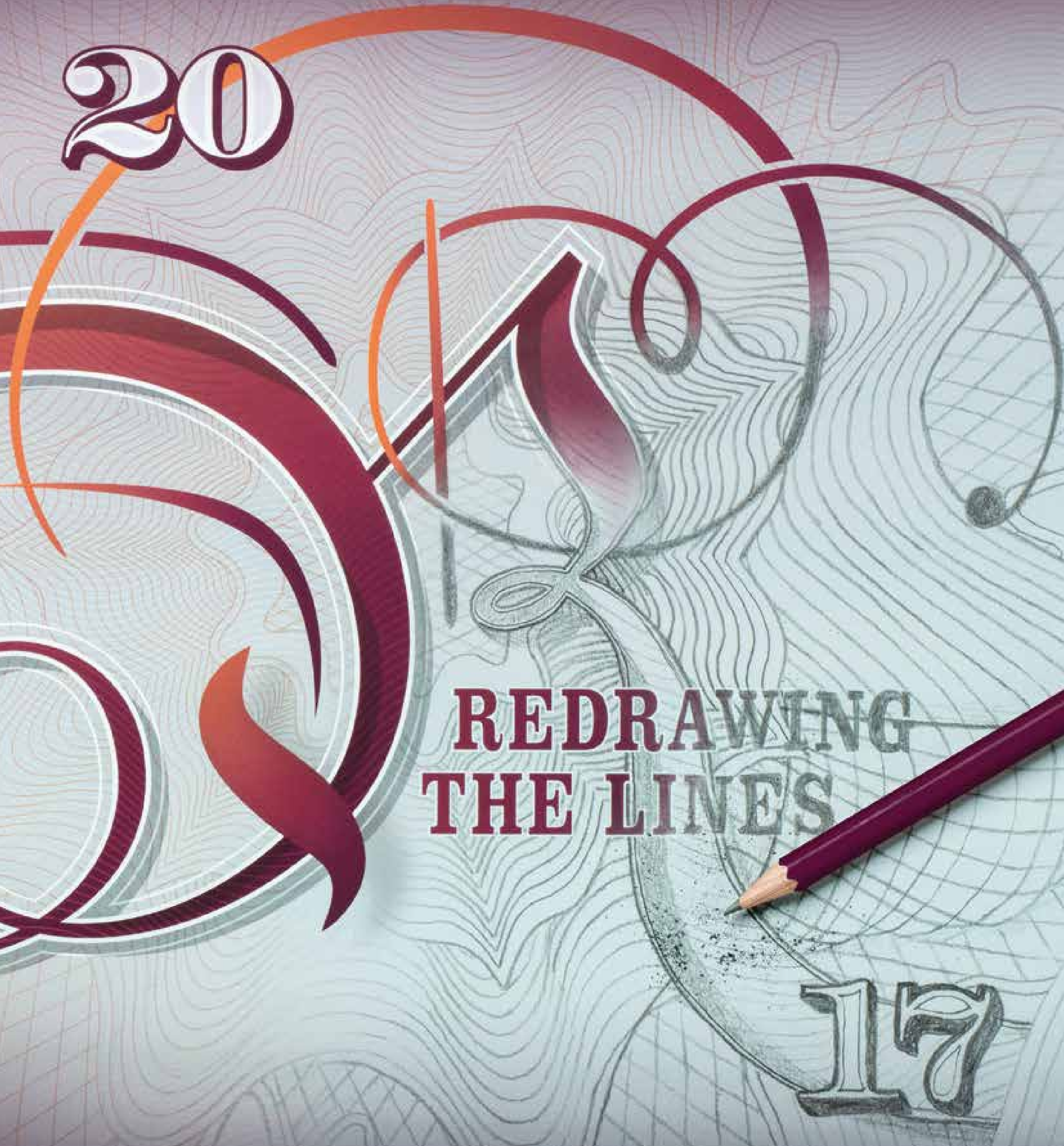
# FINANCIAL REGULATION
# EMERGING THEMES IN 2017




## FEATURED CONTENT



BERWIN
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# REDRAWING THE LINES

Welcome to our Emerging Themes in Financial Regulation publication for 2017.

The intense pace of change of financial regulation has been a recurring theme for this publication over recent years, but it is true to say that the UK's decision to leave the European Union takes us into entirely uncharted territory. Never before has there been such immense uncertainty for the industry as to what the future regulatory environment will look like for cross-border activities, and what steps international groups should be taking now in order to be ready.

Perhaps even more concerning than the referendum result itself, is the fact that the proposed timetable for the UK leaving the EU seems driven solely by political factors, without taking into account the reality of all that needs to happen before we are ready to leave.

Alongside negotiating the terms of the UK's exit and putting in place new trade and services deals with the EU and third countries, legislation will also be needed to recast the laws of England & Wales, Scotland and Northern Ireland to remove reciprocal EU rights and obligations, and transfer decision-making away from EU bodies. This hugely complicated exercise should not be underestimated. Once our laws have been amended, time will be needed to transition to the new regime – for example, within financial regulation, thousands of new authorisation applications and detailed business plans from incoming EEA firms who wish to continue conducting business in the UK will need to be assessed and determined. This is not an area where the PRA and FCA are known for their speed.

Against this unprecedented backdrop, what remains critical is that firms are alive to the issues and fleet-footed to respond to all aspects of the emerging regulatory picture. We hope that the personal insights provided in this publication by members of our Financial Regulation Group will help you in meeting this challenge.

As ever, we would all welcome your views on the issues covered so please don't hesitate to get in touch.

Nathan Willmott

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Individual
Accountability

Where the FCA or PRA imposes an enforcement sanction the matter can be referred to the Upper Tribunal for a full and independent hearing. Sidney Myers considers some recent decisions and the extent to which the Upper Tribunal has power to intervene where the regulator has imposed a prohibition order. »

# A NEW ERA OF PROHIBITION?

**Prohibition: the ultimate regulatory sanction**

Given the size of regulatory fines since the start of the financial crisis, most commentators have tended to focus on the staggering level of financial penalties imposed on banks and other financial institutions. However, in enforcement actions against individuals, the regulators also frequently look to impose an even more damaging sanction - a prohibition order. Over the past three years, the FCA has prohibited 76 individuals, considerably more than it fined during the same period. It is therefore important to understand how this regulatory 'tool' is applied in practice and the scope for challenging such decisions.

Both the FCA and the PRA can make a prohibition order if they consider an individual is not a 'fit and proper' person to perform certain functions in relation to a regulated activity. The effect of such an order is to prohibit the person from performing either a specified function (e.g. MLRO or Compliance Oversight) or any function. Thus, whilst the scope varies from case to case, the power is a very broad one and can be exercised wherever it appears that an individual has ceased to meet the fitness and propriety threshold.

**The limited scope for Upper Tribunal intervention**

The Upper Tribunal has recently considered the nature of this power, and a number of important principles emerge from their decisions:

1. A prohibition order is a 'draconian penalty that affects the ability of a person to earn a living in the financial services sector'. It should therefore not be imposed lightly.
2. It was suggested in one case that, in matters involving a lack of competence, the regulator must show that the lack of competence was to such a degree that it demonstrates that the individual is likely to represent a risk to the public in the future.

**Sidney Myers**
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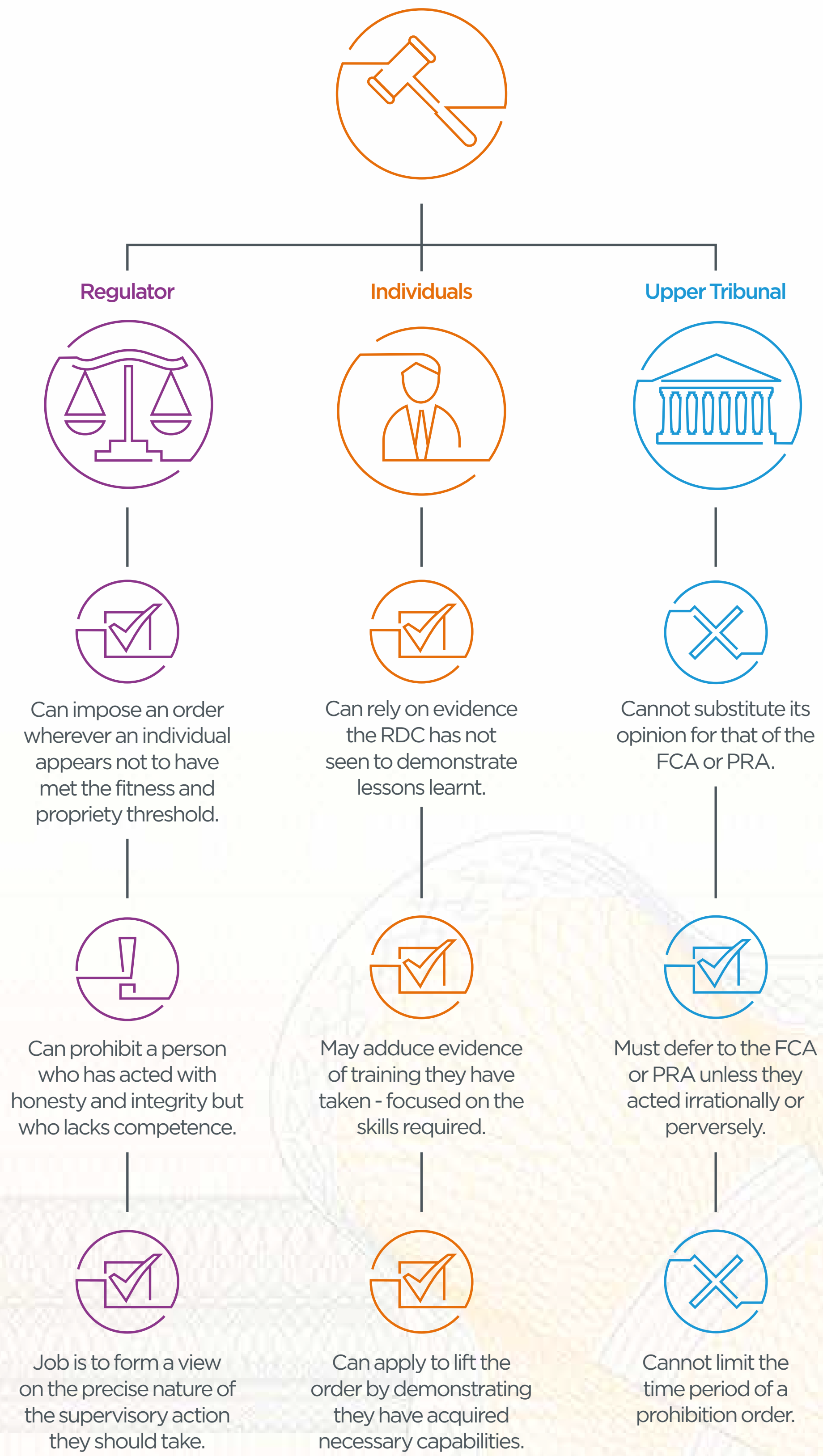
3. It will be comparatively rare for a full prohibition to be imposed in one-off cases of failure to exercise due skill, care and diligence.
4. It is open to an individual to seek to demonstrate to the Upper Tribunal that he or she has learnt any lessons from failures and would not make the same mistakes were he or she to continue in such a role. In this regard, the individual is free to rely on evidence that was not before the Regulatory Decisions Committee. This might, for example, include evidence of training that he or she has received since the RDC made its decision. That said, the Tribunal will be more impressed if the individual underwent further training shortly after the misconduct came to light.
5. When relying on having undergone further training, the individual will need to demonstrate that the training he or she received was focused on the specific skills required rather than just providing good general knowledge of the relevant areas. Detailed evidence will need to be adduced in order to satisfy the RDC or the Tribunal.
6. Crucially, recent case law suggests that it is not open to the Upper Tribunal to make an overall finding of fitness and propriety: the Tribunal cannot substitute its opinion for that of the FCA or PRA. Parliament has decided that the regulators are best placed to form a view as to the precise nature of the supervisory action they should take and has limited the Tribunal's jurisdiction accordingly. (A prohibition order is technically a non-disciplinary sanction, whose purpose is to protect the public rather than punish the offender).
7. All that the Upper Tribunal can do is to decide whether the regulator's decision to impose a prohibition order was within the range of reasonable decisions open to it. The threshold that the regulator has to meet is therefore relatively low.
8. By the same token, the Upper Tribunal does not have the power to limit the time period of a prohibition order. However, an individual can apply to lift the order if he or she can demonstrate, for example, that, through further experience of working in the industry, he or she has acquired the necessary capability to perform the relevant functions.

It therefore seems likely that the FCA and PRA will both continue to impose prohibition orders in cases where there is no finding of a lack of integrity, but merely a lack of competence. Whilst there have been a few successful challenges against the imposition of a prohibition order, unless the Upper Tribunal considers that the FCA or PRA acted irrationally or perversely, it is still for the regulator, rather than the independent Tribunal, to decide whether to impose a prohibition order.

Accordingly, it is vital that all relevant evidence is presented in full at the RDC meeting (or its PRA equivalent).



## IS THERE SCOPE TO CHALLENGE 'DRACONIAN' PROHIBITION ORDERS?



> Your reaction to issues is pivotal in terms of your personal regulatory liability – and may be closely analysed by the regulators after the event.

# AVOIDING UNWANTED ATTENTION

## HOW TO FULFIL YOUR PERSONAL REGULATORY DUTIES

A detailed understanding of your personal regulatory duties is crucial for avoiding unwanted attention from the regulator. Adam Jamieson sets out his practical tips to help you manage your regulatory responsibilities.

Following the introduction of the Senior Managers Regime (SMR) and the Senior Insurance Managers Regime (SIMR), the regulators' appetite for pursuing enforcement cases against senior managers is ever increasing.

