

# REGULATORY FOCUS

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

ISSUE 91

## MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE II IMPLEMENTATION - CONSULTATION PAPER I

On 15 December 2015, the FCA published its first consultation paper on MiFID II. The paper discusses in detail certain aspects of the UK's implementation of the Directive, including proposals on changes to the regulation of secondary markets, the scope of the application of the Principles for Businesses, and passporting. The FCA confirmed that it requires further clarity about the implementation of MiFID II before it can consult on the full range of changes that will need to be made to the FCA Handbook. All Member States must ensure that their local laws and regulations give effect to the Directive's provisions by 3 July 2016, with the new rules set to come into force from 3 January 2017.

While this consultation paper is pertinent to a wide range of financial institutions, including investment managers, investment banks, brokers, trading venues and high frequency traders, it may also be of interest to service providers that offer data reporting services.

We understand that the FCA will publish another consultation paper in the first half of 2016, which will set out the implications for SYSC and COBS.

The consultation paper can be found [here](#).

### Regulatory highlights this month include:

- FCA fines Threadneedle Asset Management Limited £6 million
- Examining the future of anti-money laundering regulations - speech by Rob Gruppetta
- Wholesale market policy - a year in review
- TR15/13: Flows of confidential and inside information
- [JFSC's Amendments to Codes of Practice](#)

### OUR RECENT AWARDS\*

ONE STAR 'VERY GOOD'  
ACCREDITATION 2015  
*Best Companies UK*

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 Matters

### Case concerning CEO referred to the Upper Tribunal

11 December 2015

On 25 September 2015, the FCA issued a Decision Notice in which it decided to impose a £86,691 financial penalty on Mr Charles Anthony Llewellyn Palmer, the majority shareholder and CEO of Standard Financial Group Limited, and prohibited him from performing any significant influence function in relation to any regulated activity. Further to the issuance of this notice, Mr Palmer decided to refer the FCA's decision to the Upper Tribunal (Tribunal).

During the period 24 February 2010 to 20 December 2012, Mr Palmer held the Controlled Function 1 (Director) at Standard Financial Group Limited and its subsidiaries, Financial Limited and Investments Limited. Together, the firms formed an adviser network and were responsible for ensuring the fair treatment of underlying customers by their Appointed Representatives (ARs) and individuals adviser. The FCA's view is that Mr Palmer failed to take adequate steps to ensure the firms' ARs and individuals adviser, who were approved to perform the CF30 (Customer Function), would give suitable advice to approximately 40,000 customers. The business model that Mr Palmer developed and maintained focused on allowing the ARs and individual advisers to be afforded a high level of flexibility and freedom, which increased the risks that the ARs and individual advisers would give unsuitable advice or sell unsuitable investments to the underlying customers.

As CEO and majority shareholder, Mr Palmer was the primary controlling influence on the firms and was responsible for developing and maintaining the firms' business model, the implementation of the model and for oversight of the general management and conduct of the firms. To this extent, Mr Palmer had a responsibility to exercise due skill, care and diligence to ensure that the Board and the firms were aware of and understood the risks.

The Decision notice follows a separate decision in which the FCA decided to fine the former risk management director for the group, Ms Paivi Katriina Grigg, £14,807 for failing to ensure that the network's risk management framework was adequate to mitigate the risks to the group's customers. She failed to properly understand and carry out a number of her specific responsibilities which resulted in the group operating under a flawed risk management framework that did not adequately identify and mitigate the risks to customers, to their detriment.

The Tribunal may uphold, vary or cancel the FCA's decision and the Tribunal's judgement will be made public on its website.

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

The decision notice for Mr Palmer can be found [here](#).

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

### FCA fines Threadneedle Asset Management Limited £6 million

15 December 2015

The FCA has fined Threadneedle Asset Management Limited (TAML, the "Firm") £6,038,054 for failing to put in place adequate controls in the fixed income area of its front office, providing inaccurate information to the regulator and failing to correct the inaccurate representation for four months. These failings, which occurred during the period from June 2010 to February 2012, were deemed by the FCA to be breaches of Principle 3 (risk management systems and controls) and Principle 11 (relations with regulators).

