2014 Regulatory Bulletin Issue 12

"It doesn't make any sense... that's why I trust it!" Kate Winslet

The FCA issued a speech setting out the main issues facing wealth managers with trust standing out as an important factor.

The ability of the public to trust their bank is a prime goal of the regulator, yet once again they have had to issue heavy fines for perceived failings, as they try to convince consumers that the 'culture'can be changed.

There has also been development on a few thematic reviews from the FCA

FCA sets out the main issues facing wealth managers

Rob Taylor has issued a speech regarding the various issues facing wealth managers in the industry.

Whilst it is not quite as comprehensive as Clive Adamson's famous "Commandments" speech, the speech gives a good oversight of the issues that will interest the FCA in 2015, and is highly relevant to wealth managers

To summarise his three points:

- Trust – this summed up by his point about clients being anxious about whether they can trust their wealth manager to do the best for them, and the firm should be saying "this is how we have earned the ability for that client not to be anxious". This section of the speech then goes into Conduct Risk territory. Do your clients trust you to do the right thing by them?
- AML and PEPs – Taylor asks whether firms ask enough questions about the sources of wealth. As the UK is seen as a good place to have money invested, a proportion of the wealth attracted here will be of dubious origin or in the hands of people the FCA don't want Firms to do business with. Are you confident your firm can spot them?
- Cost – Put simply, Wealth Managers have business models with a high cost to income ratio. This might not be sustainable if the "good times" never come back? And how does that impact on clients?

FCA publishes terms of reference for credit card market study

The FCA has published the terms of reference for a credit card market study. They announced the market study in April 2014 after its own research showed that the credit card market was not working well for some consumers.

Christopher Woolard, director of policy, risk and research at the FCA said *"The credit card market is well-established and hugely important for UK consumers, who hold around 70 per cent of all credit cards in Europe. We want to understand in more depth what drives consumers to make the choices they do and how firms develop the services they offer."* The review includes:

- How easy it is for consumers to shop around, compare cards and find one that best meets their needs.

  This includes:

  - the extent to which consumers drive competition by shopping around and switching
  - product complexity
  - transparency and fairness of terms and conditions
  - behavioural drivers

- How firms recover their costs across different cardholder groups and the impact this has on the market, for example whether certain customer groups are disadvantaged, the impact on innovation or whether it prevents new products coming to market.
- Issues around unaffordable lending and whether particular groups of consumers are over-borrowing or under-repaying their credit card balances and the possible reasons for this, including whether credit cards are marketed in a way that works against the best interests of consumers.

FCA release statement regarding Regulatory fees and Levies – Policy Proposals for 2015/16

Despite the title, this is not the document which reveals exactly how much fees are going to go up by.

This document will impact what firms pay because it announces a number of changes to fee structures, a rise in the fees paid for changes of permission etc. and the introduction of an additional fee to fund the Government's *"Guidance Guarantee scheme"* (which will ensure all customers taking advantage of the post-April 2015 pension freedoms can receive advice in relation to this area).

Firms in FCA fee blocks for asset management will bear 22% of the cost of setting up this service. This is a sharp increase from the original proposals and has risen to ensure that Pension and Investment firms pay this rather than the IFA fee block).

The document does not give enough information about the scheme cost to allow a *"guestimate"* to be made of what additional costs will be levied on such firms. All we know is that it will be more.

FCA consults on changes to the approved persons regime for Solvency II firms

The FCA has published a consultation paper on changes to the approved persons regime for Solvency II firms.

The consultation paper proposes changes to the approved persons regime for Solvency II firms to address:

- the FCA's role in reviewing firms' assessments of the fitness and propriety of certain important individuals within these firms;
- the provisions in the Financial Services (Banking Reform) Act 2013 that permit regulators to

apply conduct rules to certain individuals in authorised firms; and
- the PRA's proposed reforms to the scope of its pre-approval regime.

The deadline for comments is 2 February 2015. The shortened consultation period is to enable the FCA to support the implementation of Solvency II by the 31 March 2015 transposition deadline.

FCA Policy statement regarding Retirement Reforms and the Guidance Guarantee

The FCA is set to launch a review of rules and requirements for *"at-retirement"* products ahead of the changes to pensions in April 2015. This Policy Statement starts a sequence of consultations which includes reviews of the sale of annuities, reviews of the approach to pension drawdown and accessing uncrystallised pension fund lump sums (the part from which people might buy their Lamborghinis, if the Chancellor is to be believed!). In the short term, the FCA tells advisers that they treat the uncrystallised sums in the same way as they treat pension drawdown.

This will have the effect of slowing down possible raids on these funds, which will only be accessible after advice. It also temporarily puts the brake on the introduction of so-called pension bank accounts, which are being mooted as being accessible with a debit card.

