

REGULATORY FOCUS

A synopsis of the Financial Conduct Authority's (FCA) latest news and publications issued in August/September 2016.

ISSUE 99

Markets in Financial Instruments Directive II Implementation - Consultation Paper III

The Markets in Financial Instruments Directive II (MiFID II) is due to take effect on 3 January 2018. The FCA published its first Consultation Paper in December 2015 and its second Consultation Paper in July 2016 which detailed certain proposed changes to the FCA handbook, primarily covering SUP, SYSC, CASS, DISP, FEES, whistleblowing, remuneration, prudential rules, and commodity derivatives.

The FCA published its third consultation paper on 29 September 2016 which details the proposed changes to the handbook covering the below mentioned areas.

- Conduct of Business
- Product Governance
- Knowledge & Competence Requirements
- Recording of Telephone Conversations and Electronic Communications (taping)
- Supervision, Authorisation and Approved Persons
- Perimeter Guidance
- Consequential Changes to the Handbook

Given that many regulated firms will be affected by MiFID II, the FCA would like to receive comments on the proposals. The FCA has advised that the consultation will be open until 4 January 2017 enabling firms to provide their comments (either by using the [online response form](#) or by writing to the FCA directly). Please note however that comments must be provided by 31 October 2016 for the section entitled 'Supervision Manual, Authorisation and Approved Persons'. The FCA intends to publish the rules in a Policy Statement in the first half of 2017 after considering any feedback. The FCA has also advised that a fourth consultation paper is likely to be published towards the end of 2016.

If you would like to review the full consultation paper please click [here](#). Please note that we have published a full [regulatory update](#) on this consultation paper.

MiFID II Gap Analysis Tool

Duff & Phelps has been working closely with an IT service provider and will be making available an online tool in order to assist firms with their preparations for MiFID II. The tool will be available for firms to purchase, which they can use independently or with the assistance of Duff & Phelps in order to assess and track their readiness. For more information please contact [Caroline Gibbs](#) or [Nick Bayley](#).

OUR RECENT AWARDS*

BEST EUROPEAN OVERALL
ADVISORY FIRM 2016
HFMWeek

BEST OVERALL ADVISORY FIRM IN
THE U.S. 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

*Awarded to Kinetic Partners, which was
acquired by Duff & Phelps in January 2015

Enforcement Actions

Securities Firm Fined for Failure in its Sponsor Services

9 August 2016

An Alternative Investment Market (AIM) listed firm was fined £530,500 for failures in its sponsor services, having benefitted from a discount of 30% for settling early. The Firm failed to have appropriate systems and controls in place to ensure effective oversight of its sponsor service business and on one particular transaction, failed to act with the adequate diligence and professional care. The Firm represented to the FCA that one of its clients was eligible for a Premium Listing, when it had not carried out the necessary due diligence on that client. The transaction was eventually abandoned, as the Firm was unable to satisfy the FCA that its client was indeed eligible. The FCA restates the critical role sponsors play in maintaining the integrity of the Premium Listed equity market in London commenting that 'due to the expert nature of the role of a sponsor, and the high standards attributed to a Premium Listing, the Authority expects firms providing sponsor services to put in place robust systems and controls, and act with due care and skill, in relation to their provision of sponsor services.'

Full details can be found on the FCA website, click [here](#) for details.

The FCA Fines and Prohibits Financial Adviser for Failing to Act with Integrity and for Failing to be Open and Honest with the Regulator

1 September 2016

The FCA has fined and banned an individual from conducting any regulated activities. The individual was found to have made six false statements to the FCA between January 2013 and September 2015 in order to mislead the FCA with regards to her qualifications.

Retail Investment Advisors are required to hold a Statement of Professional Standing (SPS) and achieve the relevant qualifications, a requirement that was implemented in 2013 under the Retail Distribution Review.

The individual did not have a SPS, and in October 2013 submitted a document to the FCA which she claimed to be a SPS issued by the Chartered Insurance Institute (CII). The individual proceeded to submit a further fabricated SPS in May 2014 when asked by the FCA to confirm that she had obtained the appropriate qualifications.

In July 2015 the FCA confirmed with the CII that it had no record of the individual applying for, or being issued with a SPS, and in November 2015 the individual admitted their misconduct.

The FCA concluded that the individual's actions resulted in a failure to act with integrity and that she 'poses a risk to consumers and to the integrity of the financial system'. Mark Steward, Director of Enforcement and Market Oversight at the FCA said:

"We raised the minimum qualification standards in order to protect consumers from financial harm, and (the individual's) behaviour demonstrates a clear disregard of those standards and her duty to be honest with the FCA. We will not tolerate this sort of behaviour."