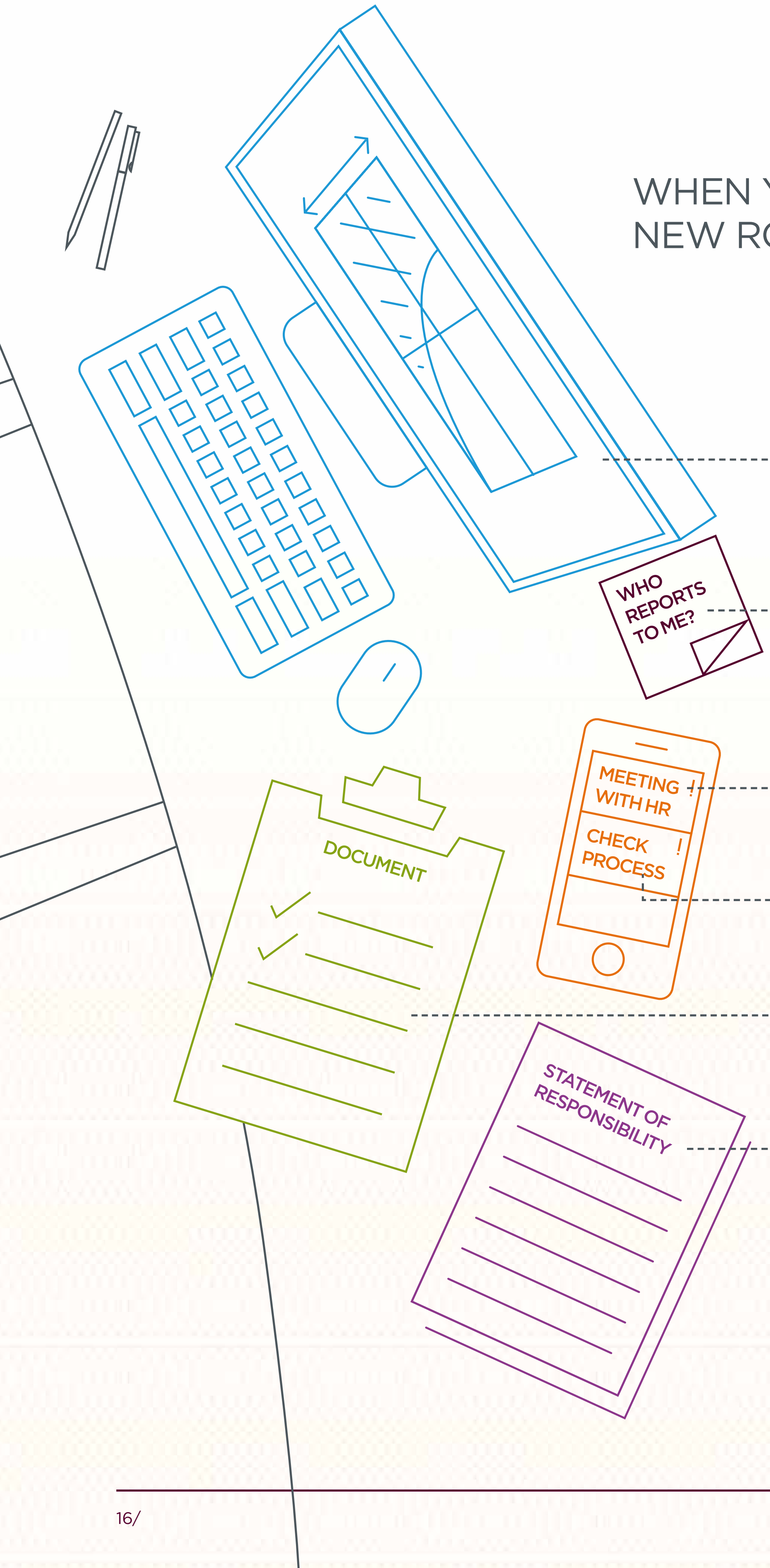
Having worked on a number of recent high profile FCA and PRA enforcement cases against individuals, both as an FCA investigator (whilst on secondment with the FCA's Enforcement and Market Oversight Division), and as a defence lawyer, I can share some insider tips on what steps you should be taking to fulfil your personal regulatory duties and, ultimately, avoid becoming the subject of regulatory enforcement action.

**What do I need to do initially when I commence my role?**
On taking up a new role within a financial institution, we recommend that you carry out a documented initial assessment of the risk management framework in place for your area of the business, within the first two/three months. To be clear, no matter how large your firm's Compliance or Risk function is, the responsibility for regulatory compliance in your area of the business lies with you.

This assessment will involve arranging meetings with the people in the business who have the best knowledge of how your area was managed before your appointment (ideally including your predecessor), and also with Compliance, Risk Management, Internal Audit, and HR. The purpose of this exercise is to understand the risk management framework and satisfy yourself that robust processes are in place to identify and assess each of the various material risks that your area of the business is exposed to. To do this, you need to understand the firm's risk appetite and how it applies to your area of the business.

You also need to make sure you are clear about which area of the firm you are responsible for from the outset. Your Statement of Responsibility will set that out. Make sure you have a copy to hand and that you are still happy it is an accurate description of your role. If it isn't, it's important that you get your firm to update it and send the updated version to the regulators. You should also ensure that the reporting lines in place will allow you to effectively oversee the areas for which you are responsible (including any specific prescribed responsibilities). »

# WHEN YOU START YOUR NEW ROLE




**KNOW** your firm's risk appetite and how it applies to your area of the business.

**ENSURE** reporting lines allow you to effectively oversee the areas for which you are responsible.

**MEET** with colleagues with the best knowledge of your area, including Compliance, Risk Management, Internal Audit, HR and ideally – your predecessor.

**CHECK** there are robust processes in place to identify and assess each material risk in your area.

**DOCUMENT** an initial assessment of your risk management framework within the first 2-3 months.

**GET A COPY** of your Statement of Responsibility – is it an accurate description of your role?

**IF IT ISN'T** – ask your firm to update it and send a copy to the regulators.

### How should I approach my duties on an ongoing basis?

We recommend carrying out documented annual reassessments of the risk management framework for your business area, even if nothing is going wrong, and you have no reason to think that anything needs improving. These reassessments should include:

- Checking that the organisational structure is operating effectively. Are reporting lines working well? Are important matters being escalated quickly enough?
- Checking that risks are being identified effectively within the framework. Has a particular risk or problem been notified to you late, having come in under the radar?
- Reviewing the competence and capability of your direct reports. Do not rely solely on their annual appraisals – ask yourself, am I happy that they are effective in supporting me to identify and manage the risks in my area of the business?
- Assessing whether the management information you are getting is appropriate – neither too little information, nor too much.

Watch out for 'red flags' (for example, critical internal audit reports or concerns which have been raised by the regulators either specific to your firm or sector wide). A 'red flag' may trigger the need to take immediate action.

Finally, remember that you can't 'press pause' on your regulatory responsibilities. Unfortunately, being under pressure at work (e.g. due to lack of resource or support from the top), or having personal difficulties, is not a defence in regulatory enforcement proceedings, however unfair this may be.

### What should I do if problems occur?

When considering your regulatory duties, perhaps the most critical time for you is when something goes wrong. Mistakes and oversights are often very difficult to avoid entirely. However, your reaction to issues is pivotal in terms of your personal regulatory liability, and may be closely analysed by the regulators after the event.

If a problem arises in area of the business for which you are responsible:

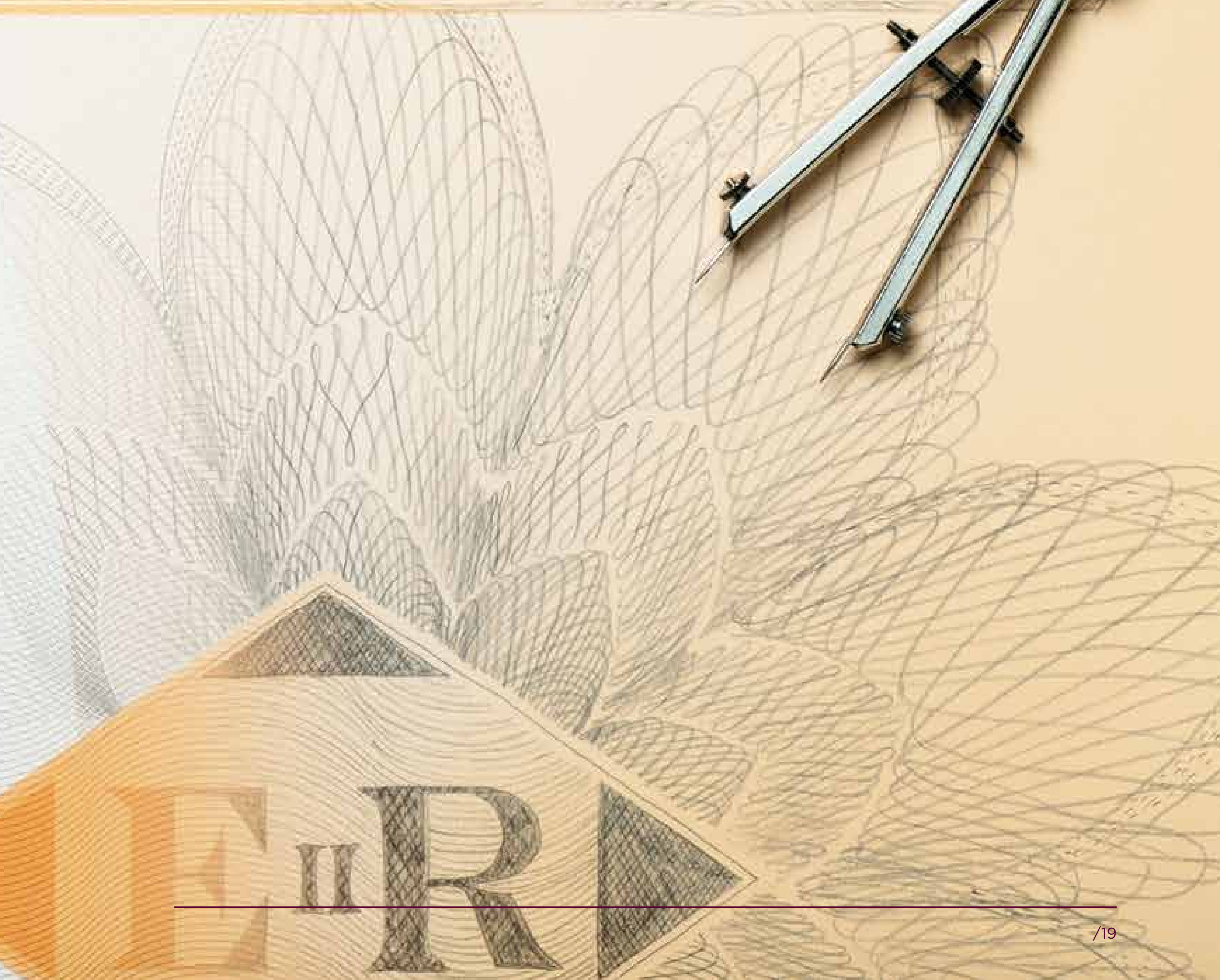
- ensure proactive steps are taken to investigate and understand it. Where an issue raises significant concerns, act quickly and decisively;
- highlight concerns to internal or external auditors and, if necessary, request that they examine the operation of the relevant controls or business functions;
- consider whether the issue has wider implications in respect of the suitability of the risk management framework;
- ensure that any concerns are appropriately escalated (including to the relevant risk committees, the Board, and/or the regulator) and effective remedial action is taken; and
- keep a written record of your actions, the outcome and the reasoning behind your decisions.

If you are unsure about your personal regulatory duties require of you, seek legal advice. We would be happy to speak to you about your regulatory position generally, or in light of a specific issue you are facing, so please do get in touch.

**Adam Jamieson**
Senior Associate, Financial Regulation

# INVESTIGATIONS





# STANDING YOUR GROUND OVER LEGAL PRIVILEGE?

Institutions are facing increasing pressure from the regulators to waive their right to legal privilege in investigations. Sarah McAtominey explains some of the risks and offers her advice on protecting legal privilege as a fundamental legal right.

## Challenging claims to privilege

In last year's Emerging Themes, we discussed the legal privilege issues considered in Property Alliance Group v RBS. Despite holding that the documents were privileged, the case prompted concerns that the protections of legal privilege were under threat, especially for institutions in the grey area of internal investigations that may or may not result in some form of enforcement or related litigation. These concerns persist with the recent decision in the RBS Rights Issue Litigation where RBS's claim for legal advice privilege over interview notes prepared in the course of an internal investigation conducted after receipt of a subpoena from the SEC failed. This fear has been compounded by statements from the FCA and the SFO, suggesting that institutions are abusing the protection of legal privilege to frustrate investigations, and that they will look to challenge claims to privilege on a routine basis.

The legal profession has, quite rightly, taken exception to these statements from regulators, given that privilege is an inalienable legal right in this country. As early as 1864, it was recognised that one cannot draw any adverse inference from a refusal to waive legal privilege. The Law Society is currently consulting on a new guidance note on legal professional privilege. It recognises the fundamental nature of this protection and encourages practitioners to advise clients robustly when documents are privileged.

But is that realistic in today's regulatory environment? There is a clear sense within many financial institutions that an assertion of legal privilege will not go down well with your regulator. It is increasingly standard for regulators to ask firms to identify documents over which the firm is asserting privilege. They are also making requests for the institution to waive privilege over categories of material as a routine matter, at an early stage of an investigation. The decision in the RBS Rights Issue Litigation will only embolden the regulators to keep pushing the boundary.

## The cross-border balancing act

In cross-border investigations, where information is likely to be shared among various regulators under information sharing rights known as 'gateways', decisions on whether to waive privilege become especially fraught with difficulties.

