

# REGULATORY FOCUS

A synopsis of the Financial Conduct Authority's (FCA) latest news and publications issued in January 2017.

ISSUE 103

## FCA requests information from Principals with Appointed Representatives in the investment management sector

This month the FCA, as part of its review of Principals and Appointed Representatives (ARs), has requested numerous firms to complete questionnaires providing information to the Regulator about their activities and those of their ARs.

The review will focus on systems and controls, particularly in respect of conduct risk, and the level of oversight and monitoring undertaken by the Principal firm on the AR.

Firms should not expect to receive individual feedback from the FCA. However, should the Regulator require a follow up visit as a result of the information provided firms will be notified. Once the review is completed a communication will be issued to the Investment Management Sector.

This is a timely reminder for all firms with ARs to ensure that they have appropriate systems, controls and oversight in place.

## SEC update

Firms that are Registered Investment Advisors with The Securities and Exchange Commission ("SEC") in the U.S. may be interested to know the areas that the Office of Compliance Inspections and Examinations ("OCIE") will be focussing on during 2017. The SEC is continuing to concentrate on protecting retail investors and also to assess market-wide risks. In particular, the areas of interest are:

### ▪ Retail customers

- Several initiatives to assess risks to retail customers
- Reviews of firms delivering investment advice through electronic mechanisms
- Reviews of firms charging investors a single bundled fee for advisory and brokerage services, known as wrap fee programmes

### ▪ Senior Investors and Retirement Investments

- Continuing its focus on public pension advisors
- Expanding its focus on senior investors and individuals investing for retirement

### Market-wide risks

- Continue its focus on firms' compliance with SEC's anti-money laundering rules and Regulation SCI (Systems Compliance and Integrity), which was adopted to strengthen technology infrastructure in the U.S. securities markets

### ▪ FINRA

- Continue to undertake inspections of FINRA operations and regulatory programmes

### ▪ Cybersecurity

- Continuing to examine for cybersecurity compliance, procedures and controls

The SEC said that the priorities listed above are not exhaustive and may be adjusted as a result of market conditions, industry developments and ongoing risk assessment activities. In addition, there have been a number of high profile resignations at the SEC over recent weeks including Mary Jo White, the Head of the SEC, in November 2016 and Marc Wyatt, Director of OCIE, on 30 January 2017. Given the political climate in the U.S. and the President's reported legislation to review the Dodd-Frank Act, there are likely to be further changes ahead.

## OUR RECENT AWARDS\*

EUROPEAN SERVICES -  
BEST CONSULTANCY FIRM 2016  
*CTA Intelligence*

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

### Two sentenced in insider dealing case

13 January 2017

Two individuals have been sentenced with regards to two counts of insider dealing.

One individual was sentenced to 10 months' imprisonment and 180 hours of community work, the other to 16 months' imprisonment and 200 hours of community work. Both sentences have been suspended for two years.

One of the individuals worked for an IT company and came into possession of insider information relating to an impending takeover of his employer by a large international firm. He disclosed this information to a neighbour, who as a result traded in shares and options relating to the firm in question. The neighbour generated a profit in excess of £100,000 and was the subject of a confiscation order of over £160,000.

Mark Steward, Executive Director of Enforcement and Market Oversight at the FCA stated; "This is another clear example for those who are tempted to insider deal, that they are more likely to be caught than ever before."

Please click [here](#) for further details.

### FCA fines investment bank £163 million for anti-money laundering controls failings

31 January 2017

The FCA has fined a large international investment bank (the Bank) £163,076,224 for failings in its anti-money laundering (AML) controls. This is the largest financial penalty for deficiencies in AML controls ever imposed by the FCA. This penalty is a result of the Bank failing to maintain an adequate anti - money laundering control framework during the period between 1 January 2012 and 31 December 2015.

The FCA stated that "as a consequence of its inadequate AML framework, the Bank was used by unidentified customers to transfer approximately \$10 billion of unknown origin from Russia to offshore bank accounts in a manner that is highly suggestive of financial crime."

The FCA found that the Bank's Corporate Banking and Securities division (CB&S) in the UK:

- Performed inadequate customer due diligence;
- Did not ensure that the Bank's front office took responsibility for the CB&S division's know your customer obligations;
- Used flawed methodologies when determining customer and country risk rating;
- Lacked sufficient AML policies and procedures;
- Had an inadequate AML IT infrastructure;
- Lacked automated AML systems for detecting suspicious trades; and
- Did not perform adequate oversight of trades booked in the UK by non UK traders.