The FCA had intended to impose a fine of £157,395 plus interest, however, due to evidence of serious financial hardship the fine was reduced to £109,400. In November 2015 the individual's authorised status was removed and she ceased trading.

Full details can be found on the FCA website, click [here](#) for details.

FCA Publishes Decision Notice Regarding Former Senior Director

14 September 2016

The FCA has published a decision notice regarding the former Chief Operating Officer of a wealth management firm ("the Firm"). This enforcement action relates to the fitness and propriety of a senior member of the Firm's operations staff after he made reckless misleading statements and omissions.

Between 20 May 2010 and 17 December 2012 the individual in question was the Global COO of the wealth and investment management division of a large investment bank. The Individual was responsible for overseeing technology infrastructure and operations activities and held the CF29 (significant management) controlled function. In this role the individual also oversaw a remediation program of the division's US branch which began in early 2012 in order to address regulatory deficiencies that the SEC had identified. A third party consultancy was engaged to examine the culture and tone of the Branch, compiling their findings into a "Cultural Audit" report. This report was highly critical of several members of the Branch's senior management and recommended that the Firm replace or seriously consider replacing the aforementioned members.

While the details of the report were shared orally with a small number of senior people within the Firm, the individual in question was the only person to actually see the report itself. The individual then made several efforts to prevent the report from being accessed by others such as refraining from recording the report on the Firm's IT systems and instructing the consultancy not to circulate it. Subsequently, the Firm's chairman received an anonymous email alleging that a "Cultural Audit Report" had been suppressed. The individual in question then made reckless misleading statements and omissions, at one time claiming that there had never been a Cultural Audit report. Additionally when the Federal Reserve Bank of New York requested a copy of the "Cultural Audit Report," the individual made statements suggesting the report did not exist. The individual later described the consultant's report as rough interview notes. The FCA believes this individual's misconduct

Supervision Matters

was serious due not only to his seniority at the Firm and breadth of experience but also to the significance of the findings in the report. The FCA believes that the Individual's actions and the misleading information provided by him may have hindered the Firm in its attempts to address serious concerns regarding compliance and culture, verify an allegation from a whistleblower and comply with a request from the Federal Reserve Bank of New York.

The FCA believes a Public Censure is an appropriate sanction rather than a financial penalty because the Individual neither profited nor caused a loss to other market users as a result of the misconduct. The Decision notice states that the FCA believes this Individual should be banned from carrying out any senior management or significant influence function and publicly censured. The Individual disputes this decision and has referred it to the Upper Tribunal.

For further information please click [here](#).

FCA Publishes Market Watch 51

29 September 2016

The FCA has published a thematic review of the Market Abuse Systems and Controls of market makers. The review was conducted on a sample of registered market makers in small and mid-cap equities. The review focused on four key areas:

- market abuse risk awareness
- wall crossing procedures and insider lists
- market abuse monitoring and surveillance
- information barriers

The FCA stated that the level of awareness of market abuse risk was generally below expectations and some firms in the review were unable to demonstrate how their market abuse surveillance tools were fit for purpose. The review also noted that wall crossing procedures generally fell below the expected standard and encouraged firms to clearly define information barriers.

The above observations are not just relevant to market makers but to a vast variety of authorised firms. With the introduction of MAR in July this year the profile of market abuse as a key risk has grown and the FCA has indicated it plans to continue market abuse theme based work.

The review also addresses the practice of Payment for Order Flow, arguing that it creates a conflict of interest between brokers and their clients, undermines transparency, and can distort competition.

For further details, please click [here](#) for our client alert. Details can also be found on the FCA website by clicking [here](#).

Emphasising the Need to Promote a Good Culture: FCA Provides Feedback on a Number of Initiatives

28 September 2016

The FCA is proposing a number of measures in order to ensure that senior management continue to enhance the culture at their firms.

Senior Managers' and Certification Regime

The regulator is set to issue feedback on how firms have implemented the Senior Managers' and Certification Regime (SM&CR), as well as to propose new measures designed to further consolidate the regime. The measures will focus on the individual accountability of senior personnel, and represents a continued focus on the culture of firms, as detailed below.

