

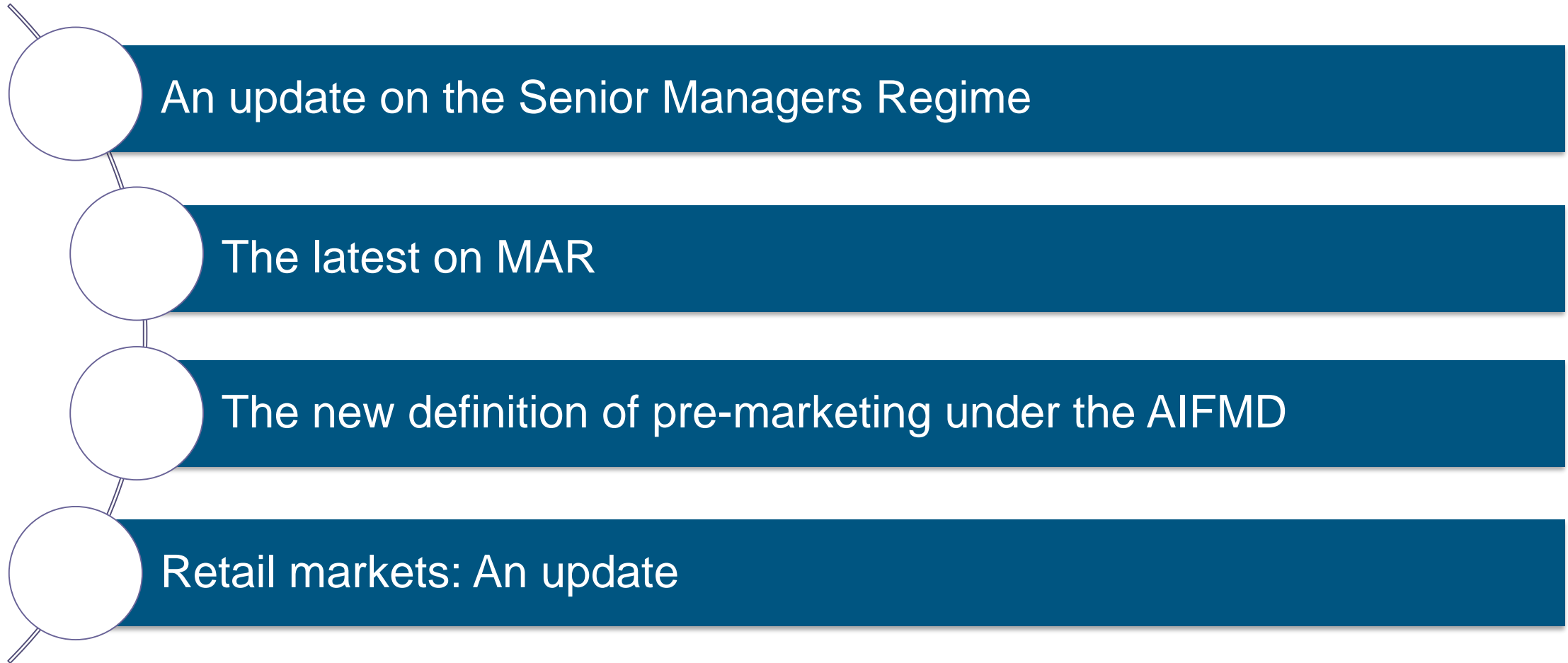
A blue-toned background image featuring a financial line chart with multiple data series and a grid. The chart shows various trends, including a sharp decline followed by a recovery and another decline.

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11 September 2019

Financial Regulation Monthly Breakfast Seminar

Overview





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An update on the Senior Managers Regime
David Berman

FCA review of banking SMCR

- The FCA recently published its findings from a review of the banking SMCR
- Relevant to all firms

FCA review of banking SMCR (cont.)

Key Observations

- Senior Manager Accountability
 - The SMCR does not seek to redefine the roles of non-executives. In particular, the FCA does not expect non-executives to act more like executive directors
- Reasonable steps
 - It is not possible for the FCA to provide an exhaustive list of “reasonable steps” under the duty of responsibility. Guidance is provided in the Decision Procedure and Penalties manual (DEPP)
 - Senior managers should be doing what they “reasonably can to prevent misconduct”
 - The FCA expects senior managers to think more broadly and to create an environment where the risk of misconduct is minimised (for example through nurturing healthy cultures)

FCA review of banking SMCR (cont.)

Key Observations (cont.):

- Certification
 - Most firms could not demonstrate the effectiveness of their assessment approach, use of subjective judgement, or how they ensure consistency across the population
- Conduct rules
 - The conduct rules are a critical foundation for firms' culture and the conduct of individuals
 - Many firms were unable to explain what a conduct breach looked like in the context of their business
 - Firms have not always sufficiently tailored their conduct rules training to job roles

FCA review of banking SMCR (cont.)

