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Regulatory Update

UK, April 2022

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1. FCA UPDATES & DEVELOPMENTS

1.1 FCA speech on critical issues in financial regulation

On 26 April 2022, the FCA has published a speech held by its CEO Nikhil Rathi at City Week 2022. The speech touched a wide range of topics, including:

Cost of living crises – inflation and surges in commodity prices are making consumers more exposed to risk and more reliant on financial services. The FCA's focus is on making sure that regulated firms are acting in their costumers' interests. Mr. Rathi emphasised that one in seven Firms applying for FCA authorisation fails to obtain it, up from one in thirteen.

New Consumer Duty – the final proposals for the new Consumer Duty, which sets higher expectations for the standard of care that firms provide to customers, are expected in July. According to Mr. Rathi, positive impacts will include action towards competitors who drive down standards and greater certainty about how to deliver good outcomes. MR. Rathi points out that he envisages fewer future rule changes and lower costs for firms as a result.

Environmental, Social and Governance (ESG) reforms – the FCA is continuing to build on the new ESG regulatory framework and is supporting international partners who are beginning to mandate climate related disclosures.

Diversity targets – the new diversity requirements for listed companies aim to assign at least 40% of board seats to women, as well as one in four senior board positions (Chair, Chief Executive Officer (CEO), Chief Financial Officer (CFO) or Senior Independent Director (SID) should be a woman). Issuers shall disclose this information in their annual financial report for financial years starting on or after 1 April 2022.

Innovation and crypto – the FCA will be providing support to more than 300 newly authorised Firms through its 'Early High Growth Oversight' initiative by the end of 2023. In May the FCA will be hosting its first Crypto Sprint, a two-day event discussing the future of crypto regulation.

Post-Brexit – the FCA reminds Firms that Overseas Person Exclusion (OPE) may be used by foreign firms doing business with a limited number of wholesale Clients, while firms with a significant amount of UK business may be required to set up an authorised subsidiary.

To discuss how the FCA's supervisory strategy impacts on your business, please contact us.

1.2 FCA reviews financial crime controls at challenger banks

The FCA has conducted a multi-firm review of financial crime controls at challenger banks. The review was triggered by concerns that challenger banks offering quick and easy onboarding processes may not be gathering sufficient information to identify high risk customers and could become targets of criminal activity.

The review was focused on relatively new digital banks covering over 8 million customers. The FCA reviewed the challenger banks' financial crime controls, including:

- governance and management information
- policies and procedures
- risk assessments
- identification of high risk / sanctioned individuals or entities
- due diligence and ongoing monitoring
- communication, training and awareness

The FCA found weaknesses in customer due diligence (CDD) processes, with certain banks failing to obtain sufficient information about customer income and reputation. Other deficiencies include failures to apply enhanced due diligence (EDD) with high-risk customers, ineffective use of transaction monitoring alerts and weak customer risk assessment frameworks. The FCA also expressed concerns about the frequency and quality of auspicious activity reports (SARs).

In one instance, a bank had been warned by internal audit of its financial control framework not being fully compliant with the Money Laundering Regulations (MLRs) but failed to notify the FCA under Principle 11 of the FCA's handbook.

To find out how Waystone can support you in strengthening your financial crime framework, please contact us.

1.3 FCA Thematic Review 22/1 on wind-down planning

On 11 April 2022, the FCA has published FCA Thematic Review 22/1 on wind-down planning that applies to all regulated firms. The FCA has focused on liquidity needs during wind-down, intra-group dependencies, and wind-down triggers in light of the COVID-19 pandemic.

The FCA has found that most wind-down plans and risk management frameworks do not satisfy the expectations of current FCA guidance. The FCA believes more work needs to be done in relation to liquidity and cashflow modelling, intra-group dependencies and wind-down trigger calibration. Firms should also test the outcomes of wind down planning as it is the best way of showing that the plan and process is operable.

The FCA encourages Firms to review the observations contained in TR22/1 and consider incorporating these, as appropriate, in their wind down plans. Please contact us for advice and support with your wind-down plans.

1.4 FCA update MAR webpage

The FCA has updated its UK market abuse regulation (MAR) webpage. The main changes relate to the section "Managers' Transactions", which refers to Persons Discharging Managerial Responsibilities (PDMRs) and Persons Closely Associated to them (PCAs).

PDMRs and PCAs have an obligation to notify the FCA within three working days of personal transactions they undertake in the issuer's shares or linked financial instruments for annual amounts exceeding €5,000.

These rules also impact:

- instruments traded only on a UK MTFs or OTFs;
- issuers who have requested admission of their financial instruments on a UK regulated market; and
- UK Emission Allowance Market Participants (EAMPs) in relation to transactions in UK emission allowances and related products.