Due to these issues the FCA found that the Bank's Russian subsidiary was able to execute over 2,400 mirror trades between April 2012 and October 2014. These mirror trades were used to convert rubles to dollars and transfer in excess of \$6 billion from Russia through the UK Firm to overseas bank accounts in a variety of jurisdictions. An additional \$3.8 billion was used in suspicious one sided trades and the FCA believes as many as 3,400 further trades formed one side of mirror trades used to facilitate the covert movement of funds.

The Bank agreed to settle at an early stage and was exceptionally cooperative with the FCA. Had this not been the case the fine would have been £229,076,224. The FCA stated that the bank generated £9.1 million in commission from the suspicious trading that has since been paid to the Regulator as part of the financial penalty. The discrepancy between the fine enforced and the revenue the activity generated exemplifies the increasingly high cost of non-compliance.

It should also be noted that the Bank has been fined \$425 million (£339 million) by the New York State Department of Financial Services for similar failings.

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

# Supervision Matters

## FCA Transaction Reporting Forum

11 January 2017

The FCA held a Transaction Reporting Forum in December 2016, which allowed firms and trade bodies to directly interact with key members of the Regulator's Markets Reporting team ("MRT"). The FCA provided feedback on the current MiFID Transaction Reporting regime before explaining how this will change with the implementation of MiFID II/MiFIR.

The Regulator emphasised that the current MiFID Transaction Reporting regime will remain in force until 3 January 2018 and that firms must continue to comply with these requirements. Additionally, they highlighted that the draft transitional rules proposed in SUP TP will impose a continuing obligation on firms to notify and remedy breaches relating to MiFID I Transaction Reporting, even after the new regime comes into effect.

With regards to the upcoming MiFIR Transaction Reporting regime, the FCA explained that MiFIR will broaden the range of entities and instruments covered and will require more detailed information to be submitted than is currently the case.

The Regulator also stressed the need for firms to start preparing for MiFIR Transaction Reporting. They should be working now to understand the MiFIR reporting requirements, to ensure that there is still time before January 2018 to understand the technical reporting specifications and to undertake technical systems implementation. They also highlighted the need for firms to contact clients to obtain their relevant details (such as their LEI (Legal Entity Identifier)) and liaise with executing counterparties, trading venues and other third party information suppliers.

The Forum also provided an opportunity for the FCA to give an overview of its new Market Data Processor ("MDP"). This is the FCA's new system that will receive, process and transfer market data to meet the requirements of MiFID II, MiFIR and MAR. Although still in development, the Market Interface Specifications are now available to relevant firms upon the signing of a Non-Disclosure Agreement. This system will undergo industry testing in Q3 2017 before going live on 3 January 2018.

To view the slides from the Transaction Reporting Forum, please click [here](#).

## FCA release MiFID II authorisation guidance

12 January 2017

The FCA has published a Guide to advise how MiFID II will affect the application and notification requirements of various types of firms, trading venues and other relevant entities.

It outlines the key differences between what's in place now and what the revised process will be from January 2018, the date that MiFID II comes into effect. Firms need to consider how MiFID II will affect them and consider the impact of the following:

- Required changes to the scope of permission
- Changes to forms
- Early applications

Due to the short timeframe, the FCA has opened the MiFID II Authorisation 'gateway' with effect from 30 January 2017.

### Key changes

The Guide provides initial background on how the changes affect MiFID investment firms and other firms, as some are now brought within the scope of MiFID for the first time. In each chapter and in Annex 1 the Guide highlights the date by which firms should submit an application, Variation of Permission or a notification and which forms must be used.

