RQC GROUP

Regulatory Newsletter

Q4 2022

Introduction

Andrew Bailey could be described as a 'Bank of England lifer'. The current Governor of the UK's central bank first joined the organisation in 1985, shortly after completing his PhD thesis on *The impact of the Napoleonic Wars on the development of the cotton industry in Lancashire*. Among other duties, he became the chief executive of the new Prudential Regulation Authority (part of the Bank of England) in 2013. He also served as the chief executive of the Financial Conduct Authority from 2016 to 2020. By becoming Governor of the Bank in March 2020 he completed a somewhat unique *hat-trick*.

An individual such as Mr. Bailey will have interesting and relevant views on the role of financial services regulation and how this aligns with the financial climate, the UK's competitive position and the Bank's other functions such as interest rate setting. The Financial Services and Markets Bill, introduced in the summer, and Chancellor Hunt's 'Edinburgh Speech', from December, collectively set out a number of reforms to the UK financial services industry. In part, this is an initiative to further bolster the UK's global standing, and to create a post-Brexit regulatory landscape shaped in the UK's best interests.

Mr. Bailey indicated that the Government should proceed with caution, stating "The notion that we're past the financial crisis and we therefore don't need the regulation that we had post the financial crisis, I would not go along with that".

It was certainly the case that the 2008 financial crisis prompted a significant amount of regulatory change. It's definitely the case that a UK investment firm operating in 2023 is subject to a greater amount of regulatory requirements compared to a similar firm operating in 1992, 2002 or 2012. The correct amount of regulation will always be a balancing act, with some – including Mr. Bailey – arguing that a strong regulatory environment can go hand-in-hand with a country's competitive position. Perhaps the key to this is ensuring that the regulation is smart. Be sensible and ditch requirements that are clearly not achieving their objectives. However, adopt a common sense approach without being too reactionary.

Over to the U.S., and the significant event of the quarter was the compliance date for the SEC's new Marketing Rule coming into effect on 4 November. The new rule seeks to prevent investment advisers from misleading clients by expanding the definition of advertisement and adding disclosure requirements. Enforcement of the new definition of an advertisement and compliance with the rest of the new rule is expected to be immediate, with the SEC noting in a September Risk Alert that its staff "will conduct a number of specific national initiatives, as well as a broad review through the examination process".

As we move forward into 2023, we await finality on a number of proposed rules, for which comment periods were reopened during the quarter following the discovery of a technological error with the SEC's internet comment form. The affected proposed rules include:

- Short position and short activity reporting by institutional investment managers;
- Cybersecurity risk management, strategy, governance, and incident disclosure;
- Private Fund advisers: Documentation of registered investment adviser compliance reviews;
- The enhancement and standardization of climate-related disclosures for investors; and
- Enhanced disclosures by certain investment advisers and investment companies about ESG investment practices.

On ESG, although a final rule is still in the pipeline, recent comments and enforcement actions indicate that the SEC is not waiting for a final rule to act and in its press release on 2022 enforcement results, the SEC specifically called out ESG-related cases. Since its formation in March 2021, the SEC's Climate and ESG Task Force has been involved in multiple ESG-related enforcement actions and Division Director Gurbir Grewal has been reported as saying the SEC will be using existing rules to hold registrants accountable.

Matt Raver
Managing Director

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UK/EU Ongoing Developments

Regulatory Review of 2022

Q1, 2022

In our Q1, 2022 newsletter, we noted a general transition from Covid-related topics, which had dominated 2020 and 2021, to other issues such as the invasion of Ukraine. The invasion added a new dynamic to regulatory issues by pushing international sanctions regimes to the fore, with regulatory commentary on other matters including anti-money laundering and market abuse. However, regulatory hot topics from the pandemic remained in situ – particularly the operational and financial resilience of firms, including business continuity and cybersecurity.

January saw the UK's Investment Firms Prudential Regime ("IFPR") take effect, albeit the vernacular has since shifted to 'MIFIDPRU regime', named after the relevant sourcebook within the FCA Handbook. This consolidated and recalibrated the prudential regime for investment firms affecting regulatory capital and liquid assets requirements, the risk/harm assessment framework (the ICARA replacing the ICAAP), remuneration requirements, and group requirements, among other topics.

The industry (including the FCA) has spent 2022 getting to grips with these requirements which contain a number of complexities and ambiguities. This included certain teething problems with the new reporting requirements, with many firms finding that their revised 'RegData' schedule of returns was inaccurate. Conversely, the FCA indicated that the quality of some of the submissions did not meet their expectations, a statement we described as 'disappointing', given all the issues and significant resource required by firms to transition to the new regime.

Meanwhile, we discussed reports that the Chancellor of the Exchequer, Rishi Sunak (the first of three Chancellors mentioned in this article), will be lighting a 'Brexit bonfire' under onshored EU legislation, the implication being that this could materially affect legislation such as AIFMD, MiFID and UCITS. We correctly predicted that such legislation would still be with us – relatively unchanged – by the end of the year. Some notable revisions included removing certain financial instruments from the 'MiFID II research rule' and revoking the 'RTS28' best execution public disclosure. Meanwhile in the EU, AIFMD, UCITS and MiFID II were revised to include provisions related to sustainability risks.

At the end of March, the FCA published a notable enforcement action against GAM International Management and a former investment director. This was due to conflicts of interest failings covering fee incentives, gifts and entertainment and personal account dealing. The involvement of Greensill, the issue-addled supply chain business, served to add some spice, however the key take-away for firms is that conflicts of interest, which has its own FCA Principle for Business (Principle 8, in case anyone's interested), is a key component of the regulatory framework.

Q2, 2022

In April, the FCA published its business plan, and announced that it would 'act faster' against firms that fail to meet its Threshold Conditions. This would lead to an increase in the number of cancellations and withdrawals over the next three years. The FCA can amend or cancel a regulated firm's permissions, for example if a permission is not being utilised.

Aligned with this, the FCA has also taken a more hard-line stance on FCA applications – we discuss this in greater detail in a separate article in this newsletter. The application fees have also increased – for asset managers the charge has doubled to £10,000.

In June, HM Treasury published a policy statement focused on mitigating risks from critical third-parties to the finance sector. This includes an observation that in 2020, over 65% of UK firms used the same four cloud providers. It's likely that the FCA will be taking a keener interest in outsourcing arrangements in the coming years.

The FCA's Market Watch 69 set out observations on Suspicious Order and Transactions Reports ("STORs"), and the regulator also published results of thematic work on wind-down planning – an important regulatory topic covering resilience, harm reduction and capital levels required to ensure an orderly wind-down.

In June, Ghana International Bank was fined for poor anti-money laundering and counter-terrorist financing controls. This set the tone for a number of similar enforcement actions throughout 2022. There was also a fine for an insurance broker for anti-bribery control failings. Both cases demonstrate that a firm can be sanctioned if its systems and controls are not up-to-scratch, even if there is no actual evidence of a financial crime having been committed.

Q3, 2022

In this quarter, a further area of regulatory priority became increasingly prominent – consumer protection.

There are many firms who do not directly or habitually deal with 'consumers' or the so-called 'retail public', but who are nonetheless impacted by various initiatives falling within this regulatory theme.

The FCA published final rules on the Consumer Duty which takes effect in 2023. This creates a new 'Consumer Principle' plus various requirements covering acting in good faith, avoiding foreseeable harm and enabling and supporting retail customers to pursue their financial objectives. There is a practical impact on the design of products and services for consumers, including their price and value, distributing products and services to consumers and ongoing support to consumers. Some firms in the 'non-retail investment sector' concluded that they are in-scope of the Consumer Duty, due to the reach of the new requirements.

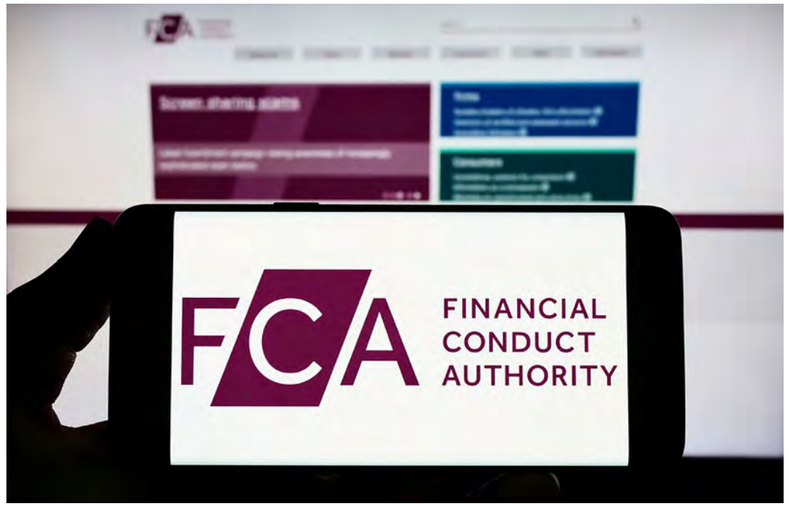
Final rules on the promotion of high-risk investments were also published. Among other things, this sets out new requirements where 'Non-Mainstream

Pooled Investments' (which includes most alternative investment funds) are promoted to certain types of individuals, including risk warnings and risk summaries, and a 24 hour 'cooling-off' period. There are also new requirements where an FCA authorised firm approves a financial promotion for an unregulated entity.

