the European Union, either as firms or branches of firms. The FCA has already provided ESMA with a comprehensive list of firms authorised under MiFID but is facing difficulty in identifying the MiFID activities actually undertaken by such firms. The UK operates under The Regulated Activities Order and consequently the FCA grants firms their Part 4A permissions. There are gaps between regulated activities permitted and MiFID activities undertaken, leading the FCA to write to MiFID Investment Firms to clarify certain information. Hence, firms need to establish which MiFID activities they undertake; however this mapping exercise of regulated activities and MiFID activities may not be straightforward. As a starting point, we encourage firms to assess the guidance in [PERG 13 Annex 2](#) of the FCA Handbook which maps MiFID activities to regulated activities under the Part 4A permission regime.

## FCA's tips on GABRIEL reporting peak period

Further to the issues encountered by firms when submitting their Annex IV reports in January 2015, the FCA decided to warn firms of potential problems ahead of the next GABRIEL peak reporting period which started on 1st April 2015. An increasing number of firms report data through GABRIEL which can considerably slow down the system, especially at peak hours (between 9am to 11am and 3pm to 5pm each day). The FCA encourages firms to:

- Prepare their reports in advance, using the Handbook guidance for help;
- Complete their reporting as early as possible in the period;
- Avoid using GABRIEL during the daily peak hours;
- Not forget to "Log Out" before closing the browser in order to ensure that the session is correctly closed.

We therefore recommend that firms follow the FCA's tips in order to minimise inconveniences.

## Regulatory highlights this month include:

- FG 15/7 Guidance on financial crime systems and controls
- FCA fines Merrill Lynch International £13.2 million for transaction reporting failures
- FCA fines The Bank of New York Mellon London branch and The Bank of New York Mellon International Limited £126 million for failure to comply with the custody rules

### Regulatory Update

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

- [2014/2015 LLP tax returns: red flags](#)
- [Global investment bank receives record fine for transaction reporting failures](#)

### OUR RECENT AWARDS

ONE STAR 'VERY GOOD'  
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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### Policy Documents

#### FG 15/7 - Guidance on financial crime systems and controls

27 April

In November 2014 the FCA consulted on proposed examples of good practice from two thematic reviews that it undertook of systems and controls around anti-money laundering and financial sanctions in small banks and bribery and corruption in small commercial insurance brokers. It also consulted on proposed amendments to its financial crime guidance to clarify its expectations in areas where it deemed significant weaknesses to persist.

Following on from this consultation, the FCA has issued a summary of the feedback it received to these proposals and amended its guidance in this area. The changes took effect on 27 April 2015.

Key comments received in relation to the proposed guidance and the FCA's response were as follows:

##### Timing in relation to the Fourth Money Laundering Directive

Two respondents asked that the publication of the final guidance be delayed until the Fourth Money Laundering Directive ("Directive") had been transposed in the UK. However, the FCA stated that it wants amendments to the guidance to clarify its expectations in areas where there are persistent weaknesses and that these should assist firms to adopt more proportionate and effective financial crime systems and controls. Consequently, the FCA does not believe it appropriate to wait until the Directive has been transposed to implement the guidance and it is confident the principles are consistent with the Directive.

##### Definition of source of funds

Ten respondents were concerned that the FCA definition of "Source of Funds" was not in line with the Joint Money Laundering Steering Group ("JMLSG") use of this term. The FCA responded that its use of this term is consistent with its use in the Money Laundering Regulations 2007, international AML standards and its own guidance. It also makes clear that "Source of Funds" refers to the activity that generated the funds used in the business relationship, whereas "Source of Wealth" describes how a customer has obtained their wealth in total. It does not believe that this contradicts the JMLSG concept of "source of funds as evidence of identity" and has amended the relevant section of the guide in consultation with the JMLSG to make this clear.

##### Whether examples of good practice could be considered binding

Two respondents were concerned that the examples of good practice could be seen as binding. The FCA responds that it has updated the Guide to emphasise the non-binding nature of the guidance and has sought to more clearly distinguish between legal and regulatory requirements and examples of good practice.

##### Possible administrative burden

One respondent was concerned about a possible administrative burden ensuing from the guidance on risk assessments, which could lead to greater bureaucracy. In response to this comment, the FCA stressed that it expects firms to identify and assess financial crime risk in a way that is appropriate and proportionate to the nature, scale and complexity of their activities. Equally, a good risk assessment should enhance a firm's understanding of the financial crime risk to which it is exposed and enable it to design and implement effective risk management systems and controls. These need not be onerous or bureaucratic.

Other minor changes were made to the Guide as a result of the feedback, including the clarification of terms used and the addition of explanatory detail where respondents felt this would be helpful.

