2014 Regulatory Bulletin Issue 9

"If your music is great, you will have fans, not because you have spent time chatting on social media" Bryan Adams

The Canadian rock star maybe has a very good point about quality of product over quality of promotion but that hasn't stopped the financial industry flocking onto social media to promote their products. Maybe with Bryan in mind the FCA has clarified its approach to regulating firm's use of social media

The FCA have also released statements regarding failures in Best Execution and other financial promotions

FCA clarify its approach to social media financial promotions

Over the past 18 months, the FCA have consulted with the industry regarding financial promotions via social media, especially regarding firms who are using, or wanting to use, social media to communicate with customers. Many firms have forecasted difficulties in complying with some of the FCA rules, particularly with the financial promotion rule for character-limited forms of social media such as Twitter.

Clive Adamson, Director of Supervision at the FCA said *"The FCA sees positive benefits from using social media but there has to be an element of compliance. Primarily, what firms do on social media must ensure customers are at the heart of their business…Our overall approach is that financial promotions, whether on social media or traditional media, should be fair, clear and not misleading."*

Consumers are expected to be provided certain minimum information, in a fair and balanced way, at the outset of firms' interaction with them.

Therefore you should ensure that any form of communication (including through social media) is compliant as it is capable of being a financial promotion.

Here is a summary of some specific points:

- Promotions for investment products – Should be identifiable as such. The FCA's view is that on social media is that firms are clear that a promotion is a promotion. E.g. by the use of #ad in online posts.
- Stand-alone compliance - Each communication (e.g. a tweet etc. or web page) needs to be considered individually and comply with the relevant rules.
- Firms are reminded that there are requirements to include risk warnings or other statements in promotions for certain products/services. These apply to social media as they would to any other medium. One solution to the problem of character limitation is to insert images, such as infographics into tweets, which allows relatively unrestricted information to be conveyed. However, where the financial promotion triggers a risk warning or other information required by our rules this cannot appear solely in the image.
- Image advertising is unlikely to present difficulties with character limits and can be used by firms to advertise for more pressure in the market.

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Failures in Best Execution

The FCA has found, after looking at 36 firms, that there is a lack of understanding with regards to the rules relating to Best Execution. Especially in controlling client costs and exaggerated by the lack of managerial oversight and engagement from front office.

- The rules were often poorly understood or incorrectly applied with frequent attempts by firms to limit their obligations to clients.
- 4 firms attempted to evade FCA rules by changing the description of services they offered to clients. The firms reviewed have ceased this practice and the FCA will take action against any firm where it continues.
- Most firms lacked the capability to effectively monitor order execution or identify poor client outcomes.
- Firms were often unable to demonstrate how they managed conflicts of interest when using connected parties or internal systems to deliver best execution for their clients.
- It was often unclear who was responsible for best execution. Reviews often focused on process rather than client outcomes, with insufficient front office engagement.

David Lawton, FCA director of markets, said *"Firms told us that best execution is a simple commercial imperative – yet our review shows many firms unacceptably fail to put their clients' interests first, undermining market integrity and inhibiting competition. The FCA expects to see firms act as good agents, placing equal focus on controlling client costs as delivering returns, and will take action where firms fall short of our standards."*

It is important that firms take into account factors such as price, speed and order size to ensure that the client receives the best result.

This review comes ahead of the introduction of enhanced EU-wide rules on best execution and is linked to the FCA's work on firms' use of client dealing commission and how they discharge their duty to act as good agents.

Proposed Changes to JMLSG Guidance

The JMLSG Board has carried out a review of its Money Laundering Guidance for the Financial Sector, looking at ways in which their Guidance laid out more effectively and with greater clarity, especially in the areas of risk assessment and monitoring the effectiveness of systems and controls. They propose to change:

- The importance that the firm's policies and procedures are communicated widely throughout the firm, to increase the effectiveness of their implementation.

