

Regulatory Update

UK Edition

MARCH 2017

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1.0 FCA UPDATES & DEVELOPMENTS

1.1 FCA Statement on Best Execution

The FCA has published its [findings](#) from supervisory work looking at how investment managers deliver best execution for their clients. The FCA found that most firms had failed to take on board the findings of its thematic review. Some good practice was found where best execution was considered during the decision-making process. Firms showing good practice had an effective governance process in place that challenged the overall cost of execution.

All firms had management information that allowed them to accurately view execution costs but the use of the data was inconsistent. Some firms could not evidence any improvement to their execution process and the review of it was largely a tick box exercise.

The FCA expects all firms to be aware of enhancements to best execution monitoring as they become available and assess whether they are suitable and proportionate for their business model. Markets in Financial Instruments Directive II (MiFID II) places a specific obligation on firms to check the fairness of prices proposed to clients when executing orders or taking decisions to deal in OTC products.

The FCA expects firms to consider the following:

- Who would the FCA hold responsible if the firm fails in its obligation to ensure it consistently achieves best execution?
- Is there a comprehensive strategy for overseeing best execution?
- Have we tested that funds and client portfolios are not paying too much for execution? Where we identified too much has been paid did we compensate the investors?
- Does the order execution policy accurately reflect our firm's business model rather than being a generic policy?
- What trades or trends have been identified as deficient through our regular monitoring?
- Have staff been adequately trained to ensure they understand what best execution means and what its consequences will be? How can we evidence this to the FCA?

The FCA will be revisiting best execution in 2017 to see what steps investment management firms have taken to assess gaps in their approach to achieving best execution. They will also be asked to show how they can evidence that funds and client portfolios are not paying too much for execution.

1.2 FCA Statement on Dealing Commission

The FCA has summarised its [findings](#) from a review that analysed dealing commission expenditure across 31 investment managers. Many of the firms the FCA visited were falling short of expectations in how they:

- Assess whether a research good or service received is substantive
- Attribute a price or cost to substantive research if they receive it in return for dealing commission
- Record their assessment to demonstrate they are not spending more of their customer's money than necessary

Poor practices were identified at many firms, including the use of dealing commission to purchase non-permissible items.

A few of the firms reviewed now cover the cost of externally produced research from their own resources rather than use dealing commission. Firms that have adopted this practice:

- Mitigate the conflicts of interest associated with using dealing commission to pay for external research
- Provide greater transparency about the charges their clients pay
- Are better placed to demonstrate that their dealing teams only execute trades with counterparties that provide best execution

- Are fully incentivised to only purchase research that represents value for money

The FCA concludes that more work needs to be done by investment management firms to ensure they spend their customers' money with as much care and attention as if it were their own. The FCA will continue to focus on the use of dealing commission, especially with the implementation of MiFID II.

1.3 FCA Policy Development Update

The FCA has published its latest [policy development update](#), which contains a timetable of upcoming publications, including:

- a consultation paper, "Insurance Distribution Directive Implementation", due in March 2017
- a consultation paper, "MAR 1 changes: inside information relating to commodity derivatives", due in March 2017
- a consultation paper, "Implementation of the Benchmarks Regulation", expected date to be confirmed
- a consultation paper, "Consultation on new rules for firms running crowdfunding platforms", due in Q1 2017
- a consultation paper, "Redress methodology for pension transfers", due in Q1 2017
- a consultation paper, "Creditworthiness and affordability in consumer credit", due in Q1 2017.

1.4 FCA Quarterly Consultation

The FCA has published its [16th quarterly consultation paper](#) on changes to the FCA Handbook, in which the FCA proposes to implement changes to:

- DEPP and EG reflecting the FCA's powers following the Bank Recovery and Resolution Order 2016.
- the Market Conduct sourcebook (MAR) relating to ESMA's guidelines on commodity derivatives.
- SUP and EG arising from the extended Immigration Act 2014 (as amended by the Immigration Act 2016).
- REC 3.9 and MAR 5.6, and minor amendments to REC 2.3.
- COBS and MCOB to improve firms' communication with consumers.
- Changes to regulatory reporting requirements.

1.5 Guidance on the Treatment of PEPs Under the Money Laundering Regulations 2017

The FCA has published a [consultation paper](#) on guidance for how financial services firms should treat customers who are politically exposed persons (PEPs) when meeting their anti-money laundering obligations. The guidance clarifies who should be considered a PEP or an associate of a PEP and the steps that firms should take when dealing with higher or lower risk PEPs.

1.6 FCA Regulation Round Up: March 2017

The FCA has published the [latest edition](#) of its regulation round up which focuses on, amongst other things, the following areas:

- The FCA reminds firms impacted by MiFID II that the very latest date for submitting complete applications for authorisation or variations of permissions is 3 July 2017
- Investment managers are still failing to ensure effective oversight of best execution
- Firms are failing to meet FCA expectations on the use of dealing commission

1.7 MiFID II Authorisations

The FCA has published near [final rules](#) on the implementation of MiFID II. These include changes to the trading of financial instruments including issues affecting trading venues, transparency of trading, and algorithmic and high frequency trading.