A summary of the feedback received by the FCA can be found [here](#).

The updated regulatory guidance can be found [here](#).

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## Enforcement Matters

### FCA fines Merrill Lynch International £13.2 million for transaction reporting failures

22 April

The FCA fined Merrill Lynch International (MLI) £13,285,900 for incorrectly reporting 35,034,810 transactions and for failing to report another 121,387 transactions between November 2007 and November 2014. This is the highest fine to date to be imposed for transaction reporting failures and other firms that are subject to transaction reporting requirements should take note.

The FCA highlighted that transaction reporting is crucial because it enables the regulator to carry out effective market surveillance for insider trading and market manipulation. This practice supports the FCA's objective of ensuring that markets work well and with integrity. Georgina Philippou, acting director of enforcement and market oversight commented that the penalty imposed: "sends a clear message that we expect to be heard and understood across the industry".

It is interesting to note that the FCA has been particularly severe in this case because it raised the penalty from £1.00 to £1.50 per line of incorrect or non-reported data, in an effort to achieve a higher level of credible deterrence.

This fine was not the first time that MLI had been alerted to its deficiencies in transaction reporting: in 2002 it was issued with a Private Warning which was followed by a fine of £150,000 in 2006. Despite being subject to disciplinary measures in the past, recent enforcement actions and the availability of extensive FCA guidance in this area MLI "has failed to get this right again" and they have been penalised accordingly.

MLI agreed to settle at an early stage of the investigation and received a 30% reduction on their overall fine of £18,979,876.

The Press Release can be found [here](#).

### FCA fines The Bank of New York Mellon London branch and The Bank of New York Mellon International Limited £126 million for failure to comply with the custody rules

15 April

The FCA has fined The Bank of New York Mellon London Branch (BNYMLB) and The Bank of New York Mellon International Limited (BNYMIL) (together 'the Firms') £126 million for failing to comply with Principle 10 and the FCA Client Assets Sourcebook (custody rules, or CASS), which applies to safe custody assets and to client money.

The Bank of New York Mellon Group, of which the Firms are a part, is the world's largest global custody bank by safe custody assets. The CASS rules set out detailed requirements placed on firms to ensure that custody assets are protected. The aim of the custody rules is to protect safe custody assets if a firm becomes insolvent and to ensure that those assets can be returned to clients as quickly and easily as possible in the event of a firm's insolvency. During the period of the failings, safe custody assets held by BNYMLB and BNYMIL peaked at £1.3 trillion and £23 billion respectively. The FCA has concluded that the Firms failed to arrange adequate protection for the custody assets for which they were responsible.

In particular, the custody rules require firms to keep entity-specific records and accounts, which are important in the event of an insolvency as they will be used by an insolvency practitioner to identify those clients whose assets are safeguarded and are due to be returned. The Firms used global platforms to manage clients' safe custody assets, which did not record which BNY Mellon Group entity clients had contracted with. This failing meant that the Firms were unable to meet their other obligations under the custody rules, such as the requirements to:

- conduct entity-specific external reconciliations;
- maintain an adequate CASS resolution pack; and
- submit accurate Client Money and Asset Returns

The FCA also found a number of other failings by the Firms including:

- preventing the commingling of safe custody assets with firm assets from proprietary accounts;
- using safe custody assets held in omnibus accounts to settle other clients' transactions without the express prior consent of all relevant clients whose assets were held in those accounts; and
- failing to implement adequate governance arrangements.

The FCA determined that these breaches reflected a failure by the Firms to properly consider the interests of their clients. In addition, the FCA's specialist client assets supervisors identified most of the failings as part of their regular review of such firms rather than the Firms identifying and remedying the failures. Were it not for a discount granted for early settlement the financial penalty would have been £180 million.

Georgina Philippou, acting director of enforcement and market oversight at the FCA said:

"Client assets protection continues to be a priority for the FCA and firms who hold client assets should review their processes in line with these findings to ensure full compliance with the custody rules."

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

This is the highest fine to date to be imposed for transaction reporting failures and other firms that are subject to transaction reporting requirements should take note.

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## FCA fines Moorhouse Group Limited for telephone sales failings

23 April

The FCA fined Moorhouse Group Limited (“Moorhouse”) £159,300 for failures in relation to its oversight and control of telephone sales and in particular the sale of commercial vehicle add-on insurance products during 2012.