In June 2010, an internal report brought to the attention of TAML a number of weaknesses in the fixed income area of the Firm's front office. In 2011, the FSA paid an ARROW visit to the Firm which was followed by a letter identifying the FSA's concerns in relation to the Firm's fixed income area, including the Emerging Markets Debt desk. The FSA was concerned about, among other things, the number of errors occurring in that area, as well as the risk of fund managers initiating, booking and executing their own trades.

The Firm responded to the FSA shortly after and explained that, in order to address the Regulator's concerns, it had specifically appointed members of staff to be responsible for all aspects of dealing on the relevant desks and that the individuals had taken on those responsibilities. In fact, these individuals had not taken on all the responsibilities outlined in TAML's response and the fund managers on those desks continued to initiate, execute and book their own trades. Approximately one month after TAML submitted the response to the FSA, a fund manager on the Emerging Markets Debt desk initiated, executed and booked a \$150 million trade to purchase Argentine warrants on behalf of three Threadneedle funds at four times their market value. The fund manager was neither the manager of the funds nor did he have authority to make the trades. TAML's outsourced back office identified the problem and did not settle the trade. Had the unauthorised transaction settled, it could have exposed the funds to a £70 million loss.

The FCA considered the failings to be particularly serious because the deficiencies allowed the unauthorised transaction to take place and decided to fine the Firm £6,038,054. This was reduced from £7,548,130 due to early settlement.

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

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

# Supervision Matters

## Personal accountability

2 December 2015

Tracey McDermott spoke at the City & Financial conference on personal accountability and the new Senior Management and Certification Regimes, which will be implemented in March for the banking sector.

Reflecting on how the industry has been “in the headlines for all the wrong reasons”, the FCA’s Acting Chief Executive spotted a common theme: finance became disconnected from the world in which it operated and the people it was supposed to serve. The culture had become one of short termism compounded by greed and a sense of impunity. The Senior Managers’ Regime was established to enable the regulator to hold senior members of staff personally responsible, with the aim of changing banking culture for the long term.

McDermott warned however that banks’ and investment Firms’ implementation of the new regimes will be key. If embraced as an example of good business instead of a compliance task, it has the capacity to lead to a sea change in how UK financial services is seen by all parties. Why? Because it should drive better, clearer decisions fostered by a sense of real responsibility and clear accountability. Firms should be able to identify how and why misconduct occurred and take the necessary corrective action, rather than the regulator having to step in.

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

## Thematic Review 15/12: Wealth management firms and private banks — suitability of investment portfolios

9 December 2015

Thematic Review 15/12 (TR15/12) is relevant to all firms that provide discretionary and or advisory portfolio management services to retail customers. It builds on the Thematic Review carried out in 2010, which led to the FSA’s Dear CEO letter in 2011 and was followed by further work on suitability in 2012.

The purpose of the TR 15/12 was to determine whether firms managing investment portfolios for retail customers had addressed concerns raised during previous FCA reviews and communications on this matter.

Overall, the results convey that there has been some improvement in the market since the work carried out on suitability in 2010. However, the practices of firms in the sample selected demonstrated a wide variation in the application of suitability standards, with both good and bad practices uncovered at the firms reviewed.

## Examples of Good Practice

Governance and control environment: cultivating a close relationship between compliance and senior management to ensure that matters of suitability are addressed appropriately; the introduction of a Non-Executive Director to provide challenge and mitigate the risk of delivering unsuitable investment portfolios to customers, and engaging third parties to provide an independent assessment of internal processes and contribute to their development.

Risk appetite: performing an annual review of each customer’s risk appetite to see if adjustments to the portfolio were required and exploring the answers provided by a risk questionnaire to ensure that the risk appetite correctly reflected the customer’s viewpoint on risk.

Putting oversight arrangements in place and carrying out effective monitoring: a member of compliance staff was allocated to the front office to ensure customer information was updated every 12 to 18 months and engaging the services of a professional compliance consultant to raise the firm’s standards of monitoring suitability.