- Outcome:
 - No policy changes
 - Increased supervisory focus on the conduct rules
- Culture – inextricably linked
 - “We will continue to build on the links between SMCR and firm culture. The SMCR is an important way to establish a culture of accountability for conduct and aligns with our cross-sector business priority to continue to work on firm culture and governance”
 - Firms have found it challenging to find appropriate ways of measuring culture

Andrew Tinney case

- Background:
 - Mr Tinney was the former COO (CF29) of a Barclays Bank PLC division
 - He received a document (“Culture Audit”) which contained critical findings about the culture within the firm. He then assisted in drafting a response to an anonymous email alleging that the “Culture Audit” had been suppressed
- FCA decision:
 - The FCA found that Mr Tinney took steps aiming to ensure that the report would not be seen by anyone else and made various misleading statements and omissions in relation to the existence of the report to his colleagues
 - Consequently, Mr Tinney breached his obligation to act with integrity and should be publicly censured and banned from carrying out any senior management or Significant Influence Functions in any regulated firm

Andrew Tinney case (cont.)

- Upper Tribunal appeal decision:
 - Mr Tinney was reckless in giving the impression that the document did not exist and, accordingly, Mr Tinney breached his obligation to act with integrity
 - However, Mr Tinney did not make false or misleading statements to his colleagues and did not mislead the FCA
 - Mr Tinney should be publicly censured but not banned
- Points to note:
 - Whilst lack of integrity has historically resulted in a prohibition, the Upper Tribunal did not uphold the FCA's prohibition order in this case
 - Recklessness versus dishonesty?

BSB Guidance: Certification Regime - Regulatory References

- The Banking Standards Board (BSB) has published a statement of good practice on the certification regime and regulatory references
- Designed to help firms implement the regulatory reference requirement for SMCR
- The guidance is based on three principles explained in more detail in the guidance:
 - Fairness
 - Proportionality
 - Consistency

BSB Guidance: Certification Regime - Regulatory References (cont.)

- Good practice when providing regulatory references
 - Who is the request from?
 - Verify that the request is legitimate
 - What is being requested?
 - Consider whether it is reasonable not to respond to any additional questions
 - The role of central functions to ensure consistency
- Good practice in obtaining a regulatory reference
 - Consider providing a short explanation outlining the background to the request and setting out the information required
 - When necessary to hire an individual whose regulatory references do not cover the whole six-year period, consider making a provisional F&P assessment that can then be revised in-year as more information about the employee is obtained

BSB Guidance: Certification Regime - Regulatory References (cont.)

- The type of information to include in a reference
 - References containing adverse information about an individual
 - Ensure there are no surprises
 - Records older than 6 years – would the firm take the information into account in its F&P assessment?
 - Case-by-case assessment
 - Discuss with the individual during the initial stages of the process
 - Incomplete disciplinary procedures
 - Firms *may* disclose unverified information (e.g. ongoing disciplinary process)
 - Consider periodic review of outgoing references to ensure fairness and consistency

BSB Guidance: Certification Regime - Regulatory References (cont.)

- Balanced decisions about incoming references
 - Balanced decision rather than a binary screening tool
- Revising regulatory references
 - Attempt to contact a former employee to allow him or her to respond to an allegation by more than one method of communication, giving a reasonable timeframe to respond (at least 15 days)
 - Ensure employees understand the requirements of regulatory references – induction, onboarding and “leaver’s pack”
 - Before sending a revised reference to another firm, ensure the other firm still employs the individual

New Form A (SMCR)

- A new Form A for SMCR is available from 9 September 2019



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The latest on MAR
Rob Moulton

Market Watch 60

- Fabiana Abdel-Malek case
 - Compliance officer
 - No “need” to access
 - No assumption that Compliance staff are ethical
 - Passed information to third party to trade CFDs
 - Both received 3 year sentences

MW60 findings – key issue

- Large numbers of staff in support functions can access inside information
 - “One insider list suggests that only 12 deal members worked on the transaction but that over 600 members of Compliance, Risk and other support functions had full access”
 - Support functions are “need to know”
 - Actual access must be tracked
 - Support staff need tailored access e.g. only to anonymised folders
 - Description as “support function” insufficient under MAR – needs reason
 - Access rights need reviewing when staff move

MW60 findings – other issues

- Insider lists omit names of people who accessed information
- Monitoring very varied
 - Some could not identify who accessed information (bad)
 - Some looked at repeated access to large numbers of documents, outside hours access, attempted access by non-permissioned staff (good)
 - Some monitoring by non-dedicated staff with insufficient knowledge (bad)
 - Some could not log access to files, or only identified create / edit / delete (bad)

MAR – polling

- October 2018 letter from Nicky Morgan (Treasury Committee) to Andrew Bailey (FCA)
- Hedge fund commissioned polls for Brexit referendum and 2017 election
- Accusations focused on private polls on polling day

MAR – polling

- Representation of the People Act 1983
 - No polls to be published on polling day
- MAR – restricts use of information which is
 - Price sensitive
 - Relates to MAR instruments
 - Precise
 - Not public
 - Information is public if anyone could obtain it with sufficient effort, resource, intelligence
 - Burning factory example