Chief Executive of the FCA Andrew Bailey has commended the efforts of many firms that have implemented the regime, stating that they have embraced "the key principles underlying the Senior Managers and Certification Regime, namely responsibility and accountability". However, it has been acknowledged that in some cases responsibility still appears to be shared amongst more junior members of staff, making it harder to establish who is genuinely responsible, which is contradictory to the purpose of the new regime. Applicable firms should review their arrangements in light of the FCA's feedback and revise where necessary.

Duty of Responsibility

The FCA is consulting on Senior Manager Guidance in relation to the 'Duty of Responsibility', with the aim of helping firms understand how the duty will be enforced. This duty will ultimately enable the regulators to take enforcement action against a Senior Manager in instances where the firm contravenes a regulatory requirement, assuming the Senior Manager is responsible for management of the activity in question. The regulator's guidance includes a (non-exhaustive) list of factors that it proposes to consider in instances where it is looking to assess whether or not a Senior Manager has taken reasonable steps to avoid the firm contravening the applicable rules.

Legal function

The FCA has launched a discussion with the aim of clarifying why, at present, the legal function is included under the Senior Managers and Certification Regime and to consider whether it should continue to be part of the regime. This is in response to issues raised by firms.

Whistleblowing

The Regulator is consulting on the requirement for UK branches of foreign banks to tell their UK based employees about the FCA and PRA's whistleblowing services. The regulator introduced rules to formalise the whistleblowing practices that exist within the financial services industry in October 2015, and is now looking to extend these rules.

Code of Conduct

The FCA is consulting on extending the Code of Conduct sourcebook (COCON) to standard non-executive directors (NEDs) in banks, building societies, credit unions and dual-regulated investment firms (relevant authorised persons - RAPs) and insurance firms. The regulator believes that applying COCON to standard NEDs will help raise the standard of conduct for such individuals and ultimately reduce the risk of future misconduct and mis-selling.

CRD IV Remuneration

The FCA is also consulting on proposals to help CRD IV firms understand the rules that apply to their remuneration policies and practices, as it looks to bring its provisions into line with EBA guidelines and to publish new non-Handbook guidance. This guidance will look to answer questions on: material risk takers, governance, groups, proportionality and variable remuneration.

Regulatory references

The regulator has issued a policy statement on regulatory references, looking at the issues that arose from the consultation paper CP15/31 and specifying what information applicable firms are required to share with each other when looking to recruit personnel for key positions. One of the main responses to CP15/31 reflected firms' concerns that they may not have sufficient time to implement the changes before the SM&CR began. In reaction to this, the regulators have introduced a five month transitional period, in order to allow firms time to make the required changes to their systems. This means that the full reference regime will take effect from 7 March 2017.

For further details on all of the above, please click [here](#).

Supervisor Review & Evaluation Process (SREP) for IFPRU firms

The FCA has issued a Dear CEO letter directed at IFPRU firms stating that it intends to conduct its SREP in line with the European Banking Authority (EBA)'s published guidelines. The SREP is the FCA's review of Firm's Internal Capital Adequacy Assessment Process ("ICAAP").

Firms are required to carry out an ICAAP, have in place suitable policies, processes, systems and controls to manage risk and hold appropriate resources to meet the overall financial adequacy rule. The FCA stated that the ICAAP should be a risk management tool used by the firm or group to inform business decisions; it should not be treated purely as a compliance exercise. The ICAAP should be reviewed at least annually.

The FCA will request a firm's most recent ICAAP as part of the review and in the Dear CEO letter sets out the details that it expects to see in the ICAAP. If a firm is reporting on a consolidated basis then this should be properly analysed.

The FCA will perform this exercise alongside a review of similar types of firms to ensure a consistent approach across the sector. The FCA has stated that where a firm or group has not provided an adequate analysis of a particular risk that it considers important, it will use alternative methodologies to estimate and quantify the risk.

As a result of the review, Individual Capital Guidance (ICG) may be given to a firm. This will advise on the amount and quality of capital that the firm should hold to meet the overall financial adequacy rule.

A risk management and governance scalar might also be imposed where insufficient information is available to the FCA as an incentive to help ensure corrective action is taken. If other weaknesses are identified, the FCA has stated that supervisory action might be considered to rectify any observed weaknesses.

The FCA intends to publish "lessons learnt" from SREPs to share good practice and common errors observed.

For further details on the above, please click [here](#).

If you need assistance in reviewing your ICAAP before submission to the FCA please contact [Peter Ray](#), [Caroline Gibbs](#) or [Andrew Lowin](#).