We also reported on the Financial Services and Markets Bill which sets out the UK's post-Brexit vision. We reported that an evolutionary, not a revolutionary, approach is being applied in particular with respect to onshored EU legislation. This newsletter includes further updates on the Bill.

In September, Chancellor of the Exchequer, Kwasi Kwarteng, announced – to much consternation – that the cap on bankers' bonuses will be removed. We indicated that this is something of a side-show and that a more forensic examination of the remuneration rules that will be retained is necessary before jumping to conclusions. The FCA published a Consultation Paper on this issue in December.

The FCA wrote to the CEOs of alternative investment firms, articulating what it considers to be the main risks of harm. This reinforces the 'consumer protection' message, the importance of conflicts of interest, risk controls including market abuse risk controls, conduct and culture (including the influence of senior managers, diversity and inclusion and staff remuneration) and ESG. We noted that these risks reflect more wider regulatory concerns, as opposed to being sector-specific.



There were two market abuse-related enforcement actions of note. Citigroup Global Markets Limited was fined for failing to properly implement trade surveillance requirements relating to the detection of market abuse. Sir Christopher Gent, the non-executive Chair of a listed company, was fined for unlawfully disclosing inside information.

Q4, 2022

As the year drew to a close, the conundrum of the future direction of UK financial services regulation took another twist with Chancellor of the Exchequer Jeremy Hunt's 'Edinburgh speech' setting out proposals for regulatory reforms. Our separate article explores this in greater detail.

The FCA took a significant step forward with its ESG regulatory requirements for the investment sector with proposed new requirements related to sustainability disclosures and investment labels. A new anti-greenwashing requirement is also proposed. These requirements are in addition to already introduced climate change disclosure requirements affecting various industry participants. Firms operating internationally are increasingly finding challenges in adopting multiple regulatory standards concerning ESG.

Traditionally, firms seeking to conduct certain financial activities have an alternative to becoming FCA authorised – becoming an Appointed Representative of an FCA authorised firm, known as a 'Principal' firm. This route has become increasingly popular; some networks comprise over 3,000 Appointed Representatives. In early December the regulatory requirements on Appointed Representatives were updated, with additional operational and disclosure requirements imposed on Principal firms. Whilst – again – this has a consumer focus, it also affects the non-consumer investment firm sector, where a number of Principal firms are in operation.

Crypto continues to set challenges for regulators including the FCA. In the UK, cryptoassets such as Bitcoin are regulated for money laundering purposes only, and they are not considered to be financial instrument types which means, for example, providing investment advice on cryptoassets is not a 'regulated activity'. The Financial Services and Markets Bill would give additional authority and powers over cryptoassets to the FCA and the Bank of England; therefore there could be some significant regulatory shifts in this sector in 2023.

Finally, as the year end closed in, there was a flurry of FCA enforcement announcements. Refer to the 'UK/EU Enforcement' section of this newsletter for further details.

Onto 2023

Regulatory initiatives such as consumer protection, resilience, conduct and culture, conflicts of interest, financial crime, ESG and responses to technological developments will continue to be prominent in 2023. The flurry of enforcement action at the end of 2022 might be a pre-amble for increased activity over the next 12 months – this is not necessarily confined to what appears in the public domain; the FCA can sanction market participants privately and can also impose remedial action and other measures including cancelling a firm's regulatory permissions.

The post-Brexit 'snail's paced evolution' mantra of the first two years following the end of the Brexit transitional period is likely to be challenged by the Financial Services and Markets Bill and the 'Edinburgh reforms'. Whilst not quite 'Big Bang 2.0', there is a clear imperative to support a competitive UK marketplace that promotes effective use of capital. Against this, the FCA's strategic objective is to make sure relevant markets function well, and the regulator also has an operational objective to protect the integrity of the UK financial system.

A key challenge for the government, legislators and regulators will be to achieve an appropriate trade-off. Removing requirements that do not achieve regulatory objectives would be a clear win-win for the industry. In particular, the investment firms sector is subject to certain requirements that were created in the abstract, were politically motivated and/or 'trickle down' from other sectors (such as banking) in a disproportionate manner. At the same time, the pace of regulatory change needs to be measured, clearly thought out and in a manner that does not overwhelm industry participants.

Edinburgh Reforms: Chancellor Hunt's Regulatory Punt

On 9 December 2022, the Chancellor of the Exchequer announced a 'bold collection of reforms' (the Chancellor's choice of words; not ours) to propel the government's ambition in creating a financial services sector that is open, sustainable, technologically advanced, and globally competitive.

These are known as the Edinburgh Reforms, and they build on the reform agenda which the government is taking forward through the Financial Services and Markets Bill. We previously wrote about the Financial Services and Markets Bill in our Q3 newsletter, which, in brief, is aimed at overhauling financial services laws derived from the EU regime and moving these to regulators' rulebooks. At the time of this writing, the Financial Services and Markets Bill has completed its passage through the House of Commons and is making its way through the House of Lords. During his speech, the Chancellor mentioned that the Bill is anticipated to receive Royal Asset by Spring 2023.

The Edinburgh Reforms include a wide range of initiatives proposed by the Chancellor, such as updating the banking regulation and ring-fencing regime, reforming certain prospectus and securitisation rules, and issuing remit letters to the PRA and FCA (to make it clear that regulators have a secondary objective to facilitate internal competitiveness of the UK economy). Other proposed measures relate to pension, payment services, e-money, crypto and digital currency, and taxation (in relation to REITs, and extending the Investment Management Exemption to cryptoassets), to name a few.

We have set out below our top 10 picks from the Chancellor's announcement which firms should take note of:

1. SMCR – Review of the regime in Q1 2023

The government will launch a Call for Evidence in Q1 2023 to gather information on the effectiveness of the current Senior Managers and Certification Regime ("SMCR"), including collating views on 'potential improvements and reforms'.

As both the FCA and PRA will be tasked to review the SMCR framework, we know at this stage that it is not only banks but other firms in the financial services industry which will be within scope of the project. This was perhaps the most surprising point made in the announcement, but few details were given save for what we have set out above.

Bearing in mind that SMCR was introduced for banks in March 2016, and even more recently for FCA-regulated firms in December 2019 (replacing the Approved Persons Regime), one wonders whether the focus of the review would be on the banking sector, or if both sectors would be given equal weighting. Would proposed reforms for the SMCR regime in relation to banks greatly influence the regime for FCA-regulated firms too? It would be quite remarkable if significant reforms were implemented for FCA-regulated firms after a short span of approximately three years of the SMCR regime being in place.

When it comes to reviewing regulatory frameworks, thus far, the spotlight tends to be on the banks. The SMCR regime for the banking industry has been in place for longer (with more data available for analysis), and the banks were of course the catalyst for the SMCR regime, which was introduced to improve accountability after the 2008 banking crisis. On 16 December 2020, the PRA published a 34-page report setting out its evaluation of the SMCR regime as it applies to dual-regulated firms[1]. This report was welcomed by the FCA, which noted that the PRA's findings were in line with the FCA's own report in 2019, announcing as well that it was 'pleased to note that [the PRA's report] found that the implementation of the SM&CR was successful and that it was driving positive behaviours in the industry'.

Will Q1 2023's Call for Evidence yield a different conclusion? Given the relatively short length of time the SMCR regime has been in place for, and the positive results of the PRA's review in 2020, we do not anticipate an overhaul of the SMCR regime, for either the banking or financial services sectors.

However, this will be the first time the SMCR regime is properly reviewed for FCA solo-regulated firms (which includes almost all UK investment firms and asset managers). Given that the Chancellor's announcement indicates that he has 'scope and proportionality' in mind when considering potential reforms, we wonder if some firms may find themselves subject to less stringent SMCR requirements at the end of the review.

In terms of timeline, there will be a review and consultation phase after the Call for Evidence, and any legislative changes recommended would take time to finalise as they make their way through Parliament. We will watch this space closely in 2023, and perhaps beyond.

2. Investor Reporting – New regulations to take effect in Q1 2023

Building on previous reforms introduced in 2021, new regulations were laid before Parliament on the same day of the announcement known as The Markets in Financial Instruments (Investor Reporting) (Amendment) Regulations 2022 (SI 2022/1297). The Chancellor announced that these would remove certain 'burdensome EU requirements' related to reporting rules.

The changes introduced by the short 2-page regulations are as follows:

(i) From 18 January 2023, there will no longer be a requirement for firms providing portfolio management services to retail clients to inform the client when the overall value of their portfolio depreciates by 10%.

(ii) From 7 June 2023, investment firms must provide information in electronic format to all clients or potential clients, unless a retail client (or potential retail client) has been informed of and has exercised their right to receive the information on paper.