MiFID II implements several changes to the scope of MiFID for investment firms. Further details can be found in the Guide, but they broadly encompass these three areas:

- Services and Activities
- Financial Instruments
- Exemptions

It is worth consulting the Guide's various chapters to assess which areas are relevant to your firm. The Guide covers the following areas:

- Investment firms
- Fees
- Article 3 MiFID Exempt Firms (Optional Exemption Firms)
- Approved Persons
- Structured Deposits
- Passport Notifications and Tied Agents
- Data Reporting Services Providers (DRSPs), Consolidated Tape Providers (CTPs) and Approved Reporting Mechanisms (ARMs)
- Market Data Processor (MDP) on-boarding and market data reporting
- Trading Venues and Systematic Internalisers
- Transparency waivers and deferrals
- Commodity regime
- Non-discriminatory clearing access for financial instruments

## Annexes

The Guide provides some useful further information for firms in a format that's easy to navigate.

- Annex 1 provides detailed Notification Tables, specific to various types of firms
- Annex 2 breaks down the FCA Connect portal for conducting authorisations and links to the relevant forms, simplifying this system for those who wish to be authorised but may not be familiar with Connect
- Annex 3 provides a list of the technical standards under MiFID II and MiFIR
- Annex 4 provides an overview of a firm's prudential category based on its MiFID business activities

## Key deadlines:

- Complete applications for full authorisation of investment firms and DRSPs, or Variation of Permissions for existing firms, must be submitted by 3 July 2017 to ensure the FCA will be able to assess them before 3 January 2018
- Notifications of cross-border service passports must be submitted by 2 December 2017 to enable the FCA to send them to relevant EEA Competent Authorities by 3 January 2018
- Notification of establishment passports for branches must be submitted to the FCA as early as possible after the 'MiFID Passporting gateway' opens on 31 July 2017

## Summary

It is important for firms to consider the changes being introduced by MiFID II and how it affects them as early as possible, particularly when it comes to knowing whether and, if so which, applications and notifications need to be made to the Regulator.

Further information can be found [here](#).

## Financial Services Compensation Scheme - Management Expenses Levy Limit 2017/18 Consultation Paper FCA CP17/1/ PRA CP1/17

16 January 2017

The FCA has published a consultation paper to outline the Management Expenses Levy Limit ("MELL") for the Financial Services Compensation Scheme ("FSCS") for 2017/2018. The MELL agreed will be the maximum amount which the FSCS may levy in a particular year without further consultation and will apply from 1 April 2017 to 31 March 2018.

The FSCS is the compensation fund of last resort for customers of failed authorised financial services firms. The scheme is beneficial in providing protection to consumers (assisting the FCA in meeting its consumer protection objective) and also helps the Prudential Regulation Authority ("PRA") to meet its general objective of 'promoting the safety and soundness of PRA-authorized firms'. The FSCS can pay compensation to consumers if a financial services firm is unable, or likely to be unable, to pay claims against it. The MELL is designed to ensure the scheme has the appropriate resources in place to deal with such claims. The protection offered by the scheme assists in ensuring public confidence in the financial system as a whole.

The FSCS is funded by the collection of two levies (although supplemental fees can and have been charged). The MELL is a management expenses levy covering 'base costs' (i.e. running costs and claims handling costs). The second levy is a compensation costs levy which covers actual or expected compensation payments, and is not being consulted on in this paper.

The MELL levy proposed for 2017/2018 is the maximum amount of £74.54 million. This covers the projected costs of operating the scheme which is estimated at £69.24 million and an unlevied contingency reserve which is estimated at £5.3 million. It has been advised that the proposed amount will enable the FSCS to meet its objective of 'providing a compensation scheme that is efficient, fair, appropriate and responsive'. This is an increase of 2.74% on the 2016/17 MELL reflecting increased claims handling costs.

The FCA would like to receive responses from firms on the proposed levy by 13 February 2017. This can be done by using the [online response form](#) or by writing to the FCA directly. The FCA intends to publish its finalised rules in March 2017. These will take effect from 1 April 2017 and invoices will be sent out from July 2017.

For further information, please click [here](#) to read the full Consultation Paper.

## Mark Steward's Speech: Financial Penalties, the Senior Managers Regime and Regulatory Enforcement

19 January 2017

Mark Steward, Director of Enforcement and Market Oversight at the FCA, recently delivered a speech at the Practising Law Institute's annual seminar on securities regulation in Europe, which focussed on three areas; financial penalties, the senior manager's regime and new ways to resolve cases without protracted litigation.