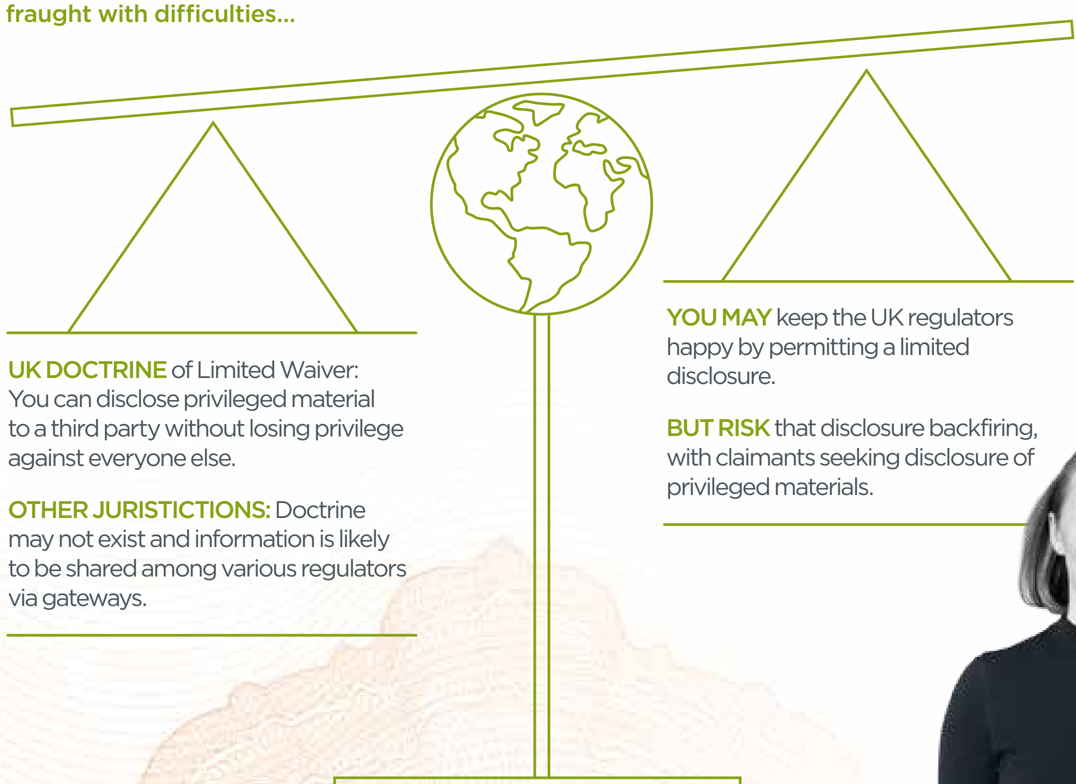
The doctrine of Limited Waiver (under which a person may disclose privileged material to a third party without losing privilege as against everyone else) exists in the UK and is expressly recognised in the FCA's Enforcement Guide. However, it does not exist in many other jurisdictions. As a result, institutions need to weigh up the benefits of keeping their UK regulators happy by permitting a limited disclosure, against the risk of that disclosure backfiring later in the context of overseas litigation, with claimants seeking disclosure of privileged materials.

## Stand your ground

In my view, it is time that the red lines around privilege were redrawn and respected. Legal privilege is a fundamental legal right and the regulators should remember that they also have the benefit of this protection. Of course, firms are free to waive privilege over material if they choose to do so, but the regulators should not be routinely asking for this. Otherwise the status quo will shift to the point where asserting a fundamental legal right starts to look like non-co-operation. That's not a regulatory landscape we want to see emerging – so our advice to firms receiving blanket requests for waivers is to respond with a polite, but firm, 'no'.

## THE CROSS-BORDER INVESTIGATIONS BALANCING ACT

**Decisions on waiving privilege can become fraught with difficulties...**



**UK DOCTRINE** of Limited Waiver: You can disclose privileged material to a third party without losing privilege against everyone else.

**OTHER JURISTICTIONS:** Doctrine may not exist and information is likely to be shared among various regulators via gateways.

**YOU MAY** keep the UK regulators happy by permitting a limited disclosure.

**BUT RISK** that disclosure backfiring, with claimants seeking disclosure of privileged materials.

**Sarah McAtominey**
Senior Associate,
Financial Regulation

# FCA'S NEW ENFORCEMENT TOOL: 'ON NOTICE' LETTERS EXPLAINED

The FCA has opened only one competition law investigation since it was granted powers to enforce EU and UK competition law in April 2015. However, it has made more frequent use of a new tool, referred to as 'on notice' letters, to tackle potential infringements of competition law. Andrew Hockley and Sarah Ward explain the circumstances in which a firm may receive such a letter, and the steps it should take in response.

**What is an 'on notice' letter?**
An 'on notice' letter notifies a firm that the FCA has evidence that it has engaged in a suspected breach of competition law. The letter will usually detail the individual(s) and other entities (if any) it understands were involved, and the nature and approximate timing of the infringing behaviour. It will state that, having assessed the suspected infringement against its prioritisation principles, it is not minded to take action at present, but that it reserves the right to revisit the matter in the future.

Firms which receive an 'on notice' letter are asked to carry out their own investigation to determine whether they have in fact breached the competition law rules, and to inform the FCA of the action they propose to take to address its concerns.

The FCA may obtain information about a suspected competition law infringement from various sources. The first time the FCA issued an 'on notice' letter was to address concerns identified during its Retirement Income Market Study. As well as market studies, another major source of information for the FCA is the compulsory disclosures made to it under SUP 15.3.32R (1), which imposes an obligation on firms to notify the FCA of any significant infringement (or potential infringement) of any applicable competition law.

> A particular benefit of issuing an 'on notice' letter from the FCA's point of view is that it transfers the burden of investigating and remedying competition law problems to individual firms.

**When does the FCA send 'on notice' letters?**
In deciding whether to open a formal investigation or issue an 'on notice' letter in a particular case, the FCA will take into account factors such as:

- the likely impact of an investigation, in terms of the direct and indirect consumer benefit it may bring;
- the significance of the case (including the possible deterrent effect of an investigation or decision);
- the risks involved in taking on a case (including the likelihood of determining whether or not there has been an infringement);
- whether other tools are available that would be more appropriate to achieve the same or a better outcome; and
- the resources required to carry out an investigation.

A particular benefit for the FCA of issuing an 'on notice' letter is that it transfers the burden of investigating, assessing and remedying potential competition law problems to individual firms. This can free up resources for higher priority matters, whilst still addressing potential competition concerns. It also demonstrates that the FCA is taking action in respect of the (potential) competition law breaches firms disclose to it. We expect the FCA's use of this 'soft' enforcement tool to continue to increase. »

**How to respond**
A firm's ultimate objective when responding to an 'on notice' letter will usually be to help the FCA confirm its working conclusion that there is no need for it to investigate the suspected infringement any further, nor to impose any sanctions on the firm or its staff. A firm which is found to have infringed EU or UK competition law can be fined up to 10% of its group annual worldwide turnover and may be subject to claims for damages by third parties who have suffered loss as a result of the breach. Individuals who engage in certain types of cartel behaviour can face criminal sanctions (including up to five years in prison) and company directors can be disqualified from holding a directorship in any UK company for up to 15 years.

A firm will minimise the likelihood of any follow-up action by the FCA by demonstrating:

- → the seriousness with which it takes the alleged competition law infringement and its compliance obligations more generally;
- → that it has carried out an appropriately in-depth investigation into the suspected infringement; and
- → that it has taken, and will continue to take, mitigating compliance steps.

The time given to respond to an 'on notice' letter is likely to be quite short. Some form of internal investigation will usually have to be carried out, including interviews with relevant staff and potentially some electronic document review. Given that the European Commission does not treat communications with in-house lawyers as legally privileged, there may be merit in involving external lawyers in this process. This will minimise the risk of potentially damaging materials being disclosable to the Commission in any subsequent competition law investigation.

During an internal investigation, a firm should keep under constant review its obligations under SUP 15 to disclose to the FCA any significant competition law infringements uncovered during this process which are not detailed in the 'on notice' letter. If any aggravating details about the suspected infringement or any further competition law infringements by the firm come to light, a firm may also have to consider admitting this to the relevant competition authorities, in exchange for immunity from, or a percentage reduction in, fines.

Once the investigation is complete, a firm will have to identify the key and specific risks which came to light and how these may be best mitigated. These mitigating steps (which may include training and new procedures), and the timetable for their implementation, will then have to be detailed in the firm's response to the FCA.

**Sarah Ward**
Senior Associate, Antitrust & Competition

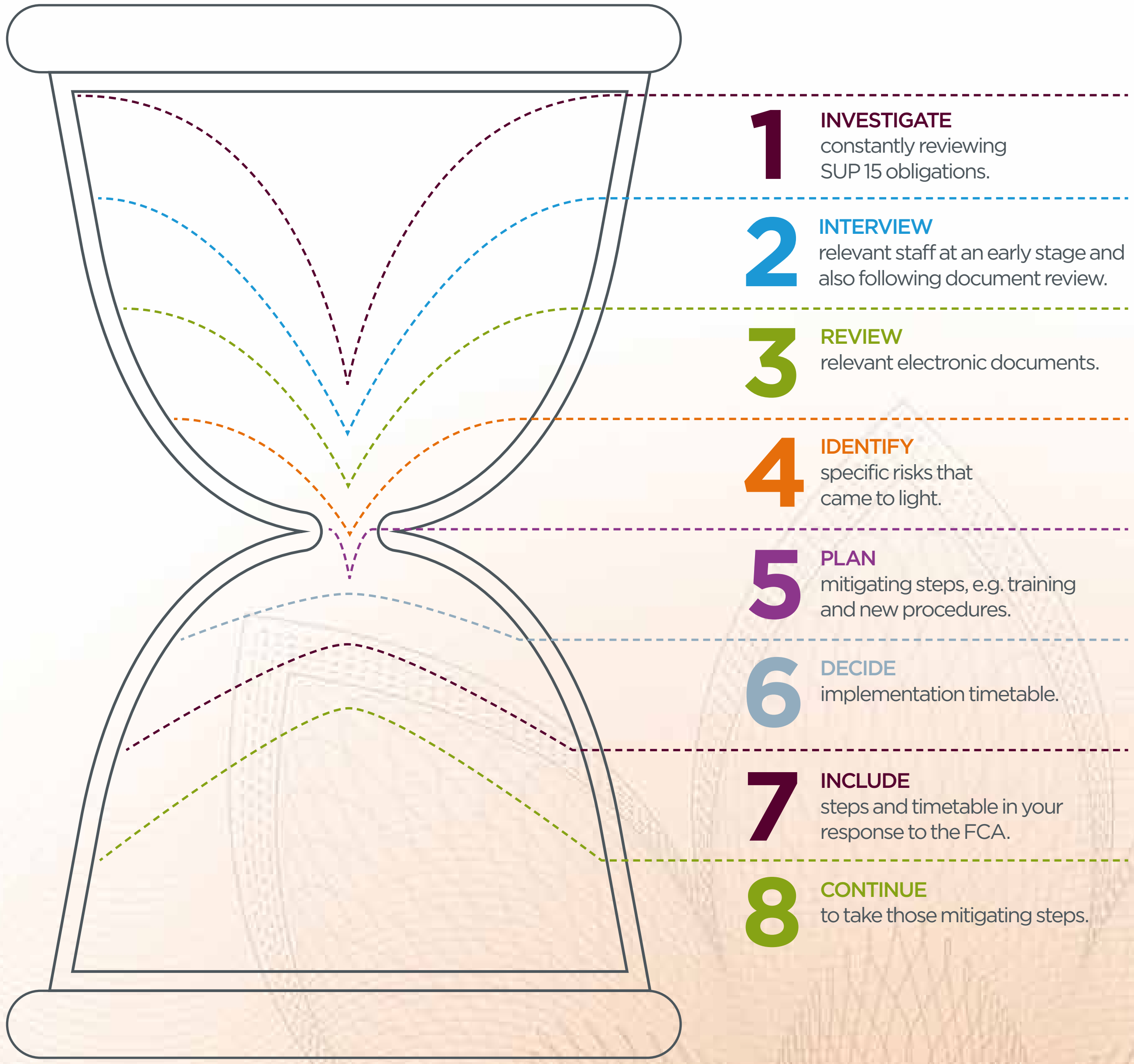
**Andrew Hockley**
Partner, Antitrust & Competition