3. Commodities Derivatives – Laws to be introduced in Q1 2023 to remove certain burdens

The Government will bring forward secondary legislation in Q1 2023 to remove burdens for firms trading commodities derivatives as an ancillary activity. The announcement included the example of when manufacturers seek to fix the future price of their purchases of specific raw materials.

4. Research - Investment Research Review to be launched

Further to the Wholesale Markets Review, the government will launch an independent review into research as part of its commitment to improve UK capital markets' competitiveness.

No further details were provided during the announcement (such as a launch date) but firms with U.S. business relationships may have reason to be hopeful: HM Treasury's publication on the Chancellor's announcement indicates

1. That is, firms regulated by both the FCA and the PRA and for which the PRA is the prudential regulator (deposit takers, very large investment firms and insurers).

that this independent review may include investigating the effects of the EU's MiFID unbundling rules, which require research to be paid for by a firm or its client (unless an exclusion applies), which notably are not applied in U.S. markets.

5. PRIIPs Regulation – Consultation launched for a new UK framework for retail disclosure

Firms that manufacture, advise on, or sell Packaged Retail and Insurance-based Investment Products ("PRIIPs") may recall that, following Brexit, the FCA proposed targeted amendments to the disclosure requirements in its Handbook rules and the Regulatory Technical Standards in CP21/23. These new rules came into force on 25 March 2022 and there was a transition period which ended on 31 December 2022, by which date firms must apply the new requirements.

It was made clear back in March 2022 that these were targeted amendments and a more thorough review of retail disclosure was due to be carried out by HM Treasury. That time is now. On 9 December 2022, HM Treasury published a Consultation Paper which 'sets out the government's plans to revoke the PRIIPs Regulation and seeks views on a proposed alternative framework for retail disclosure'. The consultation is scheduled to end relatively soon, at 11:59pm on 3 March 2023.

Some of the notable proposals made relate to:

(i) lowering the administrative burden and increasing flexibility for firms to communicate effectively with clients, such as by reserving more prescriptive disclosure formats for more high risk or complex products, and exploring digitised disclosure formats;

(ii) empowering the FCA to integrate UCITS and PRIIPs disclosure into a coherent UK retail disclosure framework (before the 2026 exemption end date, in relation to the exemption for UK UCITS from producing PRIIPs KIDs); and

(iii) improving retail investors' access to a wider range of investment products (with US-based ETFs named specifically as a recognised popular international investment product).

Whilst consumers were mentioned at numerous points in the consultation paper, the FCA's new Consumer Duty regime was not. We anticipate that there would be considerable interaction between the two regimes, and it would be interesting to observe if the FCA can maintain a consistent approach in both areas, now that the consultation paper makes clear that government's preference for the FCA to be responsible for retail disclosure, in line with the agenda set out in the Financial Services and Markets Bill which moves financial services rule-making to the regulators.

6. Short Selling – Consultation launched for a new UK regime

The Chancellor announced the government's intention to introduce a short selling regime 'tailored to the UK' and the Call for Evidence launched by HM Treasury on 9 December 2022 represents the first step to repealing and replacing the regime. The consultation closes at 11:59pm on 4 March 2023.

We have included below a list of points to note in relation to the Call for Evidence:

(i) Topics included as part of the consultation includes whether restrictions on 'uncovered' or 'naked' short selling are appropriate; seeking views about current disclosure requirements (including to the FCA and public disclosure), market maker exemption, and overseas shares arrangements; as well as inviting feedback from firms operating in multiple jurisdictions on the potential operational impact of changes to the UK short selling regime.

(ii) The consultation includes a range of questions about the FCA's role in the proposed UK short selling regime, including whether the FCA should monitor short selling, requests for information about costs and burdens for firms sending position reports to the FCA, and whether the FCA should have powers to intervene in the market in relation to short selling activity.

(iii) The consultation does not explore UK Short Selling Regulation provisions in relation to UK sovereign debt and UK sovereign credit default swaps, which the government will consider at a later date.

One of the more noteworthy points of the consultation is the ambivalent tone taken concerning the FCA's proposed role. This is in contrast to the approach advocated by the government in relation to the Financial Services and Markets Bill (and the Financial Services and Markets Act 2000 which it is based on), whereby financial services regulators generally set the rules which apply to firms in their rulebooks whilst operating within a framework established by Parliament. This approach is observed, for example, in the proposed PRIIPs Regulation, as HM Treasury's Consultation Paper clearly states that 'the government believes that regulatory requirements related to retail disclosure should be maintained in FCA rules, rather than in legislation.'

7. Settlement Period – Taskforce to report in 2023 on shortening settlement period

A new industry-led taskforce known as the Accelerated Settlement Taskforce will be set up to explore the potential of faster settlement of financial trades in the UK.

Currently, the industry standard of 'T+2' requires trades to be settled two days after trade date, with some exceptions. This has been the case in the UK and EU since 2014, and in the US since 2017. Recently, a number of jurisdictions have proposed to accelerate the settlement period (the US and Canada intend to move to a 'T+1' standard by 2024) and there are discussions of a further decrease to 'T+0' or same day settlement, using innovations such as distributed ledger technology.

The Chancellor noted in his announcement that shortening the settlement period could reduce counterparty risk and increase operational efficiency. Whilst this may be true, the Taskforce will need to first assess whether the UK's current settlement arrangements are performing effectively and are suitable for accelerated settlement. The Chair of the Taskforce is due to provide an interim public report on initial findings by December 2023, and a full report with recommendations by December 2024.

8. Market Data – Introducing a Consolidated Tape for market data by 2024

The government intends to work with the FCA to bring about a regulatory regime by 2024 to support a consolidated tape which will bring together market data from multiple platforms into one continuous feed. The government envisions that this will improve market efficiency, lower costs for firms and investors, and make UK markets more competitive.

9. Long Term Investments - ELTIF is gone while UK LTAF is here to stay

Regulations for the EU's European Long Term Investment Fund ("ELTIF"), which were retained by the UK after Brexit, will soon be repealed, thus removing ELTIF as an option for firms seeking to authorise funds in the UK. This comes as little surprise, given that to date no ELTIF was ever established in the UK and the UK had since introduced its own

Long Term Asset Fund (LTAF) regime which the government considers to be more suited to meet the needs of the UK market.

10. Sustainable Finance – Two government initiatives in early 2023

The Chancellor made it clear that sustainable finance remains a priority for the government. As part of its commitment to align the financial services sector with Net Zero, the government will publish an updated Green Finance Strategy in early 2023 and will consult in Q1 2023 on bringing ESG ratings providers into the regulatory perimeter.

The Financial Services and Markets Bill and Edinburgh Reforms indicate the start of a process of acceleration of regulatory reforms, following a period of relative inactivity in 2021 (the first year following the end of the Brexit transitional period). There are a lot of workstreams that will develop over different time periods and there remain a lot of unknowns. The consensus is that these developments will not be a revolutionary 'big bang' as was the case in 1986 when the London Stock Exchange was reformed. 'Evolution, not revolution' will continue to be the mantra, but with evolution at a greater pace.

Negotiating the FCA Authorisation Process: Pitfalls and Challenges

Firms seeking to become authorised by the Financial Conduct Authority ("FCA") are required to make an application to the regulator. The FCA's website states that a complete application can take up to 6 months and an incomplete application up to 12 months to be approved (or not). However this is a statutory mandate designed to impose service standards on the regulator, and it does not provide any clues as to the actual timing and complexity of FCA applications.

Indeed, over a 20 year period, this has fluctuated wildly. There have been occasions where the FCA has processed an application for an 'agency' investment firm (such as an asset manager, investment adviser or execution only broker) in around 3 months. Conversely, in the aftermath of the 2008 financial crisis, it would take an average of 6 months merely to appoint a case officer at the FCA to process an application. Currently, we are seeing applications take an average of 9 months to be processed by the FCA, which is higher than the historical average. There are a number of reasons for this.

Factors

First and foremost, there has been a significant shift in the stance of the FCA. In a speech from July 2021, Nikhil Rathi, the FCA's CEO, outlined the importance of robustly scrutinising applicant firms at the 'gateway':

"While oversight continues through the regulatory lifecycle, it starts at the gateway. If you let a bad firm or individual into the system, it takes up the time of supervisors and enforcers, and it risks the savings, livelihoods and health of consumers. Just one decision at the start – not letting them in – could prevent all that."

In October 2022, the FCA announced that as a consequence of increased scrutiny, the number of firms that were not authorised in 2021/22 was 1 in 5, up from 1 in 14 in the previous financial year.

This has come at a time of significant personnel changes at the FCA including in the FCA's authorisation team. Training up new staff, as well as training existing staff on new processes, has led to delays in processing applications.