In regards to financial penalties Mr. Steward stated that while the FCA and its predecessor have imposed over £3 billion in financial penalties over the past 5 years, the aggregate level of fines has been decreasing. The reason for this is not a return to "light touch regulation" but instead due to an increasing number of cases being resolved by early settlement or other agreement. This trend is also noticeable in the U.S. as more and more firms accept culpability in order to reduce fines, which may avoid the targeting of individual members of senior management and potentially prevent expensive litigation.

With regards to the Senior Managers Regime, Mr. Steward made it clear that its purpose is to hold senior managers accountable for what occurs under their watch, although the regime has introduced a new and challenging dynamic. This dynamic is three fold:

- Firstly, senior managers are expected to be more resistant to paying fines in order to resolve cases
- Secondly firms may be reluctant to pay high fines to resolve cases that do not absolve senior managers
- Thirdly, internal investigations may present a clear conflict of interest as such investigations are prepared for senior management who may well be part of the problem being reported

Mr. Steward also discussed the FCA's new proposals regarding the resolution of cases. Instead of a "take it or leave it" approach to early settlement the FCA proposes that the dispute process should allow those under investigation to accept the facts but dispute the sanction. The current rules where sanctions are reduced by 30% if firms or individuals agree to early settlement will not be changed. However, if the sanctions are disputed with the Regulatory Decisions Committee the 30% reduction will still apply. That being said, while there is significant public benefit in resolving cases as early as possible, Mr. Steward wishes to focus the FCA's resources on early detection rather than early settlement.

The full text of the speech can be found [here](#).

## Cass 7A and the special administration regime review

23 January 2017

The FCA has released a consultation paper, [CP17/2](#) consulting on changes in the Client Assets Sourcebook (CASS) relating to investment firm failure and interaction with the Special Administration Regime (SAR). The proposals set out in this consultation paper aim to speed up distribution of client assets, improve consumer outcomes and reduce the market impact of an investment firm failure. In order to accomplish these aims this consultation paper is seeking feedback on a variety of proposed CASS rule changes with a focus on the following:

- Amendments to allow more flexibility regarding transfers of the client money pool ("CMP")
- Requirements that work in conjunction with the SAR regulations to ensure an appropriate level of client protection prior to a final distribution of client assets
- Applying hindsight to the valuation of cleared margined transactions when determining a client's entitlement to the CMP
- Expressly defining in the rules which CASS requirements cease to apply or are modified following firm failures and other primary pooling events
- Amendments that ensure CASS is aligned with the SAR Regulations when firms are subject to them

Additionally, this consultation paper explains why certain other proposals brought forward in previous consultation papers, [CP13/5](#) and [DP16/2](#) are not being taken forward. Furthermore, this consultation paper addresses the forthcoming indirect clearing requirements under European Market Infrastructure Regulation ("EMIR") and Markets in Financial Instruments Regulation ("MiFIR") Regulatory Technical Standards (RTS).

Consultation relating to EMIR and MiFIR RTS proposals will be open until 23/02/17 while consultation relating to all other proposals will remain open until 24/04/17, with a policy statement expected in Q3 2017.

The FCA's press release can be found [here](#) and the full text of CP17/2 can be found [here](#).

## **Annex IV Reporting of Master Fund AIF**

27 January 2017

The FCA has published Handbook Notice No: 40 which, amongst other things, confirms the changes to AIFMD's Annex IV Reporting consulted on in September 2016's Quarterly Consultation Paper CP16/17.

The resulting changes to FUND 3 and FUND 10 are published in the Alternative Investment Fund Managers Directive (Reporting) Instrument 2017 and become effective from 29 June 2017.

From 30 June 2017 there are two fundamental changes:

- **FUND 3:** A UK AIFM which is subject to Bi-Annual or Annual Annex IV Reporting will not have to report on a Non-EEA Master AIF that is not marketed into the EEA for which it is the AIFM. This applies where its feeder AIF is marketed in the EEA as either an EEA AIF or Non-EEA AIF. Consequently, only UK AIFMs subject to Quarterly Annex IV reporting will have to include information on their non-EEA master funds
- **FUND 10:** An above threshold Non-EEA AIFM (those subject to Quarterly Annex IV Reporting) will be required to report Master AIF information if it is not marketed in the UK, but only if that Master AIF's Feeder AIF is marketed in the UK and both the feeder fund and the master are managed by the same entity

The full text of the handbook notice can be found [here](#).

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