## Recommended Actions

Firms should:

- Study the findings of TR 15/12, particularly the examples of good and poor practice, and assess whether their internal processes can demonstrate how portfolios managed by the firm are suitable;
- Ensure that customer information for portfolios managed by the firm is gathered, recorded and regularly updated;
- Embed practices which ensure that the composition of portfolios managed by the firm correctly reflect the investment needs and risk appetite of customers; and
- Review the governance, monitoring and assessment arrangements to confirm that they are adequate to meet regulatory responsibilities of suitability.

It should be noted that regulatory action was taken against some firms involved in TR15/12. The FCA had also underlined that it will be continuing and increasing its supervision of suitability standards and the issues raised by this review.

Please see [here](#) for the full Thematic Review.

## Supervision Matters (continued)

### Thematic Review 15/13: Flows of confidential and inside information

10 December 2015

The FCA has undertaken a review of the process for the handling of information within a number of small to medium sized investment banking firms. The resultant thematic review published in December 2015 contains key messages which are applicable to all investment firms that handle confidential or inside information. The FCA recommends that senior management review these findings, together with the examples of good and poor practice, and take steps to address any actions required in order to manage the flow of confidential and inside information.



#### The review drew out a number of key messages:

- It was highlighted that employees, particularly those in the line of defence, should individually be aware of their role in the control of the flow of inside or confidential information and understand that this is an on-going area of risk;

- Senior management should not only recognise, but must be able to adequately monitor the risks associated with the receipt of confidential and inside information. This should include three lines of defence providing challenge for those initially responsible for controlling flows of information; and
- On-going assessments of conduct or regulatory risks should be undertaken and circumstances that present highlighted risks should be at the centre of this ongoing risk assessment. Firms should consider whether instances of increased risk of misuse of confidential and inside information have been considered and mitigated properly.

The paper discusses the concept of “need to know”, and the requirement to act in the best interests of clients and the consideration of conflicts.

It was made clear in the review that firms should ensure that processes in place to identify and mitigate risks are proportionate to the complexity and size of the business and should also take into account changes to a firm’s business model and the additional risks which this could present. Examples of good controls include clear escalation procedures, interaction with Compliance on a day-to-day basis and a firm culture which recognises that the risk of information being mismanaged could occur at all levels.

In the review, the FCA emphasised that the inappropriate handling of confidential or inside information would detrimentally impact the FCA’s three operational objectives. Thus in ensuring that appropriate controls are in place, firms would be contributing to improved trust in the professional financial services industry and supporting market integrity.

The thematic review can be found [here](#).

## Other Developments

### Examining the future of anti-money laundering regulations

8 December 2015

Rob Gruppetta, Head of the Financial Crime Department at FCA, delivered a speech at the Accuity AML Risk Reduction and Compliance Europe Conference on 8 December 2015. The content of the speech is relevant for all financial services firms.

#### Implementation of the Fourth Money Laundering Directive

Mr Gruppetta began by discussing the upcoming government consultation paper which will be published to consult the industry on the UK implementation of the Fourth Money Laundering Directive through legislation. He discussed the potentially controversial questions arising from the Directive, such as the practicalities of the requirement to screen employees and the extension of the application of Politically Exposed Persons checks to include British public officials. He encouraged industry participation with this consultation in order to assist in shaping those sections of the Directive on which the UK has flexibility and to inform the Treasury of areas that could be “unduly burdensome” for firms.

#### Financial crime return

Mr Gruppetta also encouraged the industry to participate in the consultation regarding the new data return designed to gather information from firms about their financial crime risks. The data from this proposed return will enable the FCA to detect emerging financial crime risks which will allow it to undertake more accurately targeted supervisory work. It is also intended to enable the collection of aggregate statistics, which could then be published in order to help firms in developing their own risk assessments.