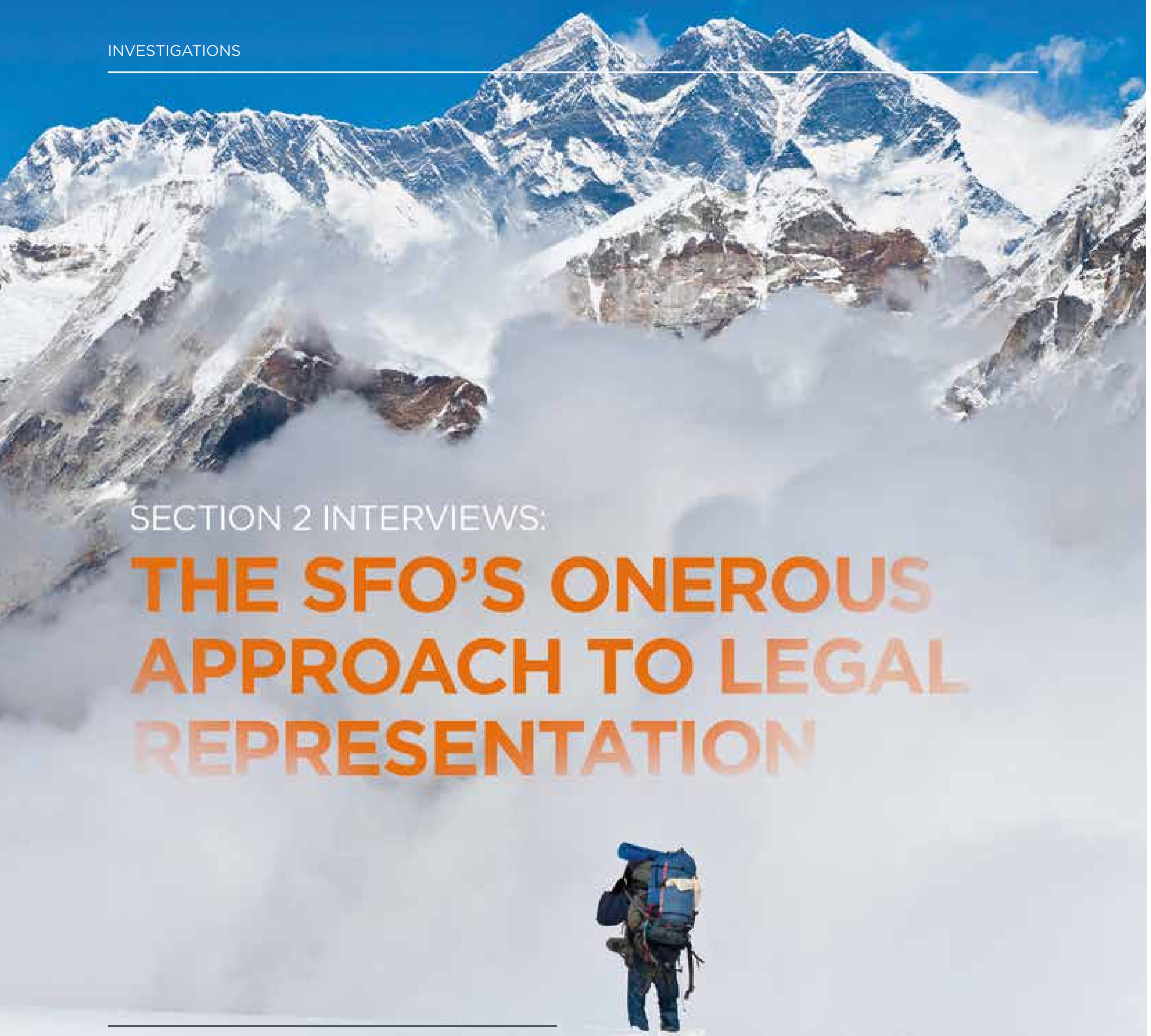




## TIME IS SHORT FOR INVESTIGATING SUSPECTED COMPETITION BREACHES...

**SO HERE'S HOW TO APPROACH IT...**





# SECTION 2 INTERVIEWS: THE SFO'S ONEROUS APPROACH TO LEGAL REPRESENTATION

In last year's publication we discussed the potential implications of the SFO's defeat of a judicial review challenge in *R (Lord & others) v SFO*. This year, Aaron Stephens and Clare Reeve take a look at the SFO's new operational guidance and consider the impact for financial institutions and their advisers.

## Section 2 interviews – the background

Section 2 of the Criminal Justice Act 1987 gives the Director of the SFO (or his delegate) the power to 'require the person whose affairs are to be investigated … or any other person whom he has reason to believe has relevant information to answer questions or otherwise furnish information with respect to any matter relevant to the investigation…'

Where the proposed interviewee is a suspect, the SFO will conduct an interview under caution. By contrast, section 2 interviews are compelled interviews which are therefore not under caution and the Police And Criminal Evidence (PACE) Codes do not strictly apply.

The SFO's operational guidance has historically allowed witnesses to be accompanied by legal representatives at section 2 interviews 'provided that their attendance does not unduly delay or in any way prejudice the investigation'.

New operational guidance was promised by the SFO following its victory in the High Court in February 2015 in *R (Lord & others) v SFO [2015] EWHC 865*. In that case - described recently by SFO Director, David Green CB QC, as a 'skirmish' - the SFO defeated a judicial review challenge to its decision to prohibit specific lawyers from accompanying witnesses to an interview under section 2. The SFO's reasoning for the prohibition was that the presence of the lawyers at interview might prejudice the investigation because the lawyers in question also represented the subject of the investigation (the witnesses' employer).

## The SFO's new operational guidance

In June 2016, the SFO published its new guidance, which comprises three separate notes:

1. internal guidance;
2. guidance for interviewees; and
3. guidance for lawyers advising those required to attend for interview under section 2.

The new guidance reiterates some points made by the SFO, and accepted by the court in *Lord*, and the basis for refusal by the SFO for a lawyer to attend remains 'potential prejudice'.

The guidance makes clear that a lawyer will be allowed to attend an interview only if the SFO believes that it is likely the lawyer 'will assist the purpose of the interview and/or the investigation, or that they will provide essential assistance to the interviewee by way of legal advice or pastoral support…' (the 'criteria').

Most interesting is the guidance for lawyers, as this sets out what the lawyer or interviewee must do to seek the SFO's permission for a lawyer to attend. Written notification must be served on the SFO at least seven days prior to the interview, or three days after receipt of the SFO's guidance note accompanying the section 2 notice (whichever is later), and must include:

1. the lawyer's name and the reasons why their presence fulfils the criteria; and
2. an acknowledgment of the parameters of the lawyer's role, namely that the lawyer may only provide 'legal advice or essential assistance', must not do anything to undermine the free flow of full and truthful information, and generally that only one lawyer will be permitted to attend.

The lawyer is also required to provide written undertakings from their law firm providing confirmation that, amongst other things, the firm does not represent or owe any duty of disclosure to anyone who *is currently* a suspect of the investigation. An interesting point to note is that the scope of these undertakings is narrower than elsewhere in the guidance - where it suggests that a lawyer who is unable to demonstrate that they are not retained by any other person who *may in the future* come under suspicion is unlikely to be allowed to attend the interview.

The new guidance does not, however, explicitly prohibit interviewees from communicating, either before or after the interview, with any lawyer of their choosing. This is important in the context of investigations involving financial institutions and corporates, as the employer's lawyers will wish to ensure that both the employee and any independent lawyer appreciate any legal privilege issues that might arise during the interview.

## What will the likely impact be?

Certain aspects of the guidance are not new or surprising. However, the new guidance is noticeably different in its tone and level of prescription from the SFO's previous policy and certain provisions appear heavy-handed and unnecessary.

This change is perhaps not surprising given the issues that arose in *Lord* and the robust approach taken by the SFO since Mr Green took the reins in 2012. The new guidance is only six months old, so how it will be applied and the extent of its practical impact is difficult to determine at this stage. Perhaps it will simply result in earlier appointment of separate legal representatives for individual employees, additional paperwork and additional costs for firms under investigation.

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**Aaron Stephens**
Partner, Head of
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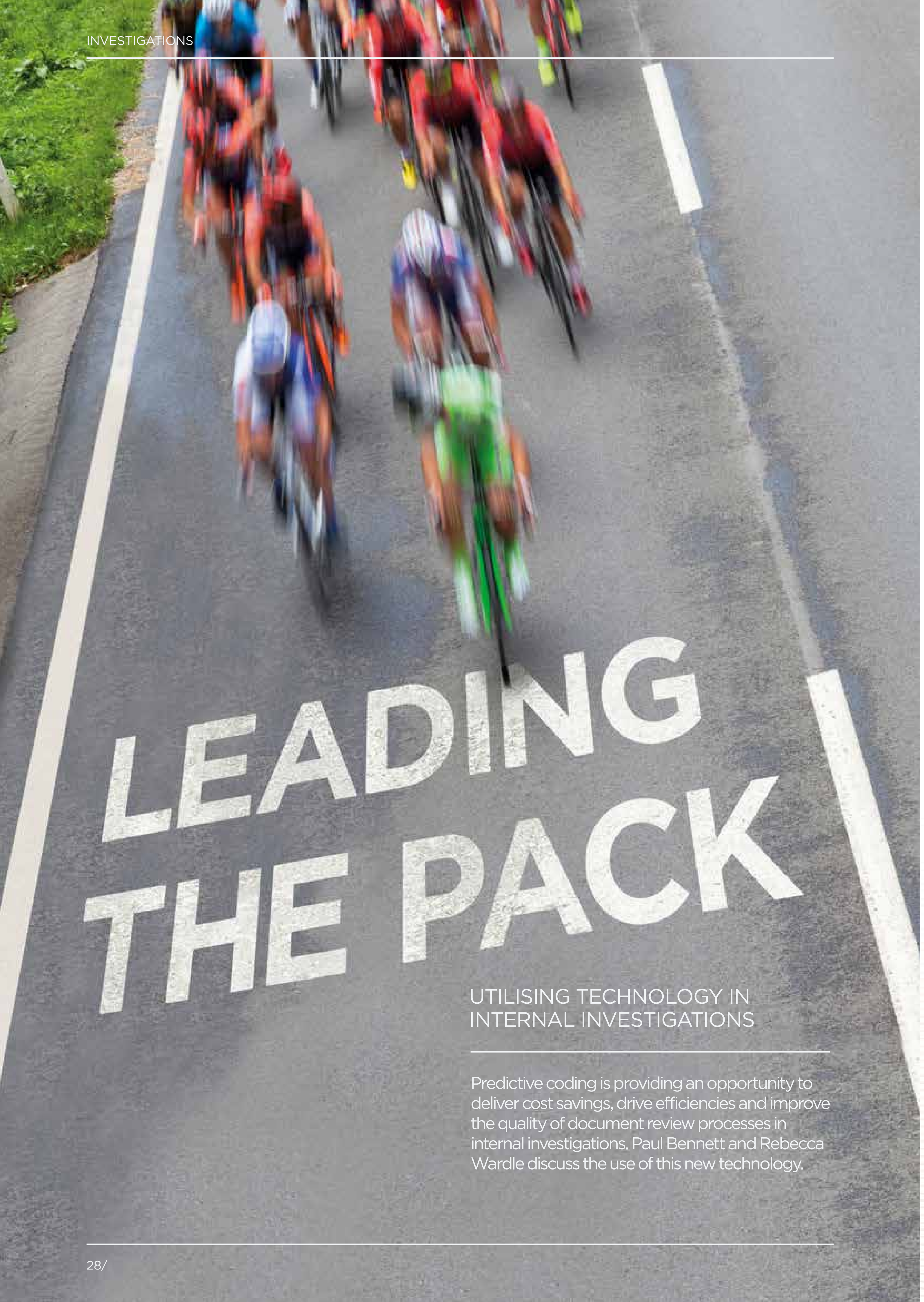
& Investigations



# LEADING THE PACK

## UTILISING TECHNOLOGY IN INTERNAL INVESTIGATIONS

Predictive coding is providing an opportunity to deliver cost savings, drive efficiencies and improve the quality of document review processes in internal investigations. Paul Bennett and Rebecca Wardle discuss the use of this new technology.

These are exciting times for technology enthusiasts; technology is empowering individuals and businesses like never before. The explosion of rich data provides businesses with the tools and insights to refine and control processes, and the diversity and richness of communications platforms makes collaboration smarter and more efficient.

But data growth also presents real challenges, especially from a risk management perspective. On the one hand, there have never been more data points available to establish a clear picture of who, what, where and when – but how do you find the pertinent information in a sea of irrelevant material? If a counterparty threatens legal action, or the regulators come calling, you need to know if and how you might be exposed as quickly as possible. This is the challenge which lies at the heart of any document review process: how to identify relevant materials quickly and efficiently, in order to assess legal and regulatory risk and respond appropriately.

Whilst technology has created this challenge of data proliferation, it has also offered solutions. We have been using 'technology assisted review' tools to map, cluster, filter and sort data for many years. These can help to narrow and focus document review processes, but frankly there are limits to their value in the face of exponential data growth. A fundamentally new approach is required, and in predictive coding we have a solution.

### What is predictive coding?

The technology received its first judicial approval in an uncontested context in February 2016, in the case of *Pyrrho Investments Ltd v MWB Property Ltd & Ors* [2016] EWHC 256 (Ch). In May, a team from BLP persuaded the court to go further, approving the use of predictive coding despite opposition from one of the parties (*Brown v BCA Trading Limited* [2016] EWHC 1464 (Ch)). In both cases, the court considered a number of factors, including the number of documents involved and the costs of manually reviewing those documents versus the effectiveness of predictive coding technology. The court concluded that all of the factors weighed in favour (or were neutral) as to the benefits of predictive coding.

So how does it work? Predictive coding inverts the traditional approach to document review, which involves large volumes of material being reviewed by junior lawyers or paralegals and filtering relevant material for review by senior team members. With predictive coding, a senior lawyer initially reviews a small sample set of documents from the wider larger document population. The decisions made by that lawyer are then used to 'train' the predictive coding algorithms on an iterative basis. This algorithm is then applied to the full set of documents, in order to grade all of the documents by potential relevance. By this method, the lawyers can much more quickly target and prioritise the most relevant materials.

### Improved quality and efficiency

The costs savings of predictive coding are well documented, but it is important to realise that this cost saving is not at the expense of quality – indeed, statistics show that a predictive coding review is actually more accurate than a traditional manual review. Furthermore, as data populations continue to grow, we will quickly reach the stage where predictive coding is not just one possible approach, but likely the *only* viable way to handle the volume of material at hand.

Most of the focus on predictive coding has so far been in the context of civil litigation, but we are now using it as a key tool in the handling of internal and regulatory investigations – helping firms to focus quickly on potential issues and formulate a coherent, informed response strategy. Regulators will also want to take advantage of the technology to expedite their investigations.

BLP has been at the forefront of promoting the use of technology to ensure that document review exercises are undertaken as efficiently and effectively as possible. Further, we are unique among law firms in having a specialist Forensic Technology Services team in-house, which offers predictive coding technology and support without having to go to an external provider.