The application process itself has also become more complicated. Over a 20 year period, regulation has been additive, for example with MiFID I replaced with the wider and deeper MiFID II, plus the addition of AIFMD, a dedicated framework for 'alternative investment funds'. This has been reflected in the application materials. Most recently, the introduction of the Investment Firms Prudential Regime at the start of 2022 has led to – potentially – more complex disclosures regarding regulatory capital, harms/risk assessment and consolidated reporting, among other things.

All in all, this means that an application for a sub-$20 million fund manager with friends and family money, submitted in the recent past, was subjected to greater scrutiny compared to that for a multi-billion dollar CDO manager, submitted in 2006. Whereas 20 questions in 2-3 rounds was once the norm, 60+ questions in 5-6 rounds is now more commonplace.

Pitfalls

To add to the complexity of the process, the FCA guidance does not necessary provide a firm indication as to the regulator's expectations, which – as alluded to above – tends to fluctuate over time. One of the reasons for this is that the Regulatory Business Plan – a key document – is 'free-form'. This leads to applicant firms making avoidable mistakes that in some circumstances lead to

the FCA requesting that the application is withdrawn (and re-submitted when the necessary corrections have been made). This is less likely to occur where professional support is provided, in particular where the professional firm has experience and expertise on authorisation matters.

Ready, Willing and Organised

The FCA has an expression, 'ready, willing and organised' that sets the tone for the processing of applications. Firms are required to, for instance, be able to clearly articulate their regulatory obligations, demonstrate initiative to understand their regulatory duties and be appropriately organised so that from day 1 of authorisation, the firm has all necessary arrangements in place.

One common theme is the completeness of the application materials at the point of submission. The FCA abhors 'skeleton' applications; an application submitted by one person who advises that all human and other resource, office premises, legal documentation etc. will follow in due course will most likely be rejected. There has to be some 'meat on the bone'. A trade-off is: how much meat, given that applicant firms are well aware that authorisation will not be granted in the near future.

FCA v SEC

In contrast to the FCA, the process for becoming a SEC registered investment adviser is more straightforward. SEC registrations are not subject to the same level of scrutiny and the process is completed in a far shorter timeframe (45 days). Where the regulators differ is what comes afterwards. Arguably, the SEC is the more 'fearsome', both in terms of the intensity of their supervisory visits and their enforcement activity. In 2021, FCA fines amounted to £567 million (of which £265 million was meted to NatWest Bank). Conversely, SEC penalties for their fiscal year 2022 amounted to $6.4 billion; considering the SEC has a far narrower scope than the FCA (it doesn't regulate banks and insurance companies, for example) the respective amounts are miles apart. In other words, whilst the FCA's stated intention is to prevent miscreants from entering the industry, this is at odds with the SEC's mantra of 'come on in – but woe betide you if you misbehave!'.

What next?

Over time, the FCA authorisation process has ebbed and flowed, and it may be the case that there will be additional changes in the coming years as staff are trained up and the FCA enhances the technical elements of its processes. The FCA will also supervise firms more closely in the initial months following authorisation, a welcome move if enacted appropriately. The dynamics of the authorisation process have real-time implications, not only in terms of the planning considerations for start-ups but also the service industry's response; regulatory hosting platforms for investment firms came to the fore in the late 2000s and early 2010s, the last time the application process became lengthy.

The FCA wants to avoid scandals but with over 50,000 organisations under the regulator's remit, scandals are inevitable. Neil Woodford was an approved person at the regulator for over 20 years before the Woodford Investment Management issue – hardly a new entrant!

Complexities will always remain. Firms typically understand how to articulate their business strategy in a language that the FCA understands, but conversely the FCA case officers often do not have practical experience of working within the industry. An expert assisting with an FCA application can sit in the middle and act as an 'interpreter', thereby becoming an invaluable part of the process.

Top 10 things to consider when seeking regulatory approval from the FCA

1. Remember the key FCA phrase 'ready, willing and organised'- don't submit a 'skeleton' application at the outset.
2. Be proactive with the FCA.
3. Oftentimes the FCA's tone will appear confrontational. This is their way of filtering out firms that genuinely do not have a coherent plan of action and hence will not be ready to conduct financial activities at the point of authorisation. However, be polite and respectful at all times!
4. Ensure that the skills and expertise of the key individuals reflect their roles and responsibilities.
5. Ensure that all relevant roles and responsibilities are covered and that where someone performs more than one role, conflicts of interest are addressed.
6. The Regulatory Business Plan is the focal point of the application materials. It must be relevant and succinct and in a tone that the FCA understands; it is not a 'marketing document'.
7. Compliance documentation requested must be fit-for-purpose and tailored to the business.
8. The regulatory licence sought must reflect activities to be conducted. The FCA might request that an activity be removed where a firm cannot demonstrate that it will be utilised.
9. Financial projections must be provided to the FCA. These must align with the other application materials, for example with reference to income and expenses assumptions.
10. If you want to commence regulated activities in advance of becoming FCA authorised, there may be the option of engaging with a regulatory hosting platform.

ESG Round-up

Looking back on last year, 2022 was a busy year for ESG. More specifically, Q4 2022 was a busy quarter, as we observed a number of important regulatory developments being announced as the year 2022 drew to a close.

We set out below some of the key ESG developments of Q4 2022 in the UK and EU:

UK

1. FCA's Consultation Paper on Sustainability Disclosure Requirements ("SDR")

On 25 October 2022, the FCA published its Consultation Paper on sustainability disclosure requirements, investment labels, and tackling greenwashing (CP22/20). We explore this paper in greater detail in the next section in this newsletter. The consultation is due to end soon, on 25 January 2023.

2. FCA's Review on Diversity and Inclusion ("D&I")

Not forgetting the "S" (social) and "G" (governance) components of ESG, the FCA published a webpage on 12 December 2022 which sets out the results of its multi-firm review on how D&I strategies were being designed and embedded in financial services firms (the "D&I Review").

The FCA has identified the D&I Review to be of interest to all regulated firms and encourages firms to consider its findings in the development of their D&I practices. Whilst the results of the D&I Review do not in themselves amount to regulatory rules, we can expect firmer guidance and more details on this topic soon, given that the FCA intends to launch a consultation in 2023 on its previous proposals on this subject matter (as set out in its joint Discussion Paper with the PRA and Bank of England, titled Diversity and Inclusion in the Financial Sector (DP21/2)).

Key points noted by the FCA in the D&I Review include the following:

(a) **Healthy D&I culture is 'essential' to enable firms to deliver better outcomes for consumers and markets:** Having identified D&I as key to delivering on consumer protection and market integrity, the FCA expressed concern that very few firms seemed to have understood that D&I is a 'fundamental' culture issue. In addition, some firms did not seem to recognise that 'fundamental issues, such as psychological safety and welcoming different perspectives, are critical to an inclusive culture'. In fact, the FCA found that only one firm had made a clear connection with diversity of thought or recognised the potential benefits that this could bring to its business!

(b) **Nurture a diverse junior talent pool rather than 'poach' diverse senior talent:** The FCA noted that firms tend to focus most on improving representation at senior leadership level, especially on gender and ethnicity. However, this focus risks creating a 'poaching' culture which is not sustainable in the long run. Instead, firms should try to 'develop their own pipelines', which the FCA believed would be more likely to bring 'meaningful and long-lasting change'.

(c) **Improve data quality:** The FCA found that firms with better diversity data had a greater understanding of their position and were better placed to decide which actions to take. It was noted that the variation was largely due to differing levels of success with staff declaration rates, and that firms with the best declaration rates have 'worked hard to achieve this' (such firms had focused initiatives to build trust and

understanding, and optimised touch points with staff).

From the tone of the FCA's D&I Review, it is anticipated that diversity, equity and inclusion will be one if its growing focus area for 2023 and the years to come. In the meantime, firms that were part of the D&I Review have received written feedback letters and the FCA will follow up with them through their usual supervisory activities to assess how they have considered the feedback.

3. UK Government's Anticipated Publications in 2023 on ESG / Sustainable Finance Topics

Before we move on to ESG developments in the EU, we set out three UK government initiatives to look out for in 2023:

(a) **ESG rating providers:** The UK government intends to launch a consultation in Q1 2023 on bringing ESG ratings providers into the regulatory perimeter. This follows the FCA's announcement on 22 November 2022 regarding the formation of the ESG Data and Ratings Code of Conduct Working Group ("DRWG") to develop a voluntary Code of Conduct for ESG data and rating providers.

This is certainly a welcome move given the widespread lack of consistency in standards and metrics currently used to produce ESG ratings and rankings. We note with interest that part of the DRWG's objective is to develop a voluntary Code of Conduct that is industry-led, proportionate, and 'globally consistent', by considering developments in other jurisdictions (such as Japan and the EU) as well as recommendations by the International Organization of Securities Commissions.

One hopes that the UK government's consultation will have similar objectives. However, considering the UK SDR's divergence from EU and US rules, we note that international consistency may not necessarily be one of the UK government's primary aims.