Article 19 disclosures shall be made only when concerning shares, debt instruments, derivatives or other financial instruments linked thereto, which are within scope of UK MAR.

"PDMRs and PCAs should notify the issuer and the FCA within three working days of the date of the transaction."

For guidance on these enhancements or support with your market abuse systems and controls, please contact us.

1.5 Investment Firm Prudential Regime (IFPR). Guidance on MIFIDPRU returns

On 27 April 2022 the Financial Conduct Authority's IFPR newsletter reminded firms that guidance on how to complete the MIFIDPRU returns is now available in MIFIDPRU 9 Annex 2.

The newsletter answered reporting queries on the following topics:

- MIF001 on adequate financial resources (own funds)
- MIF002 on adequate financial resources (liquid assets)
- MIF003 – Monitoring metrics
- MIF001 to 4 – consolidated returns
- MIF001 and 002 – certain rows when reporting on a consolidated basis
- MIF006 scheduling
- Other scheduling issues

Waystone advises MIFIDPRU Firms on their regulatory, risk and financial requirements. For further information on how we can help you file your financial returns please get in touch.

1.6 FCA releases three-year strategy and business plan for 2022

On 7 April 2022, the Financial Conduct Authority (FCA) published its three-year strategy for 2022 – 2025 and its business plan for the next 12 months.

In the three years from 2022 – 2025 the FCA will increase its focus on three themes, namely:

- **Reducing and preventing serious harm** – topics of concern include improving the redress framework, preventing financial crime and improving oversight of appointed representatives;

- **Setting and testing higher standards** – sub-themes include enabling customers to help themselves and establishing a new set of Environmental, Social and Governance (ESG) priorities; and

- **Promoting competition and positive change** – focus is on preparing financial services for the future, strengthening the UK's position in wholesale markets, and a strong focus on digital markets.

The 2022 – 2023 business plan expands on how the FCA is currently working towards reaching its objectives.

In the business plan, the FCA explains its work towards becoming a data led regulator. It is increasing its data harnessing and processing capabilities by using machine learning and AI to enhance its supervisory and enforcement. The FCA has mentioned that

- in secondary markets, data is being monitored to spot insider dealing and market manipulation

- in 2021 it has removed permissions from firms who weren't using them 161 times

- it is increasing the number of applications rejected in relation to Money Laundering Regulations (MLRs).

To discuss how the FCA's supervisory strategy impacts on your business, please contact us.

2. PRA UPDATES & DEVELOPMENTS

2.1 Bank of England considers central bank digital currency

In April 2022, the Bank of England (BoE) published a web page on Central Bank Digital Currency (CBDC), explaining how BoE is looking into the technology to facilitate CBDC. The BoE states that CBDC is "a type of money that a country's central bank can issue for people to use, but instead of being a physical note, it is digital."

The digital currency would be denominated in pound sterling and be equivalent in value to cash, which would continue to be issued by the BoE. People will be able to convert cash or money held in deposits into CBDC, which will allow for faster and more secure digital payments. According to the BoE, this could make the financial system more resilient and inclusive.

The BoE is also considering potential risk that the digital currency could bring, including:

- The role of banks as a source of lending;
- Monetary policy and inflation; and
- Privacy and security issues.

The BoE observes that a digital currency baked by the central bank will be more stable and reliable than cryptocurrencies and *stablecoins*. The BoE has stated that the CBDC will be developed only once the necessary technological and operational capabilities are available, which should happen in the second half of the decade.

3. EU REGULATORY UPDATES

3.1 European Commission consultation on ESG in credit ratings

The Directorate-General for Financial Stability, Financial Services and Capital Markets Union, which is the European Commission's department responsible for EU policy on banking and finance, issued a "targeted consultation on the functioning of the ESG ratings market in the European Union and on the consideration of ESG factors in credit ratings".

The main objective is to gain insight on the functioning of the ESG ratings' market; in particular, on how credit rating agencies incorporate ESG risk in their assessment. The consultation is part of the wider "Renewed sustainable finance strategy and implementation of the action plan on financing sustainable growth" adopted in July 2021.

Responses to the consultation may be provided between 4 April 2022 and 6 June 2022.

For guidance and support in navigating and understanding the regulatory framework surrounding ESG, please contact us.

3.2 ESMA Guidelines on the MiFID II appropriateness assessment

The official translations of the ESMA guidelines on certain aspects of the MiFID II appropriateness and execution-only have been published on 12 April 2022 and will apply six months from that date.