The FCA challenge outlining firms' effectiveness regarding Complaints from Customers

This is the initial output from a Thematic Review exercise carried out with a number of major financial services firms in the spring & summer of this year.

There may be no immediate changes required to your processes and controls, but the document does indicate some areas where firms generally could improve their complaint handling processes. You need to be aware of these points as they will form the focus of any FCA oversight in the next year, and might also be looked at by auditors, etc.

The key points were:

- Firms should decide if their internal reviews and assessments of complaint-handling policies and processes look specifically at whether the firm's approach to complaints has the interests of consumers at their heart (the FCA are concerned that some complaints processes are too "tick box" in approach, and do not think about the impact on the customer);
- Firms should look at their definition of 'complaint' and train their staff where the definition is not properly understood (here the FCA believe that firms are using too wide a definition, and should differentiate between full FCA regulated complaints and others);
- Firms should assess whether their systems and processes could inhibit accurate recording of complaints (and further consider how this impacts on their ability to conduct root cause analysis);
- The FCA have identified that the amounts of both redress payments, distress and inconvenience payments were inconsistent;
- Firms were inconsistent when undertaking root cause analysis (the firms were good at identifying operational issues that caused complaints, but poor at identifying cultural issues or poor governance);
- Complaint MI could be improved, especially messaging, interpretation, quality metrics and use of performance targets.

In key areas above, many firms processes are robust and already take account of the concerns expressed. However, your Compliance team should look at your processes and controls again in the light of these comments.

Changes to Tier 1 Investor Visa rules

The Investor Visa rules changed on Thursday 6th November.

The applicant will have to invest at least £2 million in the UK, and all of the money has to go into UK bonds or UK shares – none can go into property, as the Government want to take some of the heat out of the London property market.

Any cases looking to complete under the existing rules will need to complete by midnight on 5th November.

FCA Thematic Review of Wealth Managers and Private Banks control in-house products.

The FCA has published the results of a thematic review of the way that wealth management firms and private banks selected in-house products for their customers.

This review looked at how firms managed the potential conflict of interest that could arise when firms sold their own in-house investment products. The FCA sampled 18 wealth manager and private banking firms, which between them had £146 billion of funds under management. Around 20% of that total was invested in products that were manufactured by a party connected with the wealth manager.

Generally the FCA was happy with what they found, but they did raise some issues with the way firms communicated this issue with clients.

Good practice

- The regulator found no distribution agreements between manufacturers and distributors which indicated that firms were putting their own commercial interests above those of the customer.
- It also found that remuneration structures within distribution channels, for example in the front office and portfolio construction units, appeared to be neutral towards investment in in-house products.

Bad practice

- The FCA said that there were shortcomings and a lack of consistency in how firms articulated the way that in-house products fitted with their business model and strategy.

- It said not all firms monitored the level of in-house products in customers' portfolios which could have helped them indicate how effectively they were managing the conflicts of interest. Customer communication was not always clear about the firm's services and the extent to which in-house products might feature in customer portfolios.
- The FCA said some of the firms used terms that were inconsistent and ambiguous in their client communication, including stating they were 'restricted' but also that they were 'scanning the universe' for the 'best of class' products.

Aside from giving feedback to certain firms on how to improve their processes, the FCA said it would be taking no further action following the review.

If you do not "manufacture" your own in-house products, the points about communication and making clear why the firm's services add value for the customer still may be relevant to you.

FCA finds small firms need to manage financial crime risks more effectively

The FCA has found that many small banks and commercial insurance intermediaries fail to effectively manage financial crime risk.

While the reviews found some firms had made good progress in addressing areas of weakness and saw examples of good practice, there were significant shortcomings at other firms. The FCA has proposed further guidance for all firms to ensure that expectations are clear.

Tracey McDermott said *"Firms must take their responsibility to reduce the risk of financial crime seriously. Significant improvements are still required in this area. To do that successfully requires firms to use their judgement and common sense. That is not about box ticking or wholesale de-risking. It is about firms getting the basics right – understanding their customers, the risks they pose and managing those risks proportionately and sensibly."*

FCA confirms price cap rules for payday lenders

The FCA published its proposals for a payday loan price cap in July. The price cap structure and levels remain unchanged following the consultation.

These are:

1. Initial cost cap of 0.8% per day - Lowers the cost for most borrowers. For all high-cost short-term credit loans, interest and fees must not exceed 0.8% per day of the amount borrowed.
2. Fixed default fees capped at £15 - Protects borrowers struggling to repay. If borrowers do not repay their loans on time, default charges must not exceed £15. Interest on unpaid balances and default charges must not exceed the initial rate.
3. Total cost cap of 100% - Protects borrowers from escalating debts. Borrowers must never have to pay back more in fees and interest than the amount borrowed.