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(b) **Green Finance Strategy:** The Chancellor announced in December 2022 that the government will publish an updated Green Finance Strategy for the UK in early 2023. We note that this has been pushed back from its original publication date in late 2022 (the political upheaval which occurred then, including the ambiguity surrounding the potential PM's stance on ESG, may have had something to do with it) and it follows the UK government's first Green Finance Strategy which was published in July 2019.

We look forward to receiving details about how the UK government has delivered on some of its previously listed objectives, including its plans to become 'the world's first Net Zero-aligned Financial Centre' and the first G20 country to mandate Taskforce on Climate-Related Financial Disclosures ("TCFD") across the economy (of which 'economy-wide SDR' plays a role).

We recall how, following the TCFD's recommendations, the FCA had published a Policy Statement (PS21/24) and subsequently its new ESG Sourcebook, which sets out phased disclosure requirements at entity and product level (as an overview, these took effect for the largest firms with AUM of over £50 billion on 1 January 2022, and for other firms with AUM of over £5 billion on 1 January 2023). On the SDR regime, this looks set to grow in prominence in the next few years, and we explore the FCA's new rules later on in this newsletter.

(c) **Taxonomy Regulation:** The government intends to repeal the Taxonomy Regulation by virtue of the Financial Services and Markets Bill which would repeal retained EU law relating to financial services, including the Taxonomy regulations. The Financial Services and Markets Bill is of course still subject to parliamentary approval, but in the meantime the government has announced it will not make secondary legislation under the Taxonomy Regulations and the statutory requirement for it to do so (including making technical screening criteria regulations by 1 January 2023) would be repealed.

Surely but slowly (not the other way round), we see that the UK government is freeing itself of the EU legislative shackles. This process looks set to gather pace now. We note that the Green Technical Advisory Group, which had been set up to provide independent, non-binding advice to the government on the development of a UK Green Taxonomy, had published its advice on 7 October 2022. It is anticipated that further updates on a UK taxonomy regime will be included as part of the Green Finance Strategy publication in early 2023.

We note as well that the FCA had stated in its SDR Consultation Paper that it would consider how its disclosure rules may interact with the UK Green Taxonomy once this has been published, and that its rules may require updating as a result.

EU Developments

ESG regulatory development in the EU is clearly gathering pace. We summarise below four key updates which may be of interest to UK financial services firms with EU interests:

1. Sustainable Finance Disclosure Regulation ("SFDR")

Since 10 March 2021, the disclosure requirements under SFDR applied across the EU to create a reporting framework for financial products and financial entities.

Firms participating in the EU's financial markets may recall that the SFDR's Level 1 disclosures have applied since March 2021, and the more detailed Level 2 disclosures (which were originally scheduled to apply on 1 January 2022) were postponed to 1 January 2023. This was due to the delay in legislative approval of the accompanying regulatory technical standards ("RTS"), which, as we noted in our previous newsletter, gave various organisations (such as the Alternative Investment Management Association and the German regulator, BaFin) the opportunity to publish guidance on the implementation of SFDR in general and/or RTS in particular.

This pool of knowledge increased during Q4 2022, when on 17 November 2022 the Joint Committee of the three European Supervisory Authorities (i.e. EBA, EIOPA and ESMA) (the "ESAs") published a Q&A document on compliance with the Level 2 (i.e. RTS) rules.

For funds based in or marketed into Luxembourg, the FAQs document published on 2 December 2022 by the Luxembourg financial services regulator, the Commission de Surveillance du Secteur Financier (CSSF), may serve as useful reference as it seeks to clarify certain aspects of the disclosures under the SFDR.

The SFDR rules are meant to complement corporate disclosures on sustainability issues, which came into force on 5 January 2023. We provide some information on this further below.

2. ESMA Consultation on Funds' Names using ESG or Sustainability-Related Terms

Firms may be aware of the growing regulatory concern globally that fund names which refer to ESG terms in any way may mislead consumers regarding the investments and strategies of the fund.

Some guidance on this topic has now been made available by the European Securities and Markets Authority ("ESMA"). On 18 November 2022, ESMA published a consultation paper, including draft guidelines, on fund names which use ESG or sustainability-related terms. The consultation closes on 20 February 2023 and ESMA aims to issue final guidelines by Q2/Q3 2023.

We noted that paragraph 11 of the consultation states that the proposed guidelines are 'not intended to interfere with the requirements of SFDR or the Taxonomy Regulation'. It may have come as a little surprise to ESMA when, following the announcement, a number of large asset managers (including BlackRock, Invesco, and HSBC) announced their intention to downgrade their ESG funds. Specifically, these were downgraded from Article 9 (i.e. the 'dark

green' funds, which under SFDR are required to have sustainable investment objectives) to the less restrictive Article 8 ('light green' funds, which promote ESG factors but do not have these as the main objective).

Whilst some of these firms cited 'regulatory clarification' (or similar) as the reason for the re-categorisation in their shareholder notices or investors' notification, we note from recent market analysis that there has been an increasing trend of firms downgrading their products' SFDR classifications in preparation of the RTS coming into effect in January 2023. (ESMA must breathe a sigh of relief!)

3. Corporate Sustainability Reporting Directive ("CSRD")

On 28 November 2022, the CSRD was approved by the European Council and it was published in the Official Journal on 16 December 2022. The new CSRD rules aim to be aligned with the EU Taxonomy Regulation and SFDR, including avoiding duplicative reporting requirements under these three regimes. The new CSRD corporate disclosure regime should also help guide companies in scope to report on sustainability information which financial market participants and investors need.

As an overview of the corporate sustainability reporting regime, under the current rules (known as the Non-Financial Reporting Directive or "NFDR"), large companies (with more than 500 employees) have to publish certain information related to ESG, as well as on anti-corruption and bribery.

The CSRD, in summary, is an update to the NFDR and will require a wider set of large EU companies (with more than 250 employees and a €40 million turnover), as well as listed EU companies, to report on sustainability.

Critically, CSRD applies to certain non-EU companies which have a presence in the EU as well, including subsidiaries of non-EU based companies.

The CSRD comes into force on 5 January 2023, with approximately 50,000 EU companies estimated to be brought in-scope. The first firms in scope will be required to report from 2025 for financial years starting on or after 1 January 2024. Non-EU companies with substantial activity in the EU (with a turnover over €150 million in the EU) will also have to comply by reporting in 2029.

4. ESAs' Call for Evidence on Better Understanding Greenwashing

Last but not least, we note that on 15 November 2022 the ESAs had launched a joint Call for Evidence on greenwashing in the financial sector, with the consultation due to close on 10 January 2023.

To clarify, the term 'greenwashing' in the consultation is used broadly and is intended to cover claims relating to all aspects of the ESG spectrum (i.e., including social and governance dimensions). We note that the ESAs have specified an interest in collecting 'examples of potential greenwashing practices', as well as views from stakeholders on 'how to understand greenwashing and what the main drivers of greenwashing might be'.

The results of the consultation should enable regulators to better understand which areas may be more prone to greenwashing risks, and to tailor policy making as well as supervisory strategy accordingly. We anticipate the consultation may also provide some indication of how effective the EU's sustainability disclosure rules are, and perhaps offer some lessons to be learned in the UK and other jurisdictions.

UK/EU Regulatory News

Market Watch 71

On 14 December 2022, the FCA published the latest edition in its Market Watch series on market conduct and transaction reporting issues.

Market Watch 71 focuses on inside information, including reducing the number of permanent insiders and the content of insider lists.

Number of permanent insiders

In August 2019, the FCA shared concerns and findings about the control of access to inside information. Where this number is too high, firms increase the risk of that information being disclosed unlawfully. Among other findings, the FCA cited an insider list where 12 deal team members worked on a transaction, but over 600 members of Compliance, Risk and other support functions also had full access to inside information about the deal.

The FCA advises that since August 2019 it has seen considerable reductions in the numbers of permanent insiders at several advisory firms. Methods by which firms have reduced access include: introducing registers of events and/or product specific 'permanent insiders'; periodic reviews of the roles of all permanent insiders; and comparing electronic records containing inside information with insider lists.

The FCA has received comments from firms that they have been able to reduce the burden of maintaining insider lists by reducing the number of insiders.

Content of insider lists

Article 18 of the UK Market Abuse Regulation requires issuers or any person acting on their behalf to maintain a list of all persons who have access to inside information.

The requirements for the content of insider lists are prescriptive and include insiders' personal information including telephone numbers, dates of birth, and national identification numbers. The FCA has recently received insider lists in response to regulatory requests and notes that, on occasions, this information is missing. Such information is required to enable the FCA to cross reference the forms with other information sources including transaction reports and suspicious transaction and order reports.

FCA proposes introduction of 'gateway' for firms which approve financial promotions

6 December 2022

The FCA is proposing an authorisations process for authorised firms which approve financial promotions for unauthorised persons.

In the UK, there is a general prohibition on the communication of a financial promotion unless (i) it is communicated by an authorised firm, (ii) the content of the financial promotion has been approved by an authorised firm or (iii) an exemption applies.

This means that any authorised firm can approve any financial promotion on behalf of an unauthorised person even if this is not within the authorised firm's area of expertise.