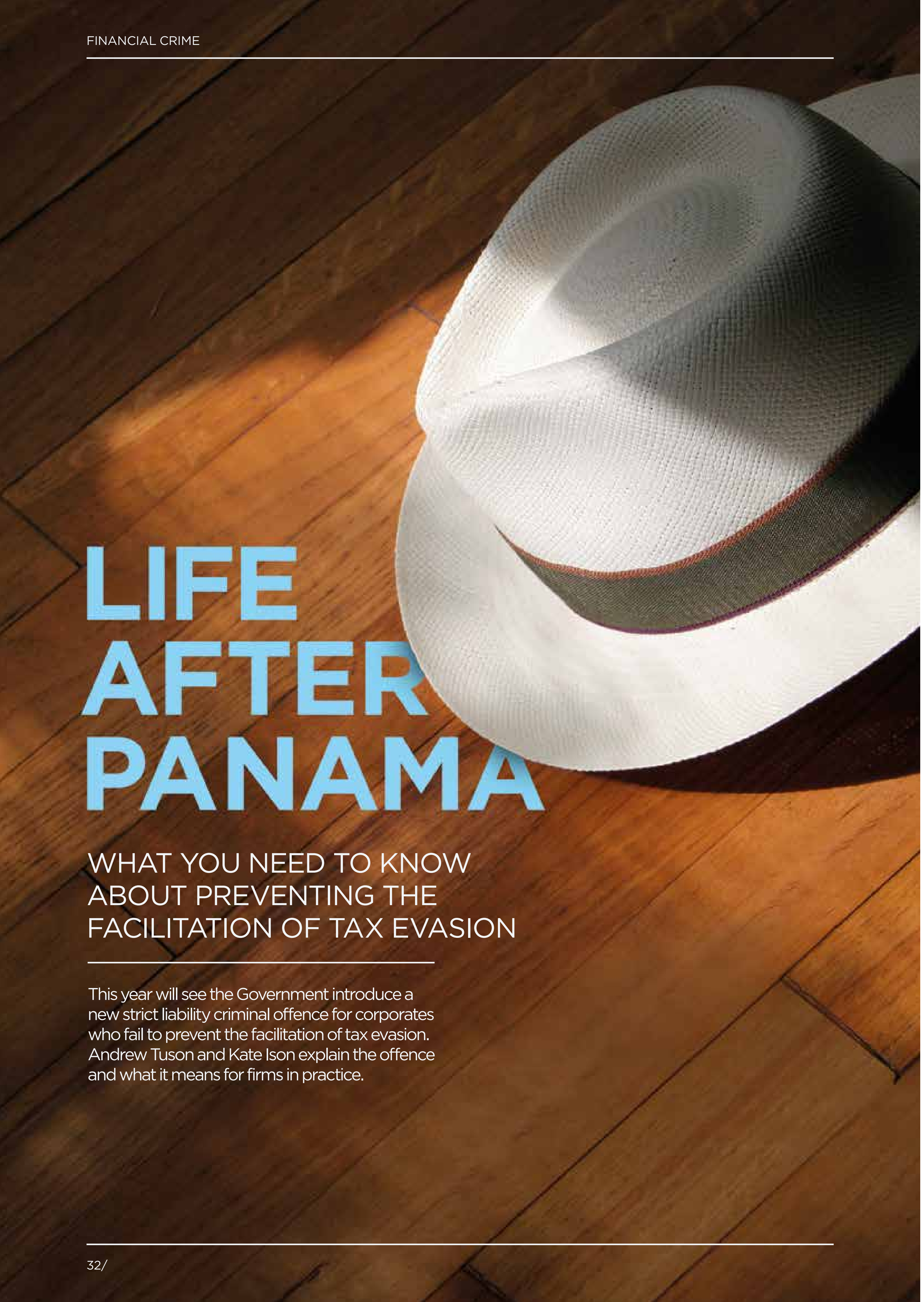
We would be delighted to hear from you if you'd like to know more about how this technology would benefit your firm in carrying out internal regulatory (or indeed other) investigations. We're very excited about it, and we think you will be too.

**Paul Bennett**
Partner, Head of Forensic Services

**Rebecca Wardle**
Associate, Financial Regulation

# FINANCIAL Crime





# LIFE AFTER PANAMA

## WHAT YOU NEED TO KNOW ABOUT PREVENTING THE FACILITATION OF TAX EVASION

This year will see the Government introduce a new strict liability criminal offence for corporates who fail to prevent the facilitation of tax evasion. Andrew Tuson and Kate Ison explain the offence and what it means for firms in practice.





**The new corporate offence explained**
The new offence is set out in the Criminal Finances Bill (the 'Bill') and provides that a corporate will be criminally liable where a person who represents it, such as an employee, contractor or agent, criminally facilitates the evasion of tax by another person. There are two distinct offences:

(i) the failure to prevent the facilitation of domestic tax evasion; and

(ii) the failure to prevent the facilitation of overseas tax evasion, where the foreign offence would also be an offence under UK law.

The key elements of these offences consist of the following stages:

**Stage one:** Criminal tax evasion by a taxpayer.

**Stage two:** Criminal facilitation of this offence by a person acting on behalf of the corporation, whether by taking steps with a view to; being knowingly concerned in; or aiding, abetting, counselling, or procuring the tax evasion by the taxpayer.

**Stage three:** If there has been a criminal offence at stage one and stage two, a corporation will be liable if it has failed to take reasonable steps to prevent its associated person from committing the criminal act at stage two.

If found liable, corporates will be subject to a fine and, given that this is a criminal offence, they may also have to make regulatory notifications, depending on their sector.

Importantly, where corporates have in place reasonable procedures to prevent the facilitation, they will not be liable. Similarly, they will have a defence where they can show that it was not reasonable in all the circumstances to expect them to have prevention procedures in place. What kind of prevention procedures are 'reasonable' is likely to be the subject of debate as the Bill passes through Parliament. Draft Guidance prepared by HMRC stresses that, ultimately, the decision of whether a firm's procedures were 'reasonable' to prevent facilitation of tax evasion will be a matter for the courts to decide on a case-by-case basis.

**What should firms be doing now?**
**Assess risks and implement policies:** It is critical that financial institutions now carry out a risk assessment and take steps in order to design and implement policies which should protect them from criminal liability in the event that an agent or employee criminally facilitates the evasion of tax by another.

Whilst the risks of the new offence are likely to cause concern to financial institutions, careful preparation of policies to mitigate against the risk of facilitating tax evasion should protect firms from corporate criminal liability. The Government has emphasised that while it is mindful that some policies will take time to roll out, it expects 'rapid implementation' of procedures targeting key risks.

**Underpin policies with proportionate checks:** In order to implement effective policies, checks should be carried out with staff working in business areas where tax evasion is possible, and firms should carefully consider their exposures. This is particularly important for financial institutions that regularly use third party service providers, contractors and agents across their businesses. Firms that operate in different jurisdictions will also face an increased exposure to the new offence.

**Engage senior management to lead training and awareness:** Senior management needs to be engaged in preparing for the implementation of the Bill and must also underline the importance of being aware of the new offence. Firms should prepare and implement training programmes in order that all staff know how to identify tax evasion and facilitation, and how to report any suspected facilitation within the organisation.

Financial institutions will need to prepare particularly carefully for the implementation of the new offence, as corporates operating in the financial services industry are likely to be scrutinised.

**Andrew Tuson**
Partner, Financial Regulation

**Kate Ison**
Senior Associate, Corporate Tax

## THE NEW FRONTIER FOR CORPORATE CRIMINAL LIABILITY

# FAILURE TO PREVENT ECONOMIC CRIME

The PM wants a crackdown on corporate crime and has set her sights on a new offence. Joanna Harris explains the background behind the proposed shake-up and outlines three key implications for financial services firms if the new law is introduced.

It is looking ever more likely that the lower threshold of corporate criminal liability in the UK which was established in Section 7 of the Bribery Act, and which has been developed in the new tax facilitation offence (see p.30), will be applied more widely in a new, strict liability corporate offence of failure to prevent economic crime.

### On the political agenda... again

The proposed new law has had a colourful history and has been on and off the political agenda several times over the past few years. Plans to consult on it were first introduced by the Government in its December 2014 UK Anti-Corruption Plan, but by 28 September 2015, the Ministry of Justice Parliamentary-Under-Secretary at the time, Andrew Selous MP, seemed to have sounded the death knell on the basis that “there have been no prosecutions under the model Bribery Act offence and there is little evidence of corporate economic wrongdoing going unpunished”.

However by the end of 2015, the first uses of Section 7 had emerged in the shape of a guilty plea and the UK’s first Deferred Prosecution Agreement and in April 2016, David Green CB QC, Director of the Serious Fraud Office and a long term advocate of the new offence, indicated that “rumours of the demise of this topic are very much exaggerated”. He was proved right in May 2016 when David Cameron announced a further consultation.

It has now been confirmed that this consultation remains firmly on Theresa May’s agenda and is to go ahead as planned.

So, if the Government does introduce this new law, what can firms expect?

> “The proposed new law has had a colourful history and has been on and off the political agenda several times over the past few years.”

1. **A broad scope**
   First of all, there is the question of which crimes will be covered. Money laundering and fraud (i.e. internal fraud by employees) are the obvious candidates and have been specifically mentioned by the Government.

2. **A familiar model**
   In terms of structure, we expect the new offence to follow the Bribery Act model, including a full defence if sufficient compliance measures are in place. This has certainly been the case with the new tax facilitation offence, which has a welcome degree of familiarity both in terms of the (draft) legislation and the guidelines on the ‘Reasonable Procedures’ defence, which mirror those on the ‘Adequate Procedures’ Bribery Act defence.

3. **Time to revisit compliance regimes...**
   From a practical perspective, organisations with existing compliance regimes in place to prevent money laundering and fraud will need to re-examine these regimes to ensure they are up to scratch; smaller organisations may need to introduce new measures, although they can look to leverage off existing anti-bribery measures.

One thing is certain: compliance looks set to remain in the spotlight for the foreseeable future.

**Joanna Harris**
Associate,
Financial
Regulation

# DIGITAL

# BIG DATA

## THE BIG CONDUCT RISK FOR INSURERS?

Should insurers expect a regulatory big data backlash? Adam Jamieson and Oliver Saunders discuss how the industry's conduct risk levels are being affected by the advent of ever growing data sets.

One of the FCA's ongoing priorities for the general insurance sector has been to understand the impact of insurers' use of 'big data' – the increasingly large and complex data sets that insurers have access to, as a result of digital technology and increased use of social media.

Everyone knows that knowledge is power, and that (as Spiderman would say), with great power comes great responsibility. It is in this context that we see big data as an increasingly important source of conduct risk for insurers. We have highlighted three key areas where we expect big data to have a significant impact...

### Product governance

The idea of product governance is not new in the UK. Since its creation, the FCA has emphasised the importance of identifying a clear target market for a product, before tailoring that product effectively to meet the needs of its target market.

However, the more data an insurer has about its customers and their needs, the higher the regulatory expectation will become when it comes to tailoring products to those needs. There will be no more excuses for a poor fit in the era of big data.

> There will be no more excuses for a poor fit in the era of big data.

### Product pricing

The FCA's recent market study on insurers' use of big data found that some insurers are using data to make pricing decisions based on 'factors other than risk'. In other words, deciding prices based on how much the customer will pay, rather than the cost of providing the product to a customer.

In its recent Mission Statement, the FCA noted this issue again and remarked that although some level of cross-subsidy based on price sensitivity is acceptable, there will be a limit. The FCA is currently thinking about where that line should be drawn. Insurers must be aware of this regulatory focus, and should think carefully about their regulatory obligation to treat customers fairly in this context.

### Cyber-risk

The more customer data you have, the more attractive you will be to cyber-criminals.

The PRA and FCA remain highly focused on cyber-crime. It is their current view that firms are not doing enough to protect themselves against cyber-attacks. The PRA has recently issued a draft Supervisory Statement on cyber-risk, in which it proposes that insurers' Boards must formally adopt a cyber-risk strategy and risk appetite. The Statement also makes it clear that Boards must increase their knowledge of, and focus on, this area, with a view to avoiding unintended exposures to cyber-risk.

**Adam Jamieson**
Senior Associate, Financial Regulation

**Oliver Saunders**
Associate, Insurance & Reinsurance

# FINTECH: PUTTING THE INNOVATION INTO REGULATION?

The FCA is a global leader in regulating FinTech. But there's clearly scope for the regulator's enthusiasm for innovation to conflict with its consumer protection statutory objective. Emma Khoo and Usman Wahid ask - how will this tension pan out? »

### The FCA – championing new FinTech frontiers...?

The FCA prides itself on being simultaneously a proponent and regulator of the UK's FinTech sector, a more business friendly combination when compared to other jurisdictions' regulators.

Pursuant to the FCA's statutory mandate to promote competition in financial services, it launched Project Innovate in October 2014, an initiative to foster innovation in financial services aligned with that objective. The result has been an open dialogue with FinTech businesses in order to remove regulatory barriers to innovation where necessary. The FCA's regulatory 'sandbox' is a good example of this engagement. It's a virtual 'safe space' which allows companies to test their products and services in a regulatory-light, but live, environment. The FCA's objective is to both improve time to market, and reduce regulatory uncertainty for early-stage companies that wish to test novel business propositions.

The FCA has also been closely involved with HM Treasury and the Department of International Trade, in establishing 'FinTech Bridges' with overseas jurisdictions (so far, Singapore, the Republic of Korea, Australia, China and most recently, Hong Kong). These bridge arrangements are intended to help UK FinTechs expand internationally. Co-operation arrangements between the FCA and overseas regulators in Australia, China, Singapore or the Republic of Korea contain cross-referral provisions to help promote innovation and reduce barriers to entry for FinTech firms doing business with, and from, these jurisdictions.

The FinTech Bridges initiative also enables the FCA to share information with, and learn from, equivalent regulators about market trends in financial innovation and regulatory issues affecting FinTechs. These global lessons should help balance innovation, regulation and customer trust.