#### The Senior Managers Regime and financial crime

Mr Gruppetta provided clarification on the requirement under the new Senior Managers Regime's (SMR) to have a senior manager at the top of the organisation, who will be required to have explicit responsibility for overseeing the firm's efforts to tackle financial crime, and how this interacts with the existing Money Laundering Reporting Officer (MLRO) role. In effect, the role is the same as the existing MLRO role under the Approved Persons Regime. The SMR ensures that the responsibility is discharged to someone sufficiently senior and accountable to ensure that the firm meets its financial crime obligations as a whole. This person may or may not be the MLRO.

#### Derisking

The phenomenon of “derisking”, where firms choose not to deal with categories of customers that they associate with higher money laundering risk, was also explored. Mr Gruppetta emphasised that the effective management of money laundering risk need not result in such wholesale derisking. To address the issue, the FCA has commissioned further research into assessing the balance between the costs of tackling anti-money laundering

and the benefits to society of doing so. The intention is to gather evidence about the nature, scale and drivers of this phenomenon to inform the regulator's response.

#### Innovation

In November 2015 a “call for evidence” was issued by the FCA for the industry to provide views both on the fostering of new technologies by the regulator, including technologies that would aid the detection and prevention of money laundering, as well as the removal of regulatory barriers that exist. Mr Gruppetta stressed that, although the FCA is technology neutral and does not endorse particular providers, it is open to and interested in technology solutions that are workable.

#### International bodies and enforcement

Mr Gruppetta underlined that the FCA is subject to scrutiny on anti-money laundering matters internationally by the International Monetary Fund (IMF) and Financial Action Task Force (FATF). An IMF assessment is ongoing and the FATF assessment is approaching. The outcomes of the assessments provide an opportunity for the FCA to learn from good practice in other jurisdictions worldwide. During assessments much emphasis is focused on evidence of enforcement and prosecutions to demonstrate the effectiveness of the rules in place. Nevertheless, Mr Gruppetta stated that the FCA is not interested in enforcement action based on “quibbling technical transgressions”, but enforcement based on material failings in high risk areas. He advised that if matters have escalated to an enforcement action it “arguably shows failure by the regulator as well as failure by the firm”.

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

### Wholesale market policy - a year in review

8 December 2015

David Lawton, FCA Director of Markets Policy and International, delivered a speech at the ICI Global Trading and Markets Structure Conference in London on 8 December 2015. The speech reflected on what 2015 has meant for the regulation of wholesale markets and the funds sector.

The Director stated that whilst many believe that regulation is continually changing he is of the opinion that there is a core of timeless, immutable goals which policymakers and regulators are pursuing. These goals can be summed up in the catchall term of ‘fair and effective markets’.

The speech then provided a brief overview of the important market policy developments in 2015 and how they may help to promote fair and effective markets.

## Other Developments (continued)

### Markets in Financial Instruments Directive 2 (MiFID II)

MiFID II is perhaps the most notable of the upcoming changes, as it will bring wide ranging and significant changes to investment firms and the wider market. Last year saw the foundation rules drafted in previous years expanded upon, with ESMA submitting draft regulatory technical standards to the European Commission for approval by the EU co-legislators.

MiFID II seeks to enhance open access, strengthen integrity of markets and help to improve market users' ability to source liquidity through better consolidation of data.

In recent weeks, the timing of MiFID II has become a subject of discussion, with the European Commission contemplating a one-year delay in the implementation of the Directive. The European Parliament's MiFID II negotiating team has signalled that it would support the delay.

### Dealing commission

ESMA provided advice to the European Commission in late 2014 on dealing commission and the FCA is awaiting clarity on this area. The FCA published consultation and feedback statements during the year. However, only once the delegated acts have been passed and the FCA has more clarity can it publish further consultation on how the rules will be implemented. Regulators have been concerned for some time about the potential unmanaged conflicts that these commissions create and the FCA has made its views clear that "further unbundling would provide better value for investors, be more transparent and enable more effective market research".