The FCA aims to rectify this by introducing conduct of business requirements for firms approving financial promotions. These requirements, which take effect in February 2023, were discussed in the earlier article on high-risk investments in our Q3, 2022 newsletter.

In addition, the FCA – in Consultation Paper CP22/27 (6 December 2022) – sets out proposed requirements for the approval and ongoing reporting requirements for approving firms.

Approval process

The approval process is an exercise to demonstrate to the FCA that a firm has the appropriate skills, systems and controls to act as an approving firm. This is a separate regime to the 'Part 4A permission' regime for conducting regulated activities. Under the FCA's proposals, firms already FCA authorised will submit a Variation of Permission via the FCA's CONNECT system. Firms seeking Part 4A permission can apply to be an approving firm at the same time.

The cost of the application will be £5,000, and the statutory timeframes for processing the application will be the same as for a Part 4A permission – up to 6 months for a complete application and up to 12 months for an incomplete application.

Reporting

Under the FCA's proposals, firms will be required to notify the FCA for every financial promotion they approve, and any subsequent amendments including withdrawing approval within 7 days. There will also be a bi-annual return submitted via the FCA's RegData system.

Exemptions

There are three key exemptions from the requirement to seek approval to conduct this activity:

- A firm approves its own financial promotions for onward communication by an unauthorised firm;
- A firm approves financial promotions for an unauthorised business in their corporate group;
- A firm approves financial promotions for their appointed representatives, where the promotion relates to a regulated activity for which the principal has the relevant permissions and has agreed to accept responsibility.

Transitional provisions

It is proposed that there will be a window during which regulated firms will be able to make an application to become an approving firm. There will then be a transitional period during which the firm can continue to approve financial promotions for unregulated persons pending the completion of the FCA authorisation process.

Timing

Responses to the Consultation Paper are requested by 7 February 2023. This initiative is aligned with the Financial Services and Markets Bill, which was introduced to Parliament in July 2022 and which contains provisions to create the gateway for approving firms. The timing of the FCA's proposals is contingent upon the Bill's passage to made legislation, in terms of both timing and any further revisions to the Bill's content.

FCA consults on sustainability disclosure and investment labels

25 October 2022

The FCA's Consultation Paper CP22/20 sets out the regulator's plans for the introduction of sustainability disclosures and investment labels, plus anti-greenwashing measures.

The proposed requirements focus on asset managers and product distributors, and cover the following areas:

1. **Sustainable investment labels** – this is a voluntary scheme enabling products to be labelled under one of the following categories: sustainable focus; sustainable improvers; and sustainable impact.
2. **Consumer-facing product disclosures** – to assist consumers to understand the key sustainability-related features of an investment product.
3. **More detailed disclosures at product and entity level** – these are targeted at a broader range of stakeholders aside from consumers. The disclosures are divided into: pre-contractual disclosures; ongoing sustainability; and entity level disclosures.
4. **Naming and marketing rules** – this includes an anti-greenwashing rule clarifying that sustainability-related claims must be fair, clear and not misleading.
5. **Requirements for distributors** – the sustainable investment label and consumer-facing disclosures must be made available to retail investors.

The Consultation closes on 25 January 2023. The final rules will then be set out in a Policy Statement which has a provisional date of 30 June 2023. The rules will then take effect over a 3 year timeframe, with the anti-greenwashing rule taking effect immediately and the disclosure requirements provisionally taking effect between 30 June 2024 and 30 June 2026.

Similarly to other recent regulatory developments such as the Consumer Duty and updated rules on the promotion of high-risk investments, these proposals have a focus on ensuring that consumer are protected. There are, however, various requirements that apply to firms that do not (directly or indirectly) engage with consumers. An institutional asset manager would, for example, need to consider amendments to marketing materials, fund offering documentation, ongoing reporting to investors and website content.

Where a product is manufactured or distributed globally, there is the additional challenge of ensuring compliance with various sustainability disclosure frameworks. Whilst there are some similarities between the FCA's proposals and other frameworks such as the EU's Sustainable Finance Disclosure Regulation ("SFDR") regime and the U.S. SEC's proposals, the frameworks are not wholly aligned. For example, the proposed investment labels are not the same as the three product categories (Article 6/8/9) under the SFDR.

UK/EU Enforcement

FCA fines Santander UK for repeated anti-money laundering failures

9 December 2022

The FCA has fined Santander UK Plc ("Santander") £107,793,300 after it found serious and persistent gaps in its anti-money laundering ("AML") controls, affecting its Business Banking customers.

Between 31 December 2012 and 18 October 2017, Santander failed to properly oversee and manage its AML systems, which significantly impacted the account oversight of more than 560,000 Business Banking customers.

Santander had ineffective systems to verify the information provided by customers about the business they would be doing.

The firm also failed to properly monitor the money customers had told them would be going through their accounts compared with what actually was being deposited.

There were also examples of the bank failing to promptly deal with 'red flags' associated with suspicious activity, such as automated monitoring alerts. These failures – which left the bank open to serious money laundering risk - led to more than £298 million passing through the bank before it closed the accounts.

FCA fines three broker firms over inadequate market abuse surveillance

8 December 2022

The FCA has fined BGC Brokers LP, GFI Brokers Limited and GFI Securities Limited £4,775,200 for failing to ensure they had appropriate systems and controls in place to effectively detect market abuse.

The firms are inter-dealer brokers specialising in broking exchange listed and over-the-counter financial products and related derivative products. The Market Abuse Regulation ("MAR") required the firms to implement trade surveillance requirements.

However, between July 2016 and January 2018, the firms had manual, automatic and communications surveillance processes that were deficient, and therefore, inadequate in properly addressing the risk of market abuse. In addition, the systems for monitoring market abuse did not have proper coverage of all asset classes which are subject to MAR.

Mark Steward, Executive Director of Enforcement and Market Oversight, commented: 'Oversight of our markets is a regulated partnership between the FCA and market participants and so gaps or holes in a firm's ability to monitor and detect abusive trading poses direct risks to market integrity. This case is another example of the FCA's determination to ensure firms prioritise market integrity and the maintenance of high standards of compliance.'

MAR was introduced in 2016 and expanded requirements to detect and report potential market abuse, including a requirement to monitor both orders and trades. UK and EU-based investment firms and asset managers trading in-scope financial instruments are subject to this requirement.

FCA fines Julius Baer International Limited £18m over inappropriate finders' fees

30 November 2022

The FCA has fined Julius Baer International Limited ("JBI"), an investment advisory and wealth management firm, £18,022,500 for breaching the FCA's Principles for Business by failing to conduct its business with integrity (Principle 1), failing to take reasonable care to organise and control its affairs (Principle 3) and failing to be open and cooperative with the FCA (Principle 11).

JBI facilitated Finder's arrangements between Bank Julius Baer ("BJB") and an employee of a number of Yukos Group Companies[2], Mr. Dimitri Merinson. Under these arrangements, BJB agreed to pay fees to Mr. Merinson for introducing Yukos Group Companies to the Julius Baer Group, on the understanding that the Yukos Group companies would then place large cash sums with Julius Baer from which Julius Baer could generate significant revenues.

In particular, uncommercial foreign exchange transactions were made in which the Yukos Group companies were

2. Yukos Group comprises a number of holding companies incorporated in various jurisdictions which own the residual non-Russian assets of the Russian oil group of the same name.

charged far higher than standard rates, with the profits being shared between Mr. Merinson and Julius Baer. Mr. Merinson received commission payments totalling approximately US$3m as a result of these arrangements.

These fees were improper and, together with the uncommercial FX transactions, showed a lack of integrity in the way in which JBI was undertaking this business.

Additionally, JBI failed to have adequate policies and procedures in place to identify and manage the risks arising from the relationships between JBI and finders (external third parties that introduced potential clients to Julius Baer in return for commission). This included having no policies which defined the rules surrounding the use of finders within JBI until after June 2010. Policies introduced after that date were inadequate.

Finally, JBI became aware of the nature of these transactions – including the commission payments to Mr. Merinson – in 2012 and suspected that a potential fraud had been committed. However, it did not report these matters to the FCA immediately as required or at all until July 2014.

These fees were improper and, together with the uncommercial FX transactions, showed a lack of integrity in the way in which JBI was undertaking this business.

The FCA also decided to ban Gustavo Raitzin, former Regional Head for BJB, Thomas Seiler, former BJB Sub-Regional (Market) Head for Russia and Eastern Europe and JBI non-executive director, and Louise Whitestone, former relationship manager on JBI's Russian and Eastern European Desk. These three individuals have referred this decision to the Upper Tribunal for determination.

Former bank CEO censured over anti-money laundering failings

18 November 2022

The FCA publicly censured Mohammad Ataur Rahman Prodhan, the former Chief Executive Officer of Sonali Bank (UK) Limited ("SBUK") for anti-money laundering ("AML") failings.