Championing new FinTech
FRONTIERS

Reinforcing boundaries of
REGULATION

**PROJECT INNOVATE**
An initiative to encourage innovation in the interest of consumers and promote competition.

**REGULATORY SANDBOX**
A virtual 'safe space' allowing companies to test their products and services in a regulatory-light, but live, environment.

**BUILDING FINTECH BRIDGES**
Helping UK FinTech firms and investors access different markets – and vice versa. Cross-referral provisions help promote innovation and reduce barriers to entry for firms.

**CALL FOR INPUT ON BIG DATA**
Concerns raised as to how big data is used to justify questionable pricing practices for consumers.

**OCTOBER 2016 MISSION STATEMENT**
The FCA said that it is looking carefully at what level of price discrimination and cross-subsidy it allows in the insurance sector.

**REVIEW OF THE CROWDFUNDING MARKET**
Identified that online portals for financing or refinancing activities pose risks when assessing the creditworthiness of borrowers.

### ... Or reinforcing the boundaries of regulations?

New technology, however, creates new market risk. As much as the FCA wants to support the FinTech sector, at the end of the day, it's still the regulator. In recent reviews and Calls for Inputs, it has highlighted a number of FinTech developments that could create negative consumer outcomes.

In its Call for Input on big data, for example, the FCA noted how big data can help insurance clients. It referenced telematics - used by insurers to help customers manage their risk and therefore reduce costs with 'pay-as-you-behave' premium calculations. However, it is becoming increasingly apparent that big data can also be used by firms to justify questionable pricing practices for consumers. The FCA is particularly interested at present in how firms are using information that they hold about customers' levels of price-sensitivity in the retail markets. In its October 2016 Mission Statement the FCA said that it is looking carefully at what level of price discrimination and cross-subsidy it ought to allow to take place in those markets, in light of its consumer protection statutory objective.

Additionally, as part of the FCA's review of the crowdfunding market, it identified that, whilst crowdfunding can create competitive pressure that benefits investors and borrowers, online portals for financing or refinancing activities can pose risks. For example, the current regulatory regime does not directly address the risk of some firms not being sufficiently clear and fair in their approach to assessing the creditworthiness of borrowers.

### So, what role should FinTech firms assume that the FCA plays?

Some might say that the FCA has carved out an arguably contradictory role for itself as both nurturer and regulator of the UK's FinTech industry.

As the FinTech sector continues to evolve, we predict that FinTech services which enhance consumers' experience of the sector will continue to be fully encouraged by the FCA, so long as they operate under no illusions that the rules apply differently to them than to other regulated firms.

The FCA's Director of Strategy & Competition, Chris Woolard, recently summarised the position very honestly when he said:

"In 'regulator speak': you must have the correct permissions for your regulated activities. In layman's terms: if you hold deposits like a bank then you should not be surprised if we expect you to be regulated like a bank. We want innovation, but we will not compromise on market integrity or consumer protection".

FinTech firms must therefore ensure they are ready for the full gamut of applicable FCA regulation once their time in the sandbox comes to an end.

**Emma Khoo**
Associate, Financial Regulation

**Usman Wahid**
Partner, Commercial

# TICK TOCK


## DID BREXIT STOP THE GDPR CLOCK?

In short, no. Brexit won't be saving anyone from the GDPR. Ian De Freitas, Tamara Quinn and Jamie Drucker outline three key reasons why firms are still pursuing the privacy 'gold standard'.





### A momentary pause

Prior to the vote for Brexit, many organisations were gearing up for the impending changes to EU data protection and privacy laws. This radical reform is being brought in mainly through the General Data Protection Regulation (GDPR), due to take effect from May 2018. In practical terms, it means that organisations have to take much greater care with individuals' personal data, with the EU representing a global gold standard in this respect. And the regime has real teeth with fines of up to 4% of group turnover for breaches.

However, after the Brexit vote, a lot of companies took a pause for breath and questioned whether the UK leaving the EU means that they can ignore GDPR. After reflection and some further developments, in our experience nearly all such organisations are now continuing down the path to compliance. Why is that?

1. **GDPR will happen**
   With the Article 50 notice to leave the EU likely to be served in March 2017, the two year negotiating period takes us to the early part of 2019. GDPR will have been in place for nearly a year by then (and remember it is a Regulation which needs no substantive UK enabling legislation). So we will all have to comply, at least for some time. Then, given that this is the position, it seems unlikely that there will be a push for another reform - other EU legislation (saved in the Great Repeal Bill announced by Theresa May) is likely to take precedence.

2. **+500m individuals will be off-limits**
   GDPR has wide territorial effect. It has a 'pay to play' approach – if businesses want to target individuals based in the EU then they have to play by EU rules on the individuals' data. So UK organisations with reasonably substantial business in the EU will have to comply (much like the Americans for example). The rest of the EU is also likely to require compliance with GDPR to allow sharing of data between the UK and EU (again, much like the transatlantic data sharing arrangements).

3. **Reputations will be at risk**
   If UK organisations do not adopt the EU's 'gold standard' they might find themselves at a competitive disadvantage with increasingly pro-privacy consumers.

All of this means that you cannot ignore GDPR. The clock continues to tick down to 25 May 2018, and if you have not started to prepare, it's getting quite late.

> "It (GDPR) has a 'pay to play' approach – if businesses want to target individuals based in the EU then they have to play by EU rules."

**Ian De Freitas**
Partner,
Intellectual
Property
and Data

**Tamara Quinn**
Consultant,
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**Jamie Drucker**
Associate,
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# Supervision

# REGULATORY SPOTLIGHT ON CORPORATE GOVERNANCE

## UNDERSTANDING THE REGULATORS' EVOLVING EXPECTATIONS

Corporate governance has become a regulatory issue at the top of the regulators' priorities list. Adam Bogdanor and Polly James discuss the regulators' expectations, and some steps you can take to help you to meet them. »

**Recognising the regulatory overlay**

For most businesses, corporate governance means directors' company law duties and the Corporate Governance Code. For financial institutions, though, corporate governance is increasingly subject to an important regulatory overlay, as the PRA and FCA join the dots between good board governance and proper risk management in firms. Recognising corporate governance as a regulatory issue is therefore key to being able to understand, assess and manage your regulatory risks effectively.

You wouldn't get this message from studying the PRA and FCA's published enforcement cases: only one individual has so far been disciplined by the FCA purely for corporate governance failings in his firm. However, firms have been publicly censured for corporate governance failings, including in situations where a particular transaction was not questioned. Rigorous scrutiny and challenge of firms' executive management (including from non-executives, Chief Actuaries or Chief Risk Officers), proper board procedures and effective documentation are all vital.

**SMCR as catalyst for the regulatory overlay**

The introduction of the Senior Managers and Certification Regime (SMCR) for banks and PRA-authorised investment firms in 2016 has triggered a renewed regulatory focus upon what good corporate governance looks like in practice. The SMCR's requirements to have Management Responsibilities Maps (MRMs) and Statements of Responsibilities (SoRs) for SMF holders have caused headaches for regulators and regulated alike, followed by a widespread realisation that formalising corporate governance arrangements and management structures actually brings benefits to risk management overall. The PRA's recent consultation paper on 'amendments and optimisations' to the SMCR explains that the PRA expects firms to incorporate MRMs into their business as usual risk management activities:

'SoRs and MRMs should not be regarded simply as regulatory returns but should be seen as valuable components of a firm's internal corporate governance documentation and processes… the PRA expects SoRs and MRMs to be used by firms to aid the clarification, documentation, embedding and review of their internal corporate governance arrangements.'

**The $64,000 governance question**

The PRA continues to be focused upon the vexed area of how far the boards of subsidiary companies that it regulates are able to govern them properly in compliance with UK law and regulation, when there is significant shareholder representation on the subsidiary board. The PRA stated in a recent Supervisory Statement that, although it recognises the fiduciary duty of directors of subsidiaries to promote the success of the company for the benefit of its shareholders, nevertheless such directors "must be capable of acting in the best interests and safeguarding the safety and soundness of the firm for which they are responsible". This matches the legal requirement that directors exercise independent judgement to promote the success of the company, not the group or the shareholder(s). This is a circle which can be very difficult to square in practice.

> Recognising corporate governance as a regulatory issue is key to being able to understand, assess and manage your regulatory risks effectively.

**What can firms and SMFs do to prepare for regulators' questions in this area?**

1. Revisit your SoRs and MRMs, in light of how delegation and oversight has been conducted in practice since the regime began. Many firms met the March 2016 deadline for filing initial SoRs and MRMs, but have paid much less attention to the obligation to keep SoRs and MRMs up to date after filing the initial returns. This is not an administrative matter - it has a real impact for the regulatory accountability of the individuals involved, as well as upon the firm's compliance with its regulatory duties. Firms should build in periodic review of their SoRs and MRMs to ensure that they reflect what happens on the ground, and that they allocate prescribed responsibilities to align with the way the reporting lines actually work.

2. Carry out, or commission, an internal review of the effectiveness of your corporate governance arrangements to ensure they are meeting the PRA's requirements (see the PRA Rulebook at General Organisational Requirements 5.1). This review should focus in particular on the adequacy of management information, data and risk assurance provided to the board and its committees, as this is a particular focus area in both PRA- and FCA-commissioned s166 governance reviews.

3. Educate parent companies and non-executive directors about this renewed regulatory focus on effective corporate governance, and in particular the emphasis from the regulators on effective corporate governance at the level of the subsidiary board. Consider providing a gentle reminder, perhaps as a refresher briefing, to directors of the subsidiary board who are performing the SMF7 role (Group Entity Senior Manager), emphasising the importance of their personal regulatory duties as SMF holders.

4. Look back over board and committee minutes: if you were the PRA or FCA, would they give you a sufficient understanding of what was discussed, including what challenges were raised in relation to important risk management issues and what alternatives and counter-arguments were considered? If not, for example if the minutes contain too much boilerplate drafting or imply rubber-stamping of decisions previously made, firms run the risk of the standard of their corporate governance arrangements being questioned or challenged by the regulators.

**Adam Bogdanor**
Partner, Corporate Finance

**Polly James**
Partner, Financial Regulation

THE FCA'S COMPETITION POWERS:

# IS YOUR FIRM PREPARED TO BE ON THE RECEIVING END?

Competition compliance programmes must take account of the FCA's rules for mandatory self-reporting of existing or potential competition law infringements. James Marshall and Marieke Datema take a look at the powerful toolkit at the FCA's disposal and explain what it means for firms in the year ahead.





### A heavy use of market studies

Since acquiring a competition mandate in April 2013, the FCA has conducted several market studies. These allow the regulator to 'peer behind the curtain' in any given market to identify structural competition, consumer or market integrity concerns. In just over three years, the FCA reviewed insurance add-ons, cash savings, credit cards, retirement income, investment and corporate banking and asset management.

The FCA has a uniquely powerful toolkit; it can use either sectoral (Financial Services and Markets Act 2000 (FSMA)) or competition (Enterprise Act 2002) powers to conduct market reviews.

To date, all FCA market studies, including those launched after the FCA acquired concurrent competition law enforcement powers in April 2015, have been carried out using FSMA powers, rather than pure competition powers under the Enterprise Act. The FCA chooses the most appropriate power on a case-by-case basis. In practice, the FCA enjoys the 'best of both worlds', in that it can pursue competition-focused investigations using extensive data-gathering powers under FSMA without being bound by tight timetables under the Enterprise Act.

If, following a market study, the FCA concludes that a market is not functioning well, it may seek regulatory changes to fix the issues identified. Potential remedies include structural reforms (e.g. rule-making, guidance and/or proposing enhanced self-regulation), or firm-specific changes (e.g. varying regulatory permissions, public censure and/or financial penalties). The FCA can also 'name and shame' firms by publishing data - one of the remedies imposed in the cash savings market study, for example, was the publication of interest rates made available by over 30 banks and building societies on certain types of savings accounts and ISAs. The FCA furthermore has the power to refer a market to the Competition and Markets Authority (CMA) for a detailed 'phase 2' market investigation, the outcome of which could include forced divestments or other major interventions.

### Zeroing-in on individual firms – 'hard' and 'soft' enforcement measures

Investigations of individual firms are common outcomes of market studies in other sectors. Early in 2016, the FCA launched its first antitrust investigation. Details of the behaviour and the firms under investigation remain confidential. While the FCA has noted some disappointment that it has not carried out more individual cases to date, we anticipate an uptick in antitrust investigations in 2017.

Despite little 'hard' antitrust enforcement, the FCA has been astute in its use of 'soft' enforcement methods, such as so-called 'on notice' letters. These letters notify a firm that the FCA has information about a suspected breach of competition law. As outlined in Andrew's and Sarah's article, '*FCA's new enforcement tool – 'On notice' letters explained*' on page 20, the firm must conduct an internal review and report back to the FCA on the scale of any competition breach identified, and what measures the firm will take to address the problem. This transfers the burden of investigating and remedying competition problems to individual firms, freeing-up FCA resources.

The FCA has also sent three 'advisory' letters – intended to raise competition law awareness and promote compliance amongst targeted firms.