Moorhouse is a general insurance broker based in Wales. It has permission to deal with both retail and commercial customers, with a focus on selling motor and liability-related insurance products to small and medium enterprises (“SMEs”). Some of these, micro-SMEs, are likely to be less sophisticated and will exhibit knowledge and experience similar to that of a retail customer:

Sales were conducted predominantly by phone and the FCA found that the Firm breached FCA Principle 3 (Management and control) by failing to take reasonable care to organise and control its compliance systems and controls responsibly and effectively in relation to its telephone sales environment. In particular it failed to:

- Ensure that a consistent and effective quality assurance process was in place;
- Ensure that the Board and senior management gave sufficient attention to compliance issues and took adequate steps to address them; and
- Identify customer data that was recorded inaccurately by Moorhouse’s telephone sales agents, which was then passed onto insurers when cover was arranged, with the potential risk that customers’ claims on their policies would not be accepted.

Moorhouse was also held to have breached Principle 7 (Communications with clients) by failing to disclose appropriate information to customers about the limitations and exclusions of commercial vehicle insurance add-on products prior to their purchase. Some of these limitations and exclusions could restrict the ambit of the cover considerably, creating a risk that Moorhouse’s customers did not have adequate information to make an informed decision at the time of sale as to whether the product was suitable for them.

Some of these failings came to light during a review conducted by the FCA in April 2013 of a random sample of 12 telephone sales of commercial vehicle core insurance products and related commercial add-on products by Moorhouse to customers. Subsequently, in May 2013, the FCA issued a requirement for a Skilled Person to review the telephone sales of products by Moorhouse during the relevant period, during which additional failings were identified.

Moorhouse will be required to communicate the outcome of the FCA’s investigation to customers who purchased commercial vehicle add-on products during 2012 and they will be encouraged to contact Moorhouse if they have concerns about the way in which these products were sold to them.

Moorhouse agreed to settle at an early stage of the FCA’s investigation and therefore qualified for a 30% (stage 1) discount - if not for this the FCA would have imposed a penalty of £227,670.

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

The final notice can be found [here](#).

## Deutsche Bank fined £227 million by FCA for LIBOR and EURIBOR failings and for misleading the regulator

23 April

Deutsche Bank became the eighth bank to be fined for LIBOR/EURIBOR failings last month when FCA levied the largest fine so far.

FCA found a widespread culture of misconduct in relation to LIBOR & EURIBOR submissions as well as serious deficiencies in the relevant systems and controls. It also concluded that, during the subsequent investigation, Deutsche Bank had been slow to provide information requested, had destroyed information which was subject to a Preservation Notice, and had attempted to mislead the FCA.

For the breaches of Principle 3 (Systems & Controls) and 5 (Market Conduct), FCA fined Deutsche £126m and for the breaches of Principle 11 (Relations with Regulators), it added another £100m.

Combined with US fines, the total fines paid by Deutsche Bank for this misconduct will amount to approximately \$2.5bn. US regulators also demanded that seven staff should be dismissed.

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

The Firm breached FCA Principle 3... by failing to take reasonable care to organise and control its compliance systems and controls responsibly and effectively in relation to its telephone sales environment.

FCA found a widespread culture of misconduct in relation to LIBOR & EURIBOR submissions as well as serious deficiencies in the relevant systems and controls.

## Tribunal directs FCA to ban a former insurance broker

16 April

The Upper Tribunal has upheld the FCA's decision to prohibit Stephen Robert Allen, a former indemnity insurance broker, from performing any function connected to a regulated activity. The FCA (then the FSA) issued Mr Allen a Decision Notice on 25 July 2012 banning him on the grounds that he was not a fit and proper person. This determination was based in part on Mr Allen allegedly charging fees improperly to a client while he was a consultant for Langman Insurance Brokers.

Mr Allen referred the Decision Notice to the Tribunal, providing a single redacted page from a High Court judgment on 11 December 2011 to discredit a witness that was scheduled to testify against him on behalf of the FCA. As Mr Allen would not supply the full undredacted copy of the judgment to the FCA, the FCA obtained the copy from the court. The FCA learned that the presiding judge found that Mr Allen had deliberately given false evidence to the High Court, which included a forged document. The FCA requested and subsequently received permission from the Upper Tribunal to prohibit Mr Allen based on his actions in the High Court. The Tribunal found in February 2014 that Mr Allen was not a fit and proper person. The Court of Appeal dismissed Mr Allen's application to appeal the Tribunal's decision in February 2015.

The pursuit of this enforcement action illustrates the FCA's continued efforts to ensure that individuals working within the financial services industry meet the FCA's expectation of fitness and propriety. As stated by Georgina Philippou, Acting Director of the FCA's Enforcement and Market Oversight Division, "honesty - including towards the FCA, towards customers and towards the Tribunal and the Courts" is a central aspect of being a fit and proper person.

The Press Release can be found [here](#).

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