In 2012-2014, Mr. Prodhan failed to take reasonable steps to assess and mitigate the AML risks arising from a culture of non-compliance among SBUK's staff. He failed to ensure that there was a clear allocation of responsibilities to oversee SBUK's branches, and he also failed to properly oversee, manage and resource SBUK's Money Laundering Reporting Officer ("MLRO") function.

In 2016, SBUK was fined over £3 million and a restriction was placed on the take-on of new customers. Steven Smith, SBUK's MLRO, was also fined £17,900 and prohibited from holding compliance oversight and MLRO positions.

The FCA initially fined Mr. Prodhan £76,400 in May 2018. Mr. Prodhan referred the case to the Upper Tribunal, where proceedings have been delayed significantly as a result of the pandemic and limitations on Mr. Prodhan's ability to travel to the UK from Bangladesh, where he now resides.

While the FCA considers the financial penalty to be appropriate, there now exist exceptional circumstances for the case to be resolved by agreement, including the lack of any prospect of enforcing payment of a financial penalty.

Mr. Prodhan has withdrawn his referral to the Upper Tribunal and agreed to accept a public censure.

Whilst the outcome vis-à-vis Mr. Prodhan is perhaps less than satisfactory from the FCA's perspective, this case does act as a reminder that both a firm and its senior managers can be sanctioned over a compliance failing.

Director banned by FCA after violent criminal conviction

14 November 2022

The FCA banned Mr. Ashkan Zahedian from working in financial services following his conviction for serious, violent offences.

Mr. Zahedian was the sole director of an FCA authorised consumer credit firm and was approved by the FCA as a Senior Manager.

In May 2020, Mr. Zahedian pleaded guilty and was convicted of grievous bodily harm and possession of an offensive weapon, having attacked a security guard at a bar with a machete. He was sentenced to 3 years' imprisonment.

Mark Steward, Executive Director of Enforcement and Market Oversight, said 'Those authorised to provide financial services are required to meet and maintain high standards of character, fitness and properness. These were serious, violent criminal offences reflecting on Mr Zahedian's character and justifying the finding that he is not a person to be working in financial services. The FCA will continue to uphold high standards of character and conduct for those working in financial services.'

This case acts as a reminder that the FCA can deem an individual to be not fit and proper due to actions outside of the workplace, and thereby not meeting the 'honesty, integrity and reputation' element of the fit and proper test.

FCA begins criminal proceedings against five individuals involved with Worthington Group plc

20 October 2022

The FCA began criminal proceedings against five individuals involved with Worthington Group plc, a company listed on the London Stock Exchange.

The FCA launched a criminal investigation into market abuse and market manipulation in April 2016, following the suspension of Worthington Group plc's ("WRN") shares from the Official List and Main Market of the London Stock Exchange on 10 October 2014.

Aidan Earley, Douglas Ware, Richard Spurway and Allan Biggar have each been charged with two counts of fraudulent trading. Mr Ware was the director and CEO, Mr. Spurway was a director, and Mr Biggar's role was as a media advisor. Mr. Earley is alleged to have been concerned in the management of WRN despite him being disqualified from acting as a company director. They are all alleged to have been involved in running the company.

The first count alleges that between the 1 June 2012 and 21 November 2016, the individuals knowingly concealed WRN's insolvent financial position from the market, its shareholders and its pension fund to make gains for themselves or others, or to cause loss to others, including new investors in WRN.

The second count alleges that, between the 1 March 2013 and 10 October 2014, Messrs. Early, Ware, Spurway and Biggar co-ordinated what is commonly referred to as a 'pump and dump scheme'. It is alleged that the defendants made a series of misleading announcements to the market about deals with energy, media and mining companies.

It is alleged that the accused wanted to artificially inflate the share price, so they could make significant profits

from selling off parts of their company shareholdings and cause a loss to those who purchased WRN shares due to the misleading statements.

Mr. Earley has further been charged with acting in contravention of a disqualification order, contrary to s13 of the Companies Directors Disqualification Act 1986.

Mr Wulstan Earley has been charged with money laundering the proceeds of the sale of shares in Worthington Group plc, contrary to s327 of the Proceeds of Crime Act 2002.

The alleged offending took place between 1 June 2012 and 21 November 2016.

FCA fines Gatehouse Bank £1.5m for poor anti-money laundering checks

14 October 2022

The FCA fined Gatehouse Bank Plc ("Gatehouse") £1,584,100 for significant weakness in its financial crime systems and controls.

Between June 2014 and July 2017 Gatehouse failed to conduct sufficient checks on its customers based in countries with a higher risk of money laundering and terrorist financing. Gatehouse also failed to undertake the correct checks when some of the customers were classed as Politically Exposed Persons.

In one instance, Gatehouse set up an account for a company based in Kuwait to aggregate customer funds. Gatehouse did not require the company to collect information about customers' source of funds or wealth, which was required under Gatehouse's anti-money laundering policies. As a result, over a two-year period, Gatehouse accepted US$62,000,000 into the account without properly vetting the funds for financial crime risks. This example illustrates the risks of failing to have proper systems and controls.

Gatehouse has subsequently taken significant steps to improve its financial crime systems and controls.

Mark Steward, Executive Director of Enforcement and Market Oversight, commented:

'Gatehouse Bank's failures exposed itself to the risk that it might be used as part of a laundering process for illegal funds. While not deliberate, there can be no excuse for failures as serious as this. The FCA will continue to hold firms to account for poor anti-money laundering systems and controls.'

FCA fines Sigma Broking Limited and fines its former directors following market abuse reporting failures

6 October 2022

Sigma Broking Limited ("Sigma") was fined £531,000 for failing to make reports crucial in fighting potential market abuse. In addition, three directors have been fined, two of whom have also been prohibited from holding significant management functions in firms regulated by the FCA.

Between December 2014 and August 2016, Sigma did not report, or failed to report accurately, 56,000 CFD transactions to the FCA. It also failed to identify 97 suspicious transactions or orders that it should have reported to the FCA.

Given their high leverage, CFDs are particularly attractive to those seeking to commit market abuse, including insider trading.

The FCA found that many of Sigma's failings had their origins in the inadequate governance and oversight provided by its board of directors.

In addition, Sigma's compliance department operated without clear reporting lines, apportionment of responsibilities or appropriately qualified staff and failed to ensure that the firm had adequate policies and procedures in place in relation to the conduct of its CFD desk brokers. There was also some confusion regarding the identity of the individual performing the Compliance Oversight function.

U.S. Ongoing Developments

SEC and CFTC announce enforcement results for Fiscal Year 2022

In November the SEC announced that it had filed 760 total enforcement cases during its recently ended fiscal year, compared to 697 the year before. The 9% increase included 462 new, or "stand alone", enforcement actions which ranged from traditional securities law violations to "first of their kind" cases in the crypto space.

Money ordered in the SEC's actions totalled $6.4 billion, an increase of 67% from Fiscal Year 2021 and the highest on record. It was also the second highest year ever in whistleblower awards, both in terms of the number of awards and the total monetary amount rewarded.

In summarizing the results, Gurbir Grewal, the Director of the Division of Enforcement, stated that "the Enforcement Division is working with a sense of urgency to protect investors, hold wrongdoers accountable and deter future misconduct in our financial markets".

Some cases of particular interest:

- Penalties totalling $1.235 billion (17 entities) for failing to maintain and preserve work-related text messages on employees' personal devices;
- Enforcement action against individuals, including charging the former CIO of an asset manager for allegedly overvaluing assets managed by the firm by more than $1 billion;
- Parallel investigations with criminal law enforcement including cases against Archegos Capital Management and its founder/owner Bill Hwang, who were charged with orchestrating a fraudulent scheme that resulted in billions of dollars in losses;
- Using data analytics to assist in various enforcement actions related to market abuse (market manipulation and insider trading);
- An increased focus on ESG-related enforcement actions, including an action charging BNY Mellon for materially misleading statements and omissions on their consideration of ESG principles when managing certain mutual funds; and
- Private fund-related enforcement actions including in relation to:
  - A fraudulent scheme to conceal the downside risks of a complex options trading strategy;
  - Failure to comply with the Custody Rule;
  - Misrepresenting fund performance and misappropriating investor funds for personal use; and
  - Failing to properly offset management fees charged to private equity funds and making misleading statements to investors about fees and expenses.

The CFTC also released their annual enforcement results for Fiscal Year 2022 in October, noting the following highlights:

- Orders imposing over $2.5 billion in restitution, disgorgement and civil monetary penalties.
- 82 enforcement actions, involving the following:
  - Digital assets related actions;
  - Manipulative and deceptive conduct and spoofing;
  - Recordkeeping and supervision;
  - Violations by registered entities;
  - Misappropriation of Material Non-Public Information;
  - Swaps reporting and swap dealer business conduct; and
  - Other enforcement actions e.g. fraud, registration, reporting, wash trading, position limit violations.

Further, the CFTC announced that it continued to expand its whistleblower program, issuing a record-breaking award of $200 million to an individual whistleblower and issuing more than $3 billion in sanctions in whistleblower-related enforcement actions.