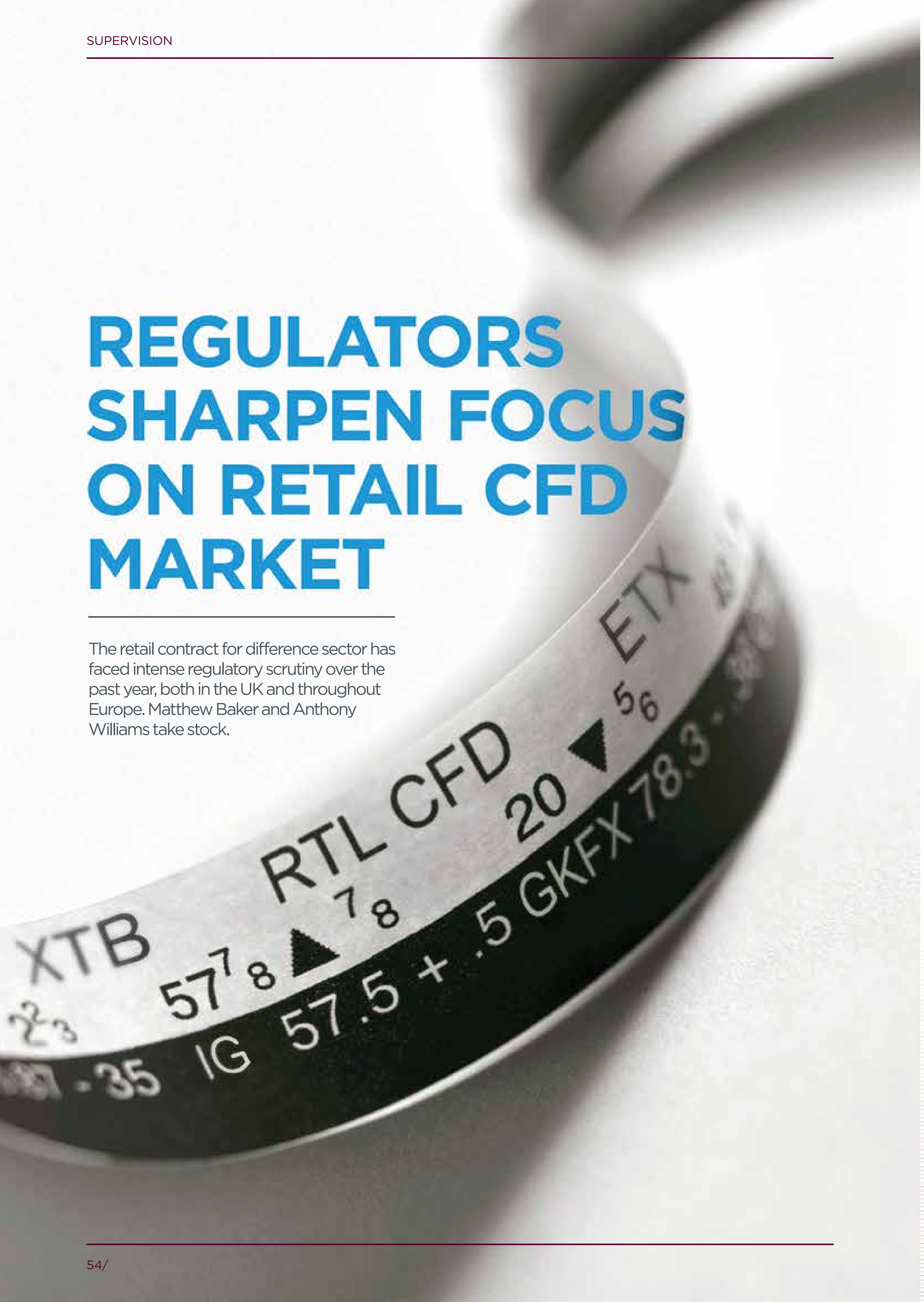
### Self-reporting competition issues – a significant question

Both market studies and 'on notice' letters can place considerable burdens on individual firms to provide evidence in response to an FCA information request. Responding to such requests can also cause firms to 'flush out' potential issues which may require self-notification under the FCA Handbook. SUP 15.3.32R (1) requires firms to notify the FCA of any significant infringement (or potential infringement) of any applicable competition law. The reference to 'any applicable competition law' means that the notification obligation extends to infringements of competition law outside the UK. Despite the extensive scope of the notification obligation, only limited guidance has been provided by the FCA, in particular in relation to how firms can determine whether an infringement is 'significant'.

The position adopted by the FCA is in stark contrast to the standard application of competition law. Leniency programmes generally provide that companies can choose whether or not to self-report competition infringements and there are, in many cases, incentives for companies to do so. If the relevant conduct identified by a firm is sufficiently serious, the FCA's mandatory self-reporting obligation can effectively force a firm to apply for leniency. Moreover, the same conduct could prove problematic under both the FCA's conduct rules and competition law. It is therefore more important than ever that regulated firms bring their competition compliance programmes in line with the self-reporting obligation and ensure that the wider implications of any notifications to the FCA are fully assessed.


James Marshall
Partner, Antitrust & Competition

Marieke Datema
Consultant, Antitrust & Competition




# REGULATORS SHARPEN FOCUS ON RETAIL CFD MARKET

The retail contract for difference sector has faced intense regulatory scrutiny over the past year, both in the UK and throughout Europe. Matthew Baker and Anthony Williams take stock.





In December 2016, the FCA announced proposals for strict rules on providers of contract for differences (CFDs) and binary options to retail customers. Following publication of a 'Dear CEO' letter in February 2016 reminding firms to look closely at their on-boarding procedures, the FCA had already been conducting close supervisory work with the industry throughout the year. But the UK regulator gave no forewarning of the proposed measures, which caught the markets by surprise.

Although the FCA's proposals were unanticipated (at least in terms of their extent and timing), they are but the latest in a series of regulatory interventions across Europe over the past year. This wave of regulatory action has arisen from regulators' concerns that inexperienced retail customers are trading without fully understanding the risks involved.

### Attention from ESMA

In April 2016, the European Securities and Markets Authority (ESMA) published an extensive set of Q&As dedicated to the retail CFD industry, designed to promote common supervisory approaches among EU member states. The Q&As were reissued in expanded format three times during the course of the year.

In July 2016, ESMA also issued a warning about CFDs, binary options and other speculative products. The warning noted an increase in the offering of these products to retail clients, together with a surge in the number of complaints from investors suffering significant losses.

### European regulators react

In the second half of the year, regulators in Belgium, France, the Netherlands and Germany each separately announced measures to restrict the promotion or distribution of CFDs to retail clients by electronic trading providers.

In November 2016, CySEC, the Cypriot regulator, introduced its own restrictions, which include a 50:1 cap on the default leverage offered to retail clients. CySEC's measures are of particular note as Cyprus is where many EU operators are authorised.

### FCA follows suit

The FCA now proposes to apply its own, stricter, leverage limits, which will depend on the volatility of the underlying asset and the experience of the client. The FCA also plans to introduce standardised risk warnings and profit/loss disclosures, together with a ban on bonus promotions. Respondents have until 7 March 2017 to provide feedback on the proposals.

Along with implementing MiFID II and the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation, unfortunately 2017 is therefore looking like it will be another compliance-heavy year for CFD providers.

### Setting a dangerous precedent

While this year's events have generally shown a more proactive approach to the sector by regulators throughout Europe, the divergent nature and severity of the various measures announced reveal a frustrating lack of coordination between different national supervisors.

Different requirements on firms in different jurisdictions will cause huge compliance costs and burdens on firms operating across the EEA under MiFID passports, as well as potentially damaging efforts to create a single rulebook. Such inconsistencies risk creating an un-level playing field and huge amounts of confusion for both clients and firms.

At a wider level, this sets a dangerous precedent for the wider financial services industry. Under MiFID II, national supervisors will gain much broader powers for product intervention. Clearly, these are powers that regulators are not afraid to use. We may have to get used to a world where product bans are a conventional part of the regulatory toolkit for national supervisors across Europe.

**Matthew Baker**
Partner,
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Management

**Anthony Williams**
Associate,
Financial
Regulation

# MARKETS




In the increasingly likely event that the UK does not retain its access rights to the single market, one of the options available to insurers is a Part VII transfer of existing European risks to a European carrier. However, it may not be a silver bullet. Geraldine Quirk, the leading practitioner in Part VII transfers, answers your key questions.

### What is a Part VII transfer?

It is a court sanctioned transfer of the whole or part of an insurer's business to another insurer.

In the context of Brexit, it allows the transfer of business from the UK to an EU entity with access to the single market. This may be necessary if UK insurers are not able, post-Brexit, to run-off existing EU risks without authorisation in the relevant EU states.

### Why use a Part VII transfer?

The process is an extremely useful tool allowing for an all-encompassing transfer of assets and liabilities – unlike procedures applying elsewhere in Europe, it is possible to transfer outwards reinsurance protections and any other ancillary contracts and liabilities.

### What's the catch?

The process requires significant engagement with the PRA and FCA. While in the past a realistic timetable for a transfer was 9 to 12 months, the process is now taking 18 to 24 months, due to the increasingly granular regulatory scrutiny. It is not clear what has motivated this change – there does not appear to have been any problem with a Part VII transfer that requires fixing.

Given the two year timescale for exiting the EU once Article 50 is triggered, it may not be possible to complete a transfer before Brexit occurs, particularly given the potential for a large number of transactions requiring PRA and FCA buy-in within that period.

**Geraldine Quirk**
Partner, Corporate Insurance / Corporate Finance

### What are the alternatives?

There are other alternatives to a Part VII transfer for moving existing business into the EU, including creating an SE or merging UK operations into an EEA group company. A merger would have to be accompanied by a Part VII transfer, because the process is obligatory when transferring insurance business from one entity to another - so this is not a solution to the timing issue.

An SE, on the other hand, can be picked up and moved in its entirety to another EU state, without a transfer of business to another entity taking place. An SE created by converting a UK insurer (only possible where it has had a subsidiary in another EEA state for two years) or by merging another EU company into the UK insurer (rather than the other way around) would avoid the need for a Part VII. There does not appear to be any reason why an EU company could not be set up expressly for this purpose.

The newly created SE would have to apply for authorisation in the EEA state it intends to relocate to – but it should be possible to complete the entire process (including creation of the SE) in a shorter timeframe than a Part VII would need.

### What should I do now?

→ **DO get in early!**
Although it may not be clear for some time whether insurers will retain the single passport for existing business, given the timescales involved in moving business into the EEA, it makes sense to start planning for the process now.

→ **DO get on the good side of the regulators**
If a Part VII is the preferred approach, early engagement with the UK regulators will be key. The PRA and the FCA have a significant role in the process and the Court application cannot go ahead without certain approvals from them.

Similarly, if the plan is to create an SE and relocate to another EU state, early engagement with local regulators is key. Establishing their expectations and timescale for the process of authorising the SE will be critical to the success of the project.

In either case, co-operation is key!

# GENDER PAY GAP REPORTING: NARROW THE GAP OR BE NAMED AND SHAMED

Gender pay gap reporting will soon be compulsory for large employers, with the government publishing league tables and highlighting those that don't comply. Rebecca Harding-Hill and Adam Turner discuss the potential implications, as well as the steps you should be taking to manage the risks.

Larger employers will soon be forced to publish their workforce gender pay gaps – that is, the difference in average earnings between men and women – under new legislation due to come into force in April 2017. The financial services sector is at a disadvantage in this area, with a 39.5% pay gap that is more than double the national average. The government has suggested it may name and shame bad employers.

How you comply with the new reporting obligations will be key to managing your reputational, litigation and employee relations risks. Do your gender pay gap statistics evidence discriminatory pay practices? How out of kilter is your firm with your competitors and the wider sector? What steps are you taking to close any pay gaps?

### What causes gender pay gaps?

A firm's gender pay gap indicates that women are not achieving their full workplace potential. There are many potential factors causing this, such as fewer women being appointed to senior roles, women taking time out to have a family, and women being more likely to work in lower paid part-time roles.

### Does a gender pay gap mean I have discriminatory pay practices?

Not necessarily. The gender pay gap and equal pay are often confused. Equal pay law requires men and women to be paid the same amount if they do the same or comparable work. This is different to the gender pay gap, which can be caused by many factors, such as those mentioned above. Whilst discriminatory pay practices can contribute to a gender pay gap, an employer with no discriminatory pay practices can still have a large pay gap.

### What steps should I consider taking now to manage my pay gap risks?

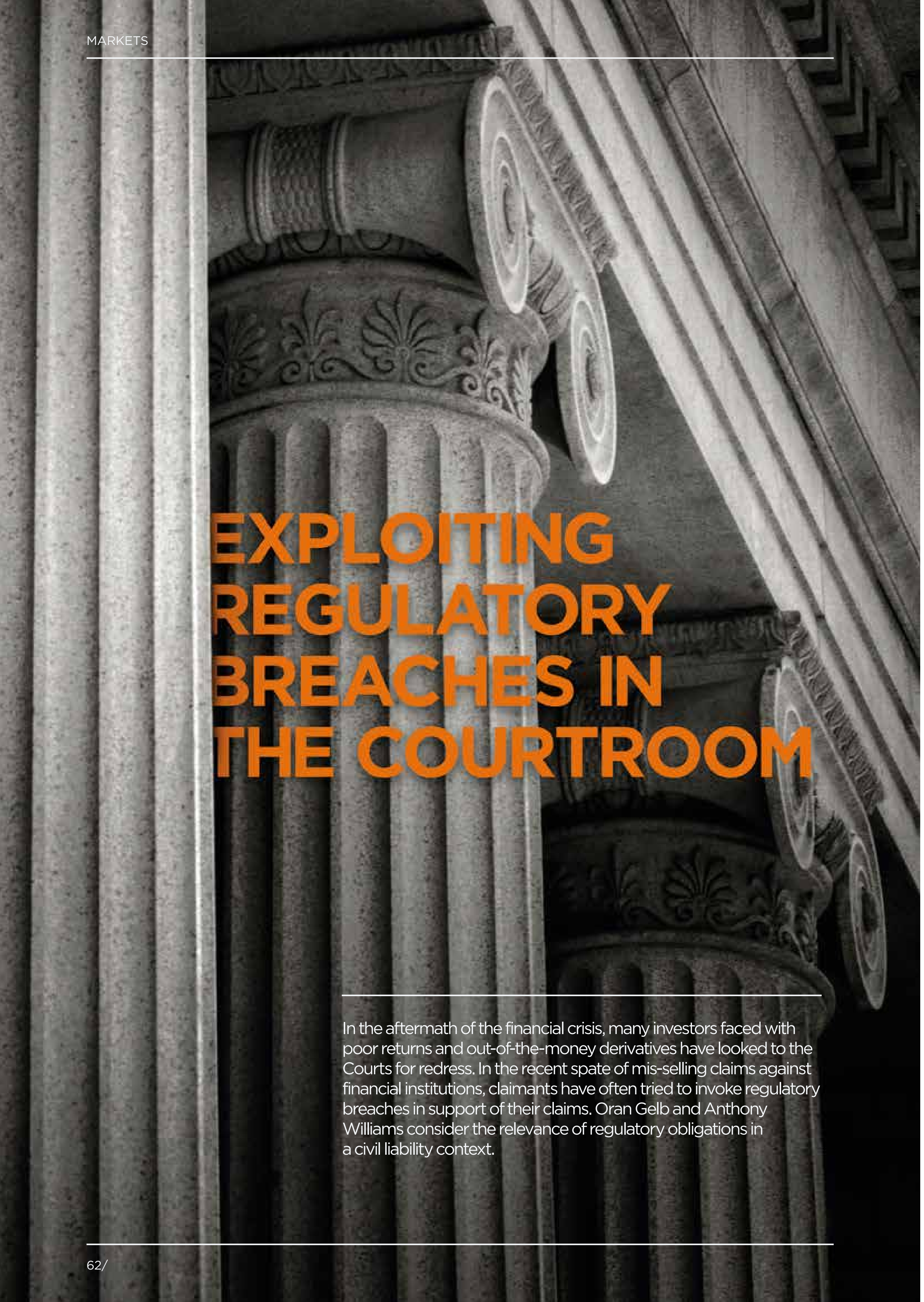
The new legislation requires you to publish various pay gap metrics. The legislative aim is to encourage employers to take steps to narrow their pay gaps. With this in mind, you should consider:

- collecting and reviewing your pay data now, to identify pay gaps and the underlying causes;
- identifying and implementing remedial steps to reduce any identified pay gaps; and
- adding context to the baseline pay gap report that the law requires firms to publish, by including a richer data analysis and a narrative to help explain your circumstances and the steps you are taking.