Executive Director of Supervision, Megan Butler, - Investment, Wholesale and Specialists at the FCA, Delivers a Speech to the BBA Financial Crime and Sanctions Conference

22 September 2016

The predominant theme of Ms Butler's [speech](#) was the importance of open and constructive engagement in tackling financial crime with the goal of "making the UK as hostile as possible to those that wish to use the financial system to further financial crime." Her speech further focused on the FCA taking a proportionate approach to the AML ("Anti-Money Laundering") requirements of firms, minimising unforeseen consequences of AML regulation and ensuring customers are not unfairly excluded from financial services as a result of AML rules.

The UK is a global financial centre, which comes with the benefit of attracting global investment and activity. In tandem however, it can attract the attention of criminals and terrorists keen on exploiting the UK's financial prominence to mask their criminal operations. In recognising this threat, the FCA has made 'Financial Crime and Money Laundering' one of its priority themes. The importance of this is hammered home by the sheer cost of serious and organised crime to the UK (£24 billion) as well as the staggering global cost of money laundering (\$1.6 trillion).

Addressing and managing the threat of global financial crime requires a complex web of governments, regulators, law enforcement agencies, international agencies and financial institutions.

Ms Butler noted the responsibility the FCA has towards ensuring it recognises where it can improve. The FCA has taken on board feedback received from banks which have raised concerns about inconsistent advice being provided, whether FCA inspections and visits are sufficiently risk-sensitive and a perceived lack of flexibility on the FCA's part towards compliance procedures.

The FCA takes a proportionate approach to regulation - focusing on firms which pose the greatest risk as a matter of priority. For example, the fourteen major retail and investment banks from the UK, US and mainland Europe, accounting for 95% of UK retail banking and 75% of UK wholesale banking revenues, are subject to a Systematic AML Programme (SAMPLP) – involving additional deep dive work on these highly prominent firms on top of its AML expectations of all firms

For smaller firms with a high level of money laundering risk, the FCA has a programme of visits catered towards them.

In addition to prevention, targeted enforcement action can and will be taken. Since 2012, the FCA has fined seven banks and one MLRO for AML failings.

The FCA wants to constantly improve and ensure procedural compliance costs do not hinder efforts to improve financial crime disruption. In particular, Ms Butler addressed industry concerns about some Suspicious Activity Reports (SARs) being overly defensive in nature and whether criminal liability attached to MLROs is driving conservatism in firms. The FCA is aware of these fears and want to make it clear that it welcomes new methods, innovations and technologies aimed towards improving compliance processes.

The FCA has innovation and reg-tech teams with a wide remit which firms are encouraged to approach with ideas about AML arrangements of key importance. From May 2016, the FCA has offered a 'Sandbox' scheme - providing firms with the opportunity to test new businesses models and innovations in a controlled environment. Here, consumers are protected but firms won't incur the usual regulatory consequences of engaging in business activities.

Ms Butler further wished to inform firms that they need not maintain costly processes just to show willingness to the regulator. The FCA's concern above all is the effectiveness of those processes.

The FCA shares frustration with firms that AML practices have largely remained static, with much the same paper-based processes in place as twenty years ago. Ms Butler emphasised that any perceived regulatory barriers firms see which may prevent a step change in efficiency should be raised with them.

Banks have a specific part to play in combating financial crime and good progress has been made (e.g. scam warnings). However, Ms Butler warned against a 'tick-box' compliance approach, emphasising that firms have to have a broad sense of social responsibility towards mitigating financial crime. This should be seen as more of an integrity and business imperative rather than just a regulatory objective. Here, the question should be 'is this the right approach?' and not just 'is this doable?'

Another concern is that of 'de-risking', whereby customers may be left without access to banking services. While individual banks are closing as few as 0.025% personal accounts for AML-linked reasons, innocent customers may find themselves cut off without warning, which can be profoundly disruptive. The FCA wishes to encourage better communication from banks to consumers regarding the exiting or rejecting of banking relationships, as well as better communication between banks. This is to ensure the right balance is maintained between protecting legitimate account holders and combatting money laundering.

Bribery and corruption risks have risen in prominence since the 2010 Bribery Act. In April 2016, the FCA published sector specific findings into inducements to complement existing guidance and rules already in this area, which Ms Butler was keen to point out does not supersede existing guidance from the FCA and the Ministry of Justice.

The FCA keeps a keen eye on external policy decisions and expects firms to do the same. A topical example of this is the upcoming legislation aimed at combatting tax evasion, covered by the Criminal Finance Bill and the Finances Bill. If passed, both will have a significant impact on how the FCA and firms operate, warranting their attention as these bills go through parliament.