The Guidelines touch on several key aspects of the appropriateness assessment, including:

- How to disclose the purpose of the appropriateness test to Clients;
- Policies and procedures that enable firms to collect all the necessary information;
- Considering the level of complexity of the service provided and the nature of the Client;
- Over-reliance on clients' self-assessment;
- Updating the client's information collected;

- Cases where the client is a legal person or a group of two or more natural persons;
- Ensuring the effectiveness of Client warnings;
- Regular training and the required level of skills, knowledge, and expertise for staff; and
- Record keeping policies and procedures.

Waystone helps MIFIDPRU businesses understand and comply with COBS requirements. Please contact us for more information.

3.3 MAR Guidelines on disclosure of inside information - ESMA translation available

On 13 April 2022, the European Securities and Markets Authority (ESMA) issued official translations of its reviewed MAR Guidelines on delay in the disclosure of inside information and interactions with prudential supervision.

The Guidelines expand on issues relating to the legitimate interests of issuers to delay the disclosure of inside information and situations in which the delay is likely to mislead the public.

Competent authorities to which these guidelines apply must notify ESMA within two months on whether they comply, intend to comply, or intend to not comply with the Guidelines.

4. FINANCIAL CRIME

4.1 European Commission updates Q&A on Russia sanctions

The European Commission continues to update its Q&A guidance on 'Sanctions adopted following Russia's military aggression against Ukraine'. The five sections in which the Q&A is divided are:

A. Horizontal - includes general questions on sanctions, circumvention, and due diligence.

B. Individual financial measures – Q&As focus on assets freeze and prohibition to provide funds or economic resources

C. Finance and banking – sub-sections include insurance, trading, sale of securities, banknotes, investment funds, credit rating, crypto, (Re)financing and SWIFT.

D. Trade and customs – Q&As relate to export-related transactions, custom related matters, gas imports, luxury goods, maritime safety, financial assistance, technical assistance, Donetsk, and Luhansk oblasts.

E. Other fields – include energy sector, aviation, media, access to EU ports, road transport, humanitarian aid, intellectual property, public procurement.

Restrictive measures adopted in April by the European Union against Russia include:

- Exclusion of Russian nationals and entities from procurement and public contracts in the EU

- Extension on the prohibitions to export banknotes or transferable securities to Russia
- Addition of 217 individuals and 18 entities to the sanction lists
- Asset freezes on four additional banks
- A ban on providing a high value crypto-asset services to Russia
- A prohibition to provide trust services to wealthy Russians
- A full ban on Russian and Belarusian freight operators in the EU.
- Extending export bans including quantum computing, semiconductors, sensitive machinery, transportation, and chemical
- Extending import bans including cement, rubber products, wood, spirits, high-end seafood
- A ban on coal imports.

If you wish to discuss how to protect your business from sanctions breaches, please contact us.

4.2 FATF issues report on compliance with its standards

On 19 April 2022, the Financial Action Task Force (FATF) issued a landmark report on the state of effectiveness and compliance with the FATF standards.

The FATF 40 recommendations set out a framework of measures which countries should implement in order to combat money laundering and terrorist financing.

In its report, the FATF expresses general satisfaction with the progress made by countries in enacting laws and regulations to tackle money laundering. The FATF states that 76% of countries have now satisfactorily implemented the FATF's 40 recommendations, moving up from just 36% in 2012.

However, the report shows that some countries still struggle to counter the risk they face, particularly in relation to prosecuting cross-border cases and preventing anonymous trusts and shell companies being used to perpetrate financial crime.

The FATF emphasises that private entities play a key role in identifying and preventing money laundering and terrorist financing, but remarks that smaller financial institutions and professionals generally still have a poor understanding of the risks they face. The FATF notes that: "Private sector entities need a change of culture in applying a true risk-based approach to conduct customer due diligence, keep records, and file suspicious transaction reports."

In the UK, non-compliance with AML and CTF regulation can lead to an unlimited fine and 14 years imprisonment. Please contact us if you wish to consider an independent review of your AML and CTF systems and controls.

5. ENFORCEMENT ACTIONS

5.1 FCA stops Alexander David Securities disposing of assets without permission

The FCA has imposed requirements on corporate advisory firm Alexander Davis Securities Limited (ADSL) prohibiting it from disposing of any assets without written consent by the regulator.

The measures are aimed at ensuring money is available for redress awarded by the Financial Ombudsman Service. The FOS has upheld complaints that Appointed Representatives (ARs) of the Firm had provided unsuitable pension transfer advice to clients of the firm, in particular advice to transfer their pension into Self Invested Personal Pensions (SIPPs) and purchase mini-bonds.

ADSL has been precluded to undertake regulated activity since 29 June 2020.

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- Hot Topics
  - COVID-19
  - Senior Managers & Certification Regime (SM&CR)
  - Fifth Anti-money Laundering Directive (5MLD)

If you wish to discuss how Waystone can assist you with any of the issues raised in this regulatory update, please contact us the details below:

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