> “The financial services sector is at a disadvantage in this area, with a 39.5% pay gap that is more than double the national average.”

**Rebecca Harding-Hill**
Partner,
Employment

**Adam Turner**
Associate
Director,
Employment



# EXPLOITING REGULATORY BREACHES IN THE COURTROOM

In the aftermath of the financial crisis, many investors faced with poor returns and out-of-the-money derivatives have looked to the Courts for redress. In the recent spate of mis-selling claims against financial institutions, claimants have often tried to invoke regulatory breaches in support of their claims. Oran Gelb and Anthony Williams consider the relevance of regulatory obligations in a civil liability context.

## Corporate claimants and the private person test

A breach of a regulatory rule is not in itself a cause of action, save for a limited group of claimants. Section 138D of FSMA provides a statutory route for a 'private person' to bring an action for damages against an authorised firm which has contravened specified regulatory rules. Under the FSMA 2000 (Rights of Action) Regulations 2001, a company cannot be a private person if it suffers the loss in the course of 'carrying on business of any kind'. Courts have applied the test restrictively against corporate claimants; a company will not be a private person even if the transaction in question is entirely incidental to its main business. The Court of Appeal gave a claimant permission to appeal the point in 2015 (*MTR Bailey Trading v Barclays*), but the case was settled before any appeal hearing.

A non-private person will need to fall back on their common law rights. Absent any breach of contract, their first hurdle will be to establish that a duty of care was owed by the firm.

Such a duty typically arises in two scenarios:

1. Where a firm has provided information, it will have a duty to ensure that such information is both accurate and fit for the purpose for which it was provided.

2. Where a firm has a contractual obligation to advise, or has in fact provided advice for which it assumed responsibility, it will have a duty to ensure that such advice is suitable.

The range of obligations owed under COBS goes well beyond these two scenarios. For example, the common law does not generally impose any obligation on a firm to advise its customer (see most recently *Finch v Lloyds TSB* [2016]), or to provide information in the first place (save where its omission would be misleading), but merely a duty to take reasonable care in respect of any information or advice that is provided. Conversely, COBS imposes a range of information and advisory obligations on firms. COBS also contains rules about process, whereas the common law is only concerned about the substantive question of what information or advice is provided. These differences are unsurprising; financial regulation is interventionist by nature and exists to protect customers, whereas the common law upholds commercial bargains and generally allows firms to prioritise their own interests when selling to customers.

## Regulatory obligations and the standard of care

Once a common law duty of care has been established, the regulatory rules may then assume more significance. In particular, they may inform the standard of care required to comply with that duty. Judges have been persuaded by the simple notion that a firm acting with due skill and care when giving advice will usually adhere to its regulatory obligations (*Loosemore v Financial Concepts* [2001]). This is particularly true for many of the core COBS obligations (e.g. ensuring suitability, identifying risks etc.). However, the Courts have been wary of treating the regulatory rules and the requisite standard of care as one and the same. In *Anderson v Openwork* [2015], the Court indicated that the regulatory regime is the starting point in considering the standard of care to be applied, but is not definitive. It does not therefore follow that a breach of a regulatory obligation, no matter how inconsequential, will necessarily give rise to a breach of a pre-existing duty of care. The High Court took a similar line in *O'Hare v Coutts & Co* [2016], affirming that the regulatory regime is 'strong evidence of what the common law requires', but remarking that 'failures of process do not matter unless they lead to a failure of substance'. In addition, even where a regulatory obligation has been breached and is within the scope of a duty of care, the claimant will still face the usual hurdle of causation.

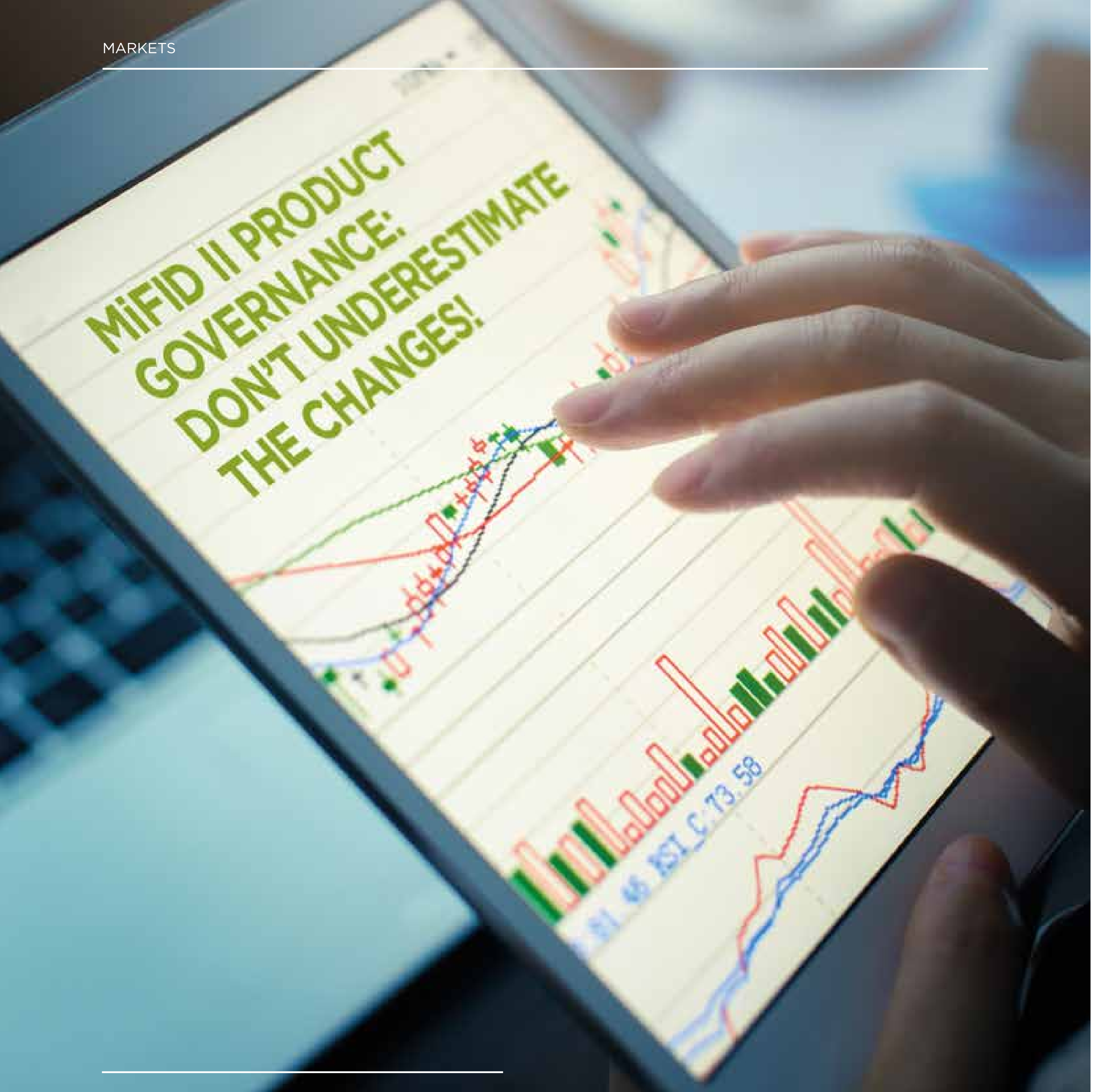
## Contractual protection

Firms are often protected from civil liability by their contractual terms. Although firms cannot 'contract out' of their obligations in a regulatory context (see e.g. COBS 2.1.2), the Courts have been very willing to uphold broad contractual disclaimers irrespective of any regulatory failures. In *Crestsign v NatWest and RBS* [2014] the Court permitted a basis clause to define the firm's relationship with its customer as non-advisory, even though the bank was found to have given negligent advice. In the world of civil litigation, well-drafted terms of business will always be a firm's trump card.

**Anthony Williams**
Associate, Financial Regulation

**Oran Gelb**
Partner, Financial Regulation

> "In the world of civil litigation, well-drafted terms of business will always be a firm's trump card"




MiFID II is set to go live in under a year. Matthew Baker and Nileena Premchand argue that firms need to look much more carefully at product launches and ongoing monitoring.

With an implementation date of 3 January 2018, a key priority for firms in 2017 will be getting ready for Markets in Financial Instruments Directive II (MiFID II). Firms will need to undertake wide-ranging changes: to policies and procedures; client documentation; reporting mechanisms; and even governance structures. These changes are likely to reach into many areas of the business and require a combined effort across different teams to meet the deadline.

### Target market identification

An area of particular relevance will be the changes that MiFID II is bringing to product design and governance. Firms who deal with retail customers, or who are involved in the design or distribution of products or services with an ultimate retail customer target market, will already be used to the FCA's expectations in meeting Treating Customers Fairly (TCF) obligations and communicating in a way that is clear, fair and not misleading. However, MiFID II is bringing in far-reaching changes and enhancements to these duties. Under MiFID II, firms that design securities for sale will need to consider carefully the target market and ensure that senior management have sign-off on the launch of the product.





Distributors will also need to identify their target market and monitor sales to ensure that securities are not inadvertently sold to the wrong customers. But perhaps the most significant element of these changes is their scope: product governance requirements will apply to the launch of all securities, including shares and bonds - not just funds or structured investment products. Furthermore, they will apply not only to investments sold to retail customers, but also those intended to be sold to professional clients.

This is likely to mean that many firms will be in scope for the first time and face having to build product governance processes from scratch. In October 2016, the European Securities and Markets Authority (ESMA) issued a consultation on proposed guidelines that will tell firms what they need to consider when identifying the target market of end-users for the products that they are designing or distributing. The guidelines set out six factors that firms must consider, require the identification of a 'negative market' of people who should not buy the product, and make it clear that there are only very limited grand-fathering provisions (meaning that even securities issued prior to 3 January 2018 will be subject to the annual review).

### Adapting processes and procedures

In addition, MiFID II imposes many broader obligations on product governance including:

1. Requiring senior management to have control over the product governance process.
2. Ensuring that the compliance function has proper oversight of that process.
3. Obliging firms to consider conflicts of interest and alignment with remuneration practices when manufacturing securities.
4. Undertaking regular review of the products they have manufactured.
5. Conducting 'scenario testing'.

These obligations are likely to lead firms to have much more documented product approval processes, as well as necessitating greater exchanges of information between manufacturers and distributors.

### Packaged investment products: PRIIPs obligations

Finally, firms involved in the sale of packaged investment products to retail customers (including funds, structured investment products and insurance-based investment products), will also need to factor in the pre-contractual disclosure obligations under the packaged retail and insurance-based investment products (PRIIPs) regulation. The good news is that the implementation date for PRIIPs has been pushed back to be in line with MiFID II in January 2018. This is much more practicable for firms than the originally intended date of 31 December 2016. Nonetheless, impacted firms should not lose sight of this additional burden when undertaking their MiFID II preparations.

### What should firms be doing now?

The FCA included its proposals for implementing the product governance requirements in its third MiFID II Consultation Paper (CP16/29). As with other aspects of its MiFID II implementation, the FCA has made clear that similar processes will be expected of third country firms operating through UK licensed branches and for non-MiFID business. The FCA proposes creating a new dedicated sourcebook called the Product Intervention and Product Governance Sourcebook (PROD) setting out the new product governance requirements.

Although the implementation deadline is 12-months away, firms should be:

→ Carefully considering the requirements (particularly the ESMA guidelines), especially if you fall in scope for the first time.

→ Reviewing project design processes to ensure they can accommodate the required sign-off and consideration processes.

→ Reviewing processes for capturing information and interacting with other relevant parties - how will this impact other areas of the business, considering the FCA's third consultation on MiFID II implementation which covers conduct of business and product governance matters?

These changes could result in a considerable workload, particularly for firms that only deal with professional clients, or in shares and bonds without funds. By taking steps to prepare now, you will reduce the risk of significant delays for