From 2 January 2015, no borrower will ever pay back more than twice what they borrowed and someone taking out a loan for 30 days and repaying on time will not pay more than £24 in fees and charges per £100 borrowed.

In the first five months of FCA regulation of consumer credit, the number of loans and the amount borrowed has dropped by 35%. To take account of this, FCA has collected additional information from firms and revised its estimates of the impact on market exit and loss of access to credit. They now estimate 7% of current borrowers may not have access to payday loans - some 70,000 people. These are people who are likely to have been in a worse situation if they had been granted a loan. So the price cap protects them.

FCA Enforcement Cases

FCA Fines three Banks £42 million for IT failures

The banks were fined £42 million for IT failures which occurred in June 2012 and meant that the Banks' customers could not access banking services.

The FCA has taken this action against the Banks for failing to put in place resilient IT systems which could withstand, or minimise the risk of IT failures.

The actual cause of the IT incident was a software compatibility problem with the underlying cause being the Banks' failure to put in place adequate systems and controls to identify and manage their exposure to IT risks.

Tracey McDermott said *'Modern banking depends on effective, reliable and resilient IT systems. The Banks' failures meant millions of customers were unable to carry out the banking transactions which keep businesses and people's everyday lives moving. The problems arose due to failures at many levels within the* [group] *to identify and manage the risks which can flow from disruptive IT incidents and the result was that* [their] *customers were left exposed to these risks. We expect all firms to focus on how they ensure that they can meet the requirements of their customers when looking at their IT strategies and policies.'*

FCA fines five banks £1.1 billion for FX failings and announces industry-wide remediation programme

The FCA has imposed fines totalling £1,114,918,000 ($1.7 billion) on five banks for failing to control business practices in their G10 spot foreign exchange (FX) trading operations

They found that between 1 January 2008 and 15 October 2013 the Banks did not exercise adequate and effective control over their G10 spot FX trading businesses.

For example policies were high level and firm-wide in nature, there was insufficient training and guidance on how these policies applied to this business, oversight of G10 spot FX traders' conduct was insufficient, and monitoring was not designed to identify the behaviours found in our investigation.

The right values and culture were not sufficiently embedded in the Banks' G10 spot FX businesses which resulted in those businesses acting in the Banks' own interests without proper regard for the interests of their clients, other market participants or the wider UK financial system.

In addition to taking enforcement action against and investigating the six firms where the FCA found the worst misconduct, The FCA are launching an industry-wide remediation programme to ensure firms address the root causes of these failings and drive up standards across the market. They will require senior management at firms to take responsibility for delivering the necessary changes and attest that this work has been completed.

Irish News

Issue 7 of Market News was issued on 5th November 2014 which reviewed the highlights of recent news. These included:

- The appointment of the Central Bank of Ireland (CBoI) as the competent authority for EMIR.
- New questions and answers regarding AIFMD (see below).
- Confirmation that an anti-dilution levy by a master UCITS to a feeder may be possible provided it has been clearly and unambiguously disclosed to investors.
- Confirmation the CBoI will not exempt SME Investment firms from CRD IV's capital conservation buffer and the counter cyclical capital buffer requirements.
- ESMA updates.

Fines

- In co-operation with the FCA, bank fines noted above the CBoI fined one bank €3,5 million for IT failings. They indicated that good governance of all aspects of operations and infrastructure (including IT) was required. IT systems are critical and it is essential that robust arrangements are in place to ensure continuity of service. The CBoI clarified that "outsourcing is no defence for regulatory failings". Where management fail to ensure robust governance they should expect vigorous investigation and follow-up by CBoI.

AIFMD

- The CBoI confirmation that firms marketing a non-EU AIF into Ireland under the AIFM regulations must report to them under regulation 25. The CBoI also include new questions regarding loan originating qualifying investor AIFS.

FMConsult News

FMConsult UK offers authorisation services to all types of Consumer Credit firms, whether you have an interim authorisation of not.

All offices provide clients with:

- Compliance monitoring services
- Company and consumer credit authorisation services
- Fund authorisation services
- Outsourced MLRO services
- Outsourced compliance solutions
- Regulatory project assistance (e.g. Investment Restrictions, Money Laundering, Client Money, ICAAPs)

UK and Ireland also provide:

- Investment & Operational Risk management services
- Fund restructuring services
- Internal Capital Adequacy Assessment Process (ICAAP) review and development;
- ACD / Management Company structuring and governance review
- Fund and firm re-domiciliation advice
- AIFM Authorisation
- AIFM monitoring (including risk services)

Dublin also provides Fund UCITS IV Reporting, MLRO and Company Secretarial Services.

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