Overall, the responsibility for improvement lies with both regulators and firms alike, with cross-agency cooperation being a key part of this. The Joint Money Laundering Intelligence Taskforce (JMLIT) was highlighted by Ms Butler as a key example of this kind of progress. The joint industry efforts on the back of the Panama papers further shows the positive benefits of cross-agency working.

Joint working at an international level is crucial for combatting financial crime globally. While there are practical difficulties, the aim should always be for regulators to work towards an ever greater consistency of standards for banks. While this is made difficult by a tension between the whims of national interests and regulatory policy convergence, the will to cooperate is evident (e.g. IOSCO, Interpol, Europol) and the FCA will continue to pursue international solutions.

Ms Butler ended her speech by emphasising closer engagement with the BBA and observing that progress is made by many small steps rather than a few great leaps. Ultimately, firms must be vigilant and proactive and avoid taking a compliance 'form over substance' approach.

For the full speech please click [here](#).

Director of Specialist Supervision at the FCA, Nausicaa Delfas, Delivers Speech to the FT Cyber Security Summit.

21 September 2016

Nausicaa Delfas highlighted the asymmetric threat posed by cyber risk, observing that it is easier to perpetrate than it is to defend against. She further stressed that this threat impacts every FCA objective: market integrity, consumer protection and competition. A cyber threat to any of the 56,000 firms the FCA regulates could pose a significant risk to any one of these objectives. Even the smallest firm may have a large amount of sensitive information which, if compromised, could create a ripple effect throughout the financial sector.

Reported attacks have been increasing year on year: 5 in 2014, 27 in 2015 and 75 in 2016. While this likely reflects an increase in attacks being carried out, it could also reflect better detection by firms. Further reports have suggested that the cyber risk challenge to firms will only get greater, which will in turn require improved vigilance.

Towards this, the FCA wishes to foster a spirit of cooperation by:

1. Engaging nationally and internationally to ensure a coordinated approach to address this threat.
2. Focusing supervisory attention on the largest providers, the critical national infrastructure and conducting probing testing.

The FCA takes a tailored approach with each firm, providing communications and encouraging self-help while taking a much closer supervisory approach with the more at risk firms whose disruption would pose the greatest risk to FCA objectives.

It's important that a 'security culture' is fostered from the top of a firm. Cyber security is not just an IT concern, but impacts people, processes and technology. Good governance is vital towards ensuring this culture permeates throughout a firm, with senior management engagement and effective challenge at the Board level. While the FCA acknowledges that firms have encountered difficulties in recruiting the right people with the appropriate cyber risk management skills, it feels that good progress has been made in this area.

The FCA also wants firms to ensure they've identified their key assets and have suitable protections around them. Further to this, the FCA wants firms to have adequate detection capabilities in place so threats don't go dangerously unnoticed. While constant innovations are being made in cyber protection, it is important firms prepare for the event of an unforeseen interruption. Adequate business continuity plans, such as measures for recovery and response and preserving essential data, are crucial.

Under Principle 11, the FCA expects firms to report material breaches to it and to share information with others via the Cyber Information Sharing Partnership platform, a government initiative. Ms Delfas was keen to emphasise just how important it is that information is shared in order to combat patterns of attacks and enhance wider industry protection.

Key emerging risk areas identified by the FCA are:

Ransomware

Individuals and firms are targeted with a phishing email which, once accessed, installs ransomware onto a system and encrypts key information. A 'ransom' will then be demanded by the hackers to release this information. This form of attack is increasing and becoming ever more sophisticated. The FCA expects firms to be alive to this threat through user education and awareness.

Data storage/outsourcing

Outsourcing data storage means that firms adopt the risk profile of the outsourcing provider. This means firms need to work closely with these providers to ensure their data is protected, as the responsibility for this data ultimately lies with the firm. The FCA recently released further [guidance](#) about this.

Skills

There exists a skills gap in cyber risk management. While not the fault of firms, they should do all they can to attract talent into the cyber field and take advantage of any practical initiatives aimed at addressing it (e.g. the government's FastTrack cyber apprenticeship scheme).

Ms Delfas concluded her speech by observing that most successful attacks come about as the result of basic failings rather than the sophistication of the attacks themselves. The most effective way to address this is to ensure that a security culture becomes the norm from the top to bottom of a firm, covering technology, people and processes. The FCA intends to play a greater part in cyber resilience and wants to engage with a broader amount of firms to address this threat as a priority.

Please click [here](#) for full article.

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