### Market Abuse Regulation (MAR)

The new Market Abuse Regulation is progressing, with detailed level two measures currently being finalised. ESMA provided final technical standards in September of this year, and the FCA is expecting delegated acts from the Commission to be published shortly. These acts will provide the final detail and should enable the regime to become live in July 2016. The new rules take into account the new instruments brought into scope by MiFID II, define new abusive market practises, take into account new technology being used in the market, and provide the regulator with new tools for tackling market abuse risks. MAR is important for fair and effective markets.

### Capital Markets Union (CMU)

The European Commission initiative to create a Capital Markets Union was another important development to occur during 2015. The Commission stated that the CMU will be tasked with ensuring that financial markets are properly regulated and supervised so that they remain stable, competitive and transparent.

The second half of 2015 saw the Commission produce an Action Plan, described as "ambitious" by the FCA. Two legislative proposals have been published, the first updating the existing rules in the Prospectus Directive, and the second seeking to facilitate simple, transparent and standardised securitisation.

### Fair and Effective Markets Review (FEMR)

The UK's Fair and Effective Markets Review was published in the summer of 2015. It was launched in the wake of significant fines from regulators around the world, related to the identified

misconduct in FX market trading, and earlier in relation to LIBOR. The report summarised the causes of misconduct, considered what new regulations and industry initiatives exist to address the causes and how effective these might be in mitigating future risks.

The final report made 21 recommendations to the authorities, the government, international standard setters such as IOSCO and the FSB, and finally the industry itself. The three key recommendations were the proposed extension of the SMR regime to a wider group of firms, new criminal offences for market abuse and the establishment of the new FICC Market Standards Board to help identify trends and risks, produce guidance and market standards and share good practise with firms in the FICC (fixed income, currency and commodity) markets.

### Wholesale competition studies

In February 2015, the FCA concluded its call for evidence regarding competition issues in the wholesale market. The Regulator received a good deal of feedback from the industry, both positive and negative.

The issue of competition within the investment banking and corporate banking sector was of key concern to many respondents. The FCA's competition team is therefore focusing on this via a market study.

### Asset management competition market study

In November 2015 the FCA launched the terms of reference for the asset management competition study. The market study is anticipated to take approximately one year to complete, with an interim report due to be released in the summer of 2016. The FCA competition market studies are typically started when there are features that may be causing markets to not work in the most fair and effective way, rather than when there is a crystallised risk requiring action.

### Financial stability board systemic nature of funds debate and bond market liquidity

The debate around the systemic nature of funds continued in 2015. The key questions being asked are: if a fund were to face significant outflows, make significant losses or be unable to redeem investors of their investments should they wish to exit the fund, could the impact of these events cause damaging ripples, or even waves, in the market?

It is generally considered that a single fund is unlikely to have a significant systemic impact. However, further work will be completed in a number of different forums throughout 2016.

### Conclusion

In conclusion, the Director summarised that 2015 was a busy year for the regulators and policymakers and it is anticipated that this will continue in 2016 and 2017. David Lawton commented that all of the regulation and change that is occurring is not just for its own sake, but aims to improve the way markets work, "because we all want markets that are fair and effective, which serve their users well".

The full speech can be accessed [here](#).

---

For more information about our  
global locations and expertise, visit  
[www.duffandphelps.com](http://www.duffandphelps.com)

## About Duff & Phelps

Duff & Phelps is the premier global valuation and corporate finance advisor with expertise in complex valuation, dispute and legal management consulting, M&A, restructuring, and compliance and regulatory consulting. The firm's more than 2,000 employees serve a diverse range of clients from offices around the world.

M&A advisory and capital raising services in the United States are provided by Duff & Phelps Securities, LLC. Member FINRA/SIPC. Pagemill Partners is a Division of Duff & Phelps Securities, LLC. M&A advisory and capital raising services in the United Kingdom and Germany are provided by Duff & Phelps Securities Ltd., which is authorized and regulated by the Financial Conduct Authority.

## Compliance Consulting

[andrew.shrimpton@duffandphelps.com](mailto:andrew.shrimpton@duffandphelps.com)  
[jane.stoakes@duffandphelps.com](mailto:jane.stoakes@duffandphelps.com)