- Emphasis on the difference in the roles of Nominate Officer and MLRO.
- Emphasis on what the FCA expect from firms

FCA handbook notice

The FCA has published handbook notice no.14, which sets out changes made by the FCA to the handbook on 26 June and 24 July 2014. Changes were made in four instruments which, among other things:

- set out the FCA's fees and levies rates for 2014/15 (from 4 July 2014);
- clarify the application of the existing crowdfunding rules (from 4 August 2014) these changes include clarification the AML and DISP apply to crowdfunding platforms and that Suitability rules do not apply to P2P arrangents; and
- change the minimum level of capital which self-invested personal pension operators must have invested in their businesses (from 1 September 2016).

FCA statement to firms regarding financial promotions

The FCA has stated this month that firms need to do more to ensure that financial promotions meet the relevant regulations. Firms need to increase efforts to meet these standards, to ensure that advertisements are not misleading to consumers, or risk FCA enforcement.

This follows a review by the FCA of over 1,500 financial promotions for consumer credit products since 1 April 2014. In this time the FCA opened 227 cases related to non-compliant promotions.

Financial promotions which fell short of the standard required were:

- advertisements for fee-paying debt management firms which did not make it clear that the firms charged for their services;
- promotions that guaranteed that firms would provide credit regardless of the customer's circumstances;
- internet search terms that re-routed consumers to unrelated sponsored links; and
- a logbook lender that falsely implied its services were FCA-endorsed and made unclear comparison between its annual percentage rates (APR) and those of other lenders.

Clive Adamson, director of supervision at the FCA, said *"…We are disappointed to see standards fall short of what we expect, particularly in the consumer credit space, four months from when we took over regulation. We believe that firms in this sector can do more to ensure financial promotions meet the standards we would expect and will continue to monitor performance in this area."*

FATCA

The Foreign Account Tax Compliance Act (FATCA) requires foreign banks to reveal Americans with accounts over $50,000. Non-compliant institutions could be frozen out of U.S. markets, so everyone is complying. America taxes its citizens—and even permanent residents—on their worldwide income regardless of where they live. In 2009, the IRS struck a ground-breaking deal with UBS for $780 million in penalties and American names. Recently, Credit Suisse took a guilty plea and paid a record $2.6 billion fine.

More than 80 nations have agreed to the law and over 77,000 financial institutions have also registered.

UK FATCA

The UK and Isle of Man tax authorities agreed to an automatic exchange of information modelled on the FATCA regulations of the IRS.

This was soon extended to all the Crown Dependencies and is referred to informally as "UK FATCA".

FATCA–style information exchange agreements are being negotiated between more than 40 other countries at this stage and it is expected to see more multi-lateral, rather than bilateral agreements, exchange of tax information over the next few years.

Crown Dependency financial institutions

A financial institution must report information on Specified US Persons in relation to US FATCA, and on Specified UK Persons in relation to UK FATCA.

Compliance with both is required.

FATCA: financial institutions with no United States investors

Any non-US financial institution must register under FATCA regardless of whether or not it has US investors.

The FATCA agreements and regulations apply to all financial institutions, but the actions required of the financial institutions depend on a number of factors, one of which is whether they hold accounts of US persons (or any Specified Persons).

US individuals

US citizens who have specified foreign financial assets above $50,000 at the end of the tax year, have to report those. However for US persons who live outside the US the threshold is $200,000.

Co-operation

Most co-operating countries have entered into bilateral agreements with the US in terms of which the US will provide reciprocal information to the country signing an agreement with it.

Under a Model 1 agreement the UK agrees to report to the IRS specified information about the US accounts maintained by all relevant financial institutions in the jurisdiction. The financial institutions report to their own tax authorities, who then report the information to the IRS on an annual basis.

Not complying with FATCA

A firm that does not comply with FATCA will be a determined as a Non-Participating Financial Institution (NPFI).

In a jurisdiction that has signed a Model 1 agreement with the IRS; other financial institutions must report any payments they make to an NPFI to the "immediate payor" of the income/ funds.

On a practical level, it will be difficult for an NPFI to establish business relations with counterparties that are FATCA-compliant, due to the additional burden this would place on the counterparty and a likely reluctance to enter into the relationship.

PRA & FCA looking to improve responsibility and accountability in the banking sector

The PRA and FCA have announced proposals for a number of major changes, the biggest in ten year, to management responsibility standards and also to staff conduct requirements within the Banking Industry. This is of note to FCA firms as it has been issued as a joint paper by both regulators and may therefore give some insight as to which direction the FCA will take their regulations in the future.

There are three parts to the plans:

Senior Managers

A new registration process will replace the existing Approved Persons regime. Requires registration for:

- All directors, MLRO, Compliance Office and;
- Senior managers with significant responsibilities for areas such as;
  - financial crime*,
  - client money/client assets*,
  - investment management*,
  - settlement and advice*,
  - sales,
  - research,
  - client service,
  - complaints handling,
  - IT business continuity
  - HR…etc.

*These people might be Executive directors, but, never the less, the FCA will want to see that individuals will not be responsible for other issues as well – these will be their main or exclusive area of responsibility.

The proposals imply that all members of the firm’s parent board which will control the firm will also be required to be registered as Senior Managers, but this matter will be part of further discussions between the FCA and EEA governments.

All Senior Managers will be required to submit a Statement of Responsibilities to the FCA with their application, which will define exactly the areas they are responsible for. If there is then a failure in that area, the regulator will then assume the Senior Manager is at fault for that failure, and it will be for the Senior Manager to demonstrate they were not responsible for the failure. Any changes to their responsibilities will require a revised Statement to be lodged with the PRA/FCA.

Certified Staff

All managers controlling areas that are not caught by the Senior Management regime will come under this heading. These individuals will not be directly registered with the PRA/FCA – instead, a Senior Manager (the FCA anticipate this being a main board director) will take personal responsibility for their day-to-day conduct, and will ensure that there is an annual testing and certification process to make sure they have the skills and knowledge to do the job going forward, and they have not caused customers any harm in the last year.

All Staff

All staff working at the firm will be required to sign an annual statement which will require them to behave with integrity, to ensure they exercise due skill and diligence, and ensure they are open and transparent to the PRA/FCA. Senior Managers will additionally declare that their areas have been controlled effectively and are compliant, and if they delegate tasks that delegation has been properly controlled.

If implemented this is a major change to the existing regime putting much more responsibility on traceable individuals in a firm. Consultation will run until October, with new rules coming into force in Late 2015 or early 2016.

FCA restricts distribution of Contingent Convertible securities (CoCos) to retail investors

The FCA will restrict firms from distributing CoCos to the mass retail market from 1 October 2014. The FCA has taken this action as they believe these to be highly complex products not suitable for this market. So they have stepped in to temporarily restrict their distribution to only professional, institutional and sophisticated or high net worth retail investors ahead of consulting on permanent rules later this year.

FCA Enforcement Cases

FCA fine insurance firm £8.4 million

The FCA said that between April 2011 and December 2012, the firm targeted low and middle income customers without college degrees or professional qualifications, with its personal accident, accidental death and accidental cash plan insurance products.

The sale of the Policies was outsourced and offered over the telephone, where people were encouraged to buy more expensive products and companies responsible for post-sale support actively discouraged customers from cancelling their policies.

Tracey McDermott, FCA director of enforcement and financial crime, said *"Customers are entitled to expect firms to provide them with fair and balanced information to enable them to make the right choices about the product that is right for them. [The firm] failed to do this and, when customers tried to cancel, put up barriers to prevent them from doing so. <u>Firms must take responsibility for their outsourcing arrangements and ensure that they treat customers fairly."</u>*

Court rule on money laundering case

The court of appeal have ruled that an individual who allows receipt of sums obtained by fraud into his foreign bank account and then allowing the sums to be withdrawn can by prosecuted under the Proceeds of Crime Act (POCA).

In the case in question a man, who was not a regulated individual, had converted fraudulently obtained sums by permitting its receipt into his personal bank accounts in Spain and allowing the subsequent withdrawal of the money. This fell afoul of the laws regarding concealing criminal property.

For this the man in question was sentenced to 2 years and 10 months imprisonment, with his conspirators receiving far lengthier sentences.

AML procedures are an incredibly important element of compliance as failure to comply can lead up to 14 years imprisonment and an unlimited fine.

Banking Group fined £105m for serious LIBOR and other benchmark failings

£70 million of the fine relates to attempts to manipulate the fees payable to the Bank of England for the firms' participation in the SLS, a taxpayer-backed government scheme designed to support the UK's banks during the financial crisis. The £105 million total fine is the joint third highest ever imposed by the FCA or its predecessor, the Financial Services Authority, and the seventh penalty for LIBOR-related failures.

Whilst the firms' LIBOR-related misconduct is similar in many ways to that of other financial institutions, the manipulation of the Repo Rate benchmark in order to reduce the firms' SLS fees is misconduct of a type that has not been seen in previous LIBOR cases.

Tracey McDermott, the FCA's director of enforcement and financial crime, said *"The firms were a significant beneficiary of financial assistance from the Bank of England through the SLS. Colluding to benefit the firms at the expense, ultimately, of the UK taxpayer was unacceptable. This falls well short of the standards the FCA and the market is entitled to expect from regulated firms"*

Two banks fined £14.5m for failures in mortgage advice

The two banks failed to ensure that the products offered and sold to client were suitable and the firms' own mystery shopping led to examples of advisers giving personal views on the future movement of interest rates.

Only 2 of the 164 sales reviewed were considered to meet the standard required overall in a sales process. The issues were:

- affordability assessments failing to consider the full extent of a customer's budget when making a recommendation,
- failing to advise customers who were looking to consolidate debt properly, and
- not advising customers what mortgage term was appropriate for them.

Tracey McDermott, director of enforcement and financial crime at the FCA said *"We made our concerns clear to the firms in November 2011 but it was almost a year later before the firms started to take proper steps to put things right. Where we raise concerns with firms we expect them to take effective action to resolve them without delay. This simply failed to happen in this case."*

FCA Fine Bank's London branch £4.7m

The fine has been issued for failings in transaction reporting between November 2007 and April 2013. When they failed to report 29,411,494 Equity Swap CFD (contracts for difference) transactions in the correct manner.

The FCA's overall objective is to ensure that markets work well and with integrity. Accurate and complete transaction reporting by firms is an essential tool in delivering this objective. The FCA uses these reports in a number of ways – including identifying and investigating suspected market abuse

Tracey McDermott, the FCA's director of enforcement and financial crime, said *"Effective market surveillance is critical to maintain the integrity of our markets and depends on accurate and timely reporting of transactions. [This Bank] is a major market participant responsible for reporting millions of transactions every year. We have repeatedly highlighted the importance of accurate transaction reporting and taken enforcement action against a number of firms. There is simply no excuse for [The Bank's] failure to get this right. Other firms should be in no doubt about our continued focus on this issue."*

Irish News

Central Bank – Publication of Handbook of Prudential Requirements for Investment Intermediaries

The Central Bank has issued a Handbook on the requirements imposed under the Investment Intermediaries Act, 1995. These requirements affect the investment business firms which come within the definition of an investment intermediary.

The Handbook covers the following areas:

- General supervisory requirements;
- Financial position and reporting requirements;
- Professional indemnity insurance;
- Organisation and management; and
- Books and records.

The Handbook requirements in the handbook come in to place on 1 October 2014 and replace the Handbook of Prudential Requirements for Authorised Advisors and Restricted Intermediaries introduced in July 2006.

Dubai News

On the 24 August 2014 the DFSA Board introduced new Rules in respect of Depositor Protection, and made amendments in respect of Client Money Distribution Rules, in the COB module of the DFSA Rulebook.

By these amendments, the DFSA has introduced a regime of depositor preference through a new Rule which provides protection in the event of insolvency of a Bank which is a Domestic Firm.

The DFSA Board was satisfied that any delay in the making of the new and amended rules would be prejudicial to the interests of the DIFC. Accordingly the rules were not consulted upon.

FMConsult News

FMConsult is currently recruiting high experienced Compliance executives for roles in its UK and Irish Offices.

All offices provide clients with:

- Compliance monitoring services
- Company 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
- AIFMD impact assessment and implementation project
- AIFM Authorisation
- AIFM monitoring

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

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