Firms impacted by the changes to the activities covered by MiFID should now apply for variations of permission or authorisation, or risk being unable to trade after MiFID takes effect (3rd January 2018).

The near final rules cover:

- the new category of firms - data reporting services providers
- position limits and reporting for commodity derivatives
- systems and controls requirements for firms providing MiFID investment services

The FCA is also providing an update on the taping of telephone conversations by retail financial advisers. After considering the feedback from firms the FCA agrees that a full taping obligation may not always be appropriate. The FCA will allow retail financial advisers to comply with the ‘at least analogous’ requirement by either taping all relevant phone conversations or taking a written note of those conversations.

2.0 EU REGULATORY UPDATES

2.1 Q&As on CFDs and Other Speculative Products

ESMA has published an updated version of its [Q&A](#) on the application of MiFID II to the marketing and sale of financial Contracts For Difference (CFDs) and other speculative products to retail clients, such as binary options and rolling spot forex.

This Q&A includes a new section 10 – pages 84-96 – and provides clarifications on:

- Passporting and the cross-border provision of services by investment firms offering CFDs and other speculative products to retail clients
- Assessment of the use of third parties by investment firms
- Examples of poor practice observed by NCAs in respect of the use of third parties by investment firms.

3.0 FINANCIAL CRIME

3.1 Money Laundering Regulations 2017 – HM Treasury Consultation

HM Treasury has published a [consultation](#) on The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, which outlines the UK government policy position and the responses following the previous consultation on the transposition of the Fourth Money Laundering Directive and Fund Transfer Regulations.

The Treasury has published plans to create a new watchdog, the Office for Professional Body Anti-Money Laundering Supervision (OPBAS), which seeks to bring the UK’s Anti Money Laundering (AML) and Counter Financing for Terrorism (CFT) regime into line with the latest international standards.

3.2 UK Government Review of AML/CFT Regime

The UK Government has published a [report](#) summarising views and evidence submitted to it during the “Cutting Red Tape” review of the Anti-Money Laundering and Counter Financing of Terrorism regime. Responses to the report can be summarised as:

- Guidance
 - Firms commented that the large volume of guidance creates confusion and unnecessary cost for businesses
 - The structure of the regime leads to overlapping and duplicated guidance
 - It is hard to distinguish between legal requirement and good practice
- Overall approach to compliance and its impact on the effectiveness of the regime
 - Some businesses feel that the prescriptive approach of regulation, combined with the fear of the consequences of making a mistake result in an industry unwilling to challenge regulatory guidance

- Financial technology firms reported that their growth is hampered by regulators' preference for traditional methods
- Overall approach to compliance and its impact on the economy
 - The complexity of customer due diligence requirements hits small businesses particularly hard and thus limits competition in the provision of services
- Other findings
 - Many firms felt that there was insufficient dialogue with, or feedback from, HMRC and the FCA

3.3 JMLSG Consults on Revised AML/CFT Guidance for the UK Financial Sector

The JMLSG has published [proposed revisions](#) to Part 1 of its guidance on the prevention of money laundering and the financing of terrorism for the UK financial services industry. The proposed revisions reflect the provisions of the proposed new Money Laundering Regulations published by HM Treasury on 15 March 2017.

4.0 ENFORCEMENT ACTION

4.1 FCA Fines Former Investment Banker for Sharing Confidential Client Information

The Financial Conduct Authority (FCA) has today [fined](#) Christopher Niehaus, a former investment banker, £37,198 for sharing client confidential information over WhatsApp. The FCA found that Mr Niehaus failed to act with due skill, care and diligence.

ABOUT CCL

Established in the UK in 1988, 2006 in the UAE and 2012 in India, CCL provides specialist compliance services to firms regulated by the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA).

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 - Money Laundering Regulations 2017 (MLR2017)

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- Compliance Skills
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- FCA Regulations
- MiFID II
- Senior Managers & Certification Regime (SM&CR)
- Senior Management & The Board
- Finance Induction Training

If you wish to discuss how CCL can assist you with any of the issues raised in this Regulatory Update, please contact one of the directors using the details below:

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This Regulatory Update provides information about the consultative documents and publications issued by the FCA/PRA which are still current, proposed changes to the Rules and Guidance set out in the FCA and PRA Handbooks, actual changes to Rules and Guidance that have occurred in the months leading up to the update and other matters of relevance to FCA/PRA-regulated firms. This Regulatory Update is intended to provide general summarised guidance only, and no action should be taken in reliance on it without specific reference to the particular FCA/PRA document referred to.