Polls – FCA's view

- FCA does not police the use of polling day information under Representation of the People Act 1983
- MAR does not restrict use of polling information whilst polls are open unless MAR definition is met
- “If an established polling firm is due to publish polling results and on publication the results are likely to affect the price of government bonds, and meet the other criteria...it could be an offence under MAR to share that information”

Polls – FCA’s view – other points

- Other rules (e.g. PRIN) may be relevant
- “Determining whether information is inside information requires judgment based on facts at the time. We encourage firms, where appropriate, to take legal advice”



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The new definition of pre-marketing under the
AIFMD
Anne Mainwaring

Harmonising the requirements in relation to pre-marketing

- New legislation is being introduced which will, amongst other things:
 - Introduce a harmonised definition of pre-marketing; and
 - Harmonise the conditions under which an EU AIFM can engage in pre-marketing
- 2 year transition period means this legislation will be applicable from mid 2021

New pre-marketing definition

- Pre-marketing means:
 - “the **provision of information or communication, direct or indirect, on investment strategies or investment ideas** by an **EU AIFM or on its behalf**, to **potential professional investors** domiciled or with a registered office in the Union in order to test their interest in an AIF or a compartment which is **not yet established, or which is established, but not yet notified for marketing in accordance with Article 31 or 32**, in that Member State where the potential investors are domiciled or have their registered office, **and which in each case does not amount to an offer or placement to the potential investor to invest in the units or shares of that AIF or compartment**”

Conditions for pre-marketing in the EU by an EU AIFM

- An authorised EU AIFM may engage in pre-marketing in the EU, except where the information presented to potential professional investors:
 - Is sufficient to allow investors to commit to acquiring units or shares of a particular AIF;
 - Amounts to subscription forms or similar documents whether in a draft or a final form; or
 - Amounts to constitutional documents, a prospectus or offering documents of a not-yet-established AIF in a final form

Conditions for pre-marketing in the EU by an EU AIFM (cont.)

- Where a draft prospectus or offering documents are provided, they must not contain information sufficient to allow investors to take an investment decision and must clearly state that:
 - They do not constitute an offer or an invitation to subscribe to units or shares of an AIF; and
 - The information presented therein should not be relied upon because it is incomplete and may be subject to change

Additional compliance burden

- Within two weeks of beginning to pre-market an AIF, the AIFM is required to send an ‘informal letter’ to its home regulator stating:
 - The Member State in which and the periods during which the pre-marketing is taking place;
 - A brief description of the pre-marketing including information on the investment strategies presented; and
 - (Where relevant) a list of the AIFs and compartments of AIFs which are / have been the subject of the pre-marketing

Key impacts

- Reverse solicitation
 - Any subscription by professional investors within 18 months of the EU AIFM having begun pre-marketing shall be considered to be the result of marketing
- Non EU AIFMs
 - The new pre-marketing requirements are applicable to EU AIFMs but Member States are required to ensure that implementation of these new rules does not in any way disadvantage EU AIFMs vis-à-vis non-EU AIFMs
 - Watch point: Whether Member States update their national private placement regimes to extend these rules to non-EU AIFMs
- Brexit



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Retail markets: An update
Nicola Higgs

Retail Client Terms & Conditions

- European Commission Unfair Contract Terms Guidance (22 July 2019):
 - Article 6(2) UCTD provides: Member States shall take the necessary measures to ensure that the consumer does not lose the protection granted by this Directive by virtue of the choice of the law of a non-Member country as the law applicable to the contract if the latter has a close connection with the territory of the Member States
 - EU Guidance: *“This provision may grant the consumer extra protection since it applies in every case where the law of a third country is chosen but where there is a close connection with a Member State. Furthermore, the Court has held that, under Article 3(1) UCTD, a contract term whereby a contract concluded with a consumer is to be governed by the law of the Member State in which the [firm] is established is unfair if it does not unambiguously specify that consumers can still rely on the mandatory consumer protection rules of the country of their usual residence”*

ACTION: Check that the jurisdiction clauses in your retail client terms of business make clear that customers outside the UK can still rely on the mandatory consumer protection rules of the country of their usual residence.

Retail Client Terms & Conditions

- European Commission Unfair Contract Terms Guidance (22 July 2019) (cont.):
 - See additional handout for guidance on how best to present information to consumers

FCA Dear CEO Letter to Wealth Managers

- April 2019 – April 2021 FCA is carrying out a strategy to identify, diagnose, and remedy the harm that wealth managers and stockbrokers may cause.
- Following areas of focus:
 - **Fraud, investment scams, and market abuse:** ensure suitability and do not include high-risk investments inappropriately
 - **Best execution:** Effective day-to-day execution processes, contingent arrangements for periods of market distress, and clear, comprehensive, and effective oversight and monitoring arrangements. Consider reliance on a single retail service provider (RSP)
 - **Costs and charges disclosures:** The FCA expects firms to review their own costs and charges disclosures to ensure they are satisfying all relevant requirements, including for both ex-ante and ex-post costs and charges disclosures. Particularly transaction and incidental costs and charges
 - **EU withdrawal:** The FCA reminds firms of the need to act in customers' best interests, maintain clear communications, and take steps available to continue to service customers in the EEA in accordance with local law and national regulators' expectations

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Questions?