U.S. Regulatory News

The SEC addresses Private Fund adviser issues at its National Compliance Outreach Webinar

15 November 2022

The Securities and Exchange Commission ("SEC") hosted their National Compliance Outreach Program on 15 November 2022 and for registered investment advisers of private funds, the message was very clear – "most issues boil down to a disconnect between disclosures and actual practice."

Fund disclosures evolve over time, and while improvements are a positive outcome, firms are reminded that often disclosures in old fund documents do not match current practice.

The SEC highlighted that their primary focus during examinations continues to be conflicts of interests. In assessments, the regulator looks at conflicts through different lenses:

- Actual practices in the firm;
- Disclosures to fund investors, looking at both fund documents and communication to investors; and
- Firm policies and procedures to identify, address and mitigate conflicts.

Conflicts can be transaction specific, such as adviser-led secondaries and stapled transactions. The SEC scrutinizes these transactions to determine how these assets were valued both before and after the transaction and communications to both the seller and buyer.

Conflicts can also be structural where side by side management issues are present when an adviser has different types of clients. These include:

- Allocation of opportunities;
- Cross trades;
- Valuation;
- High leverage or concentration;
- Liquidity mismatch between investor profile and the fund;
- Funds which put up gates or suspension of redemptions;
- Affiliated transactions; and
- Undisclosed or inadequate disclosure of these conflicts.

In the private equity space, fees and expenses remain a concern and the SEC has identified a number of issues in this area. Valuation of assets should be a documented process demonstrating how the firm drew their conclusions. Additionally, firms should exercise caution when calculating management fees in the post commitment period as well as the use of affiliates and the reimbursement of expenses.

These issues continue to be prioritized by the SEC in their supervision by examination. Firms are selected for examinations on a risk basis and fall into three categories:

1. Internal SEC initiatives and thematic reviews focused on higher risk issues;
2. The broader national and international examination plans; and
3. "TCRs" – examinations where the SEC has received a tip, complaint or referral.

CFTC recognizes the FCA for cross-border enforcement cooperation

3 November 2022

The CFTC has recognized and expressed appreciation to the FCA for taking actions that demonstrated critical cross-border cooperation to ensure the integrity of U.S. markets and markets abroad.

During an investigation into certain crude oil trading on a U.S. derivatives exchange, the FCA obtained information from UK based traders on behalf of the CFTC. Subsequently, said traders challenged the FCA's authority to obtain such records, but permission to proceed with a judicial review was refused by the Court of Appeal of England and Wales.

According to the CFTC, the court's decision "shows that traders cannot hide from regulatory oversight just because they are overseas. The CFTC is grateful for the FCA's efforts to secure this result and its commitment to cross-border enforcement cooperation".

SEC adopts new reporting requirements for certain Private Funds and their Investment Advisers

2 November 2022

The Securities and Exchange Commission ("SEC") has adopted new Rule 14Ad-1, which requires "institutional investment managers" subject to section 13(f) reporting requirements to disclose annually on Form N-PX their proxy votes on executive compensation matters, otherwise called "say-on-pay" votes. Previously, only investment companies or funds registered under the Investment Company Act of 1940, as amended (the "1940 Act") were required to file Form N-PX. The new rules will become effective for votes occurring on or after July 1, 2023, with the first filings due in 2024.

Many registered investment advisers will be familiar with the definition of institutional investment manager as a manager that exercises investment discretion over $100 million or more in 13(f) securities. These institutional investment managers will now need to file their "say-on-pay" votes with the SEC annually on Form N-PX by August 31 of each year if they "exercised voting power" over a security.

The SEC has adopted a two-part test for determining if a manager exercised voting power over a security. The manager must (1) have the power to vote, or direct the voting of, a security and (2) "exercise" this power to influence a voting decision for the security. This test "focuses on the exercise, rather than the mere possession, of voting power." However, the SEC would consider a manager deciding not to vote or whether to recall loaned securities in advance of a record date for a vote in order to vote the shares is exercising voting power.

Along with the new rule, the Form N-PX will be amended to make the information easier to analyze. Votes will be standardized into categories, such as director elections, say-on-pay and audit matters and will require managers to report proxy voting matters using the same language and order as disclosed in the issuer's proxy. Managers will have to disclose the number of shares that were voted or instructed to be voted, as well as the number of shares loaned and not recalled. Managers will also be able to indicate that they have a disclosed policy of not voting proxies and did not vote during the reporting period.

It is unclear how these transparency requirements will impact institutional investment managers, but it is anticipated that institutional investors will scrutinize the data especially for funds targeting ESG priorities.

SEC proposes new oversight requirements for certain services outsourced by Investment Advisers

26 October 2022

Continuing with a very robust year for the introduction of new rules, the Securities and Exchange Commission ("SEC") has issued a Release proposing a new rule (the "Proposed Rule") under the Investment Advisers Act of 1940 to prohibit registered investment advisers from outsourcing certain services and functions without conducting due diligence and monitoring of the service providers. The Proposed Rule would also require the adviser to disclose information about these service providers on their Form ADV.

The Proposed Rule would require advisers to:

- Conduct due diligence prior to engaging a service provider to perform certain "covered functions" for the purpose of making a determination that it would be reasonable and appropriate to outsource those services to that provider; and
- Periodically monitor the performance of the service provider and reassess the retention of the service provider for the purpose of making a determination that it is reasonable and appropriate to continue to outsource to that service provider.

Covered Functions

A "covered function" is defined as:

A function or service that is necessary for the investment adviser to provide its investment advisory services in compliance with Federal securities laws, and that, if not performed or performed negligently, would be reasonably likely to cause a material negative impact on the adviser's clients or on the

adviser's ability to provide investment advisory services. A covered function does not include clerical, ministerial, utility, or general office functions or services.

The covered function test has two elements:

1. "Functions or services that are related to an adviser's investment decision-making process and portfolio management". The Release points to a broad interpretation of fact – certain of these functions may be covered functions for one adviser but not for another adviser, depending on the facts and circumstances.

   Examples include:

   - Providing investment guidelines (including maintaining restricted trading lists);
   - Creating and providing models related to investment advice;
   - Creating and providing custom indexes;
   - Index providers;
   - Providing investment risk software or services;
   - Providing portfolio management or trading services or software;
   - Implementation and allocation services;
   - Providing portfolio accounting services;
   - Providing investment advisory services to an adviser or the adviser's clients (sub-advisory services); and
   - Compliance, valuation and pricing services.
2. The second element is less clear and relates to the definition – "if not performed or performed negligently, would be reasonably likely to cause a material negative impact on the adviser's clients or on the adviser's ability to provide investment advisory services."

Due Diligence and Ongoing Monitoring Requirements

Advisers outsourcing covered functions are required to undertake due diligence to confirm and document six aspects of the intended outsourced services, including:

- The nature and scope of the services;
- Potential risks resulting from the service provider performing the covered function, including how to mitigate and manage such risks;
- The service provider's competence, capacity and resources necessary to perform the covered function;
- The service provider's subcontracting arrangements related to the covered function;
- Coordination with the service provider for federal securities law compliance; and
- The orderly termination of the provision of the covered function by the service provider.

The Proposed Rule requires documentation of an adviser's third-party due diligence assessment, including "any policies or procedures or other documentation showing how the adviser would mitigate and manage the risks it identifies, both at a covered function and a service provider level." The Proposed Rule also requires ongoing monitoring of the covered function services, assessments of the engaged service provider's performance, and that an adviser retains records related with the monitoring and assessment of the service provider.

Recordkeeping

The Proposed Rule would require the adviser to maintain specific records which include:

- A list of service providers undertaking covered functions and the documented rationale, along with a copy of the written agreement with the provider;
- Specific records related to due diligence assessments of the service provider; and
- Monitoring records of the service provider.

U.S. Enforcement

SEC charges Goldman Sachs Asset Management for failure to follow ESG policies and procedures

22 November 2022

The SEC charged Goldman Sachs Asset Management, L.P. ("GSAM") for policies and procedures failures involving two mutual funds and a separately managed account strategy marketed as Environmental, Social and Governance ("ESG") investments.

The SEC's order found that from April 2017 until February 2020, GSAM had several policies and procedures failures involving the ESG research its investment teams used. In addition, from April 2017 until June 2018, the company failed to maintain any formal policies and procedures for ESG research in one product, and once policies and procedures were established, the firm failed to follow them consistently.

The SEC's order found that GSAM violated Section 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-7. Without admitting or denying the SEC's findings, GSAM agreed to a cease-and-desist order, a censure, and a $4 million penalty.

Federal Court concludes receivership in CFTC Ponzi scheme action, resulting in the recovery of over $1 billion

17 October 2022

The CFTC announced the successful conclusion of the receivership in CFTC v. Walsh, et al., a $1.3 billion Ponzi scheme case which the CFTC filed in 2009.

During the receivership, over $1 billion was returned to investors in a commodity pool operated by defendants Paul Greenwood and Stephen Walsh, constituting 100% of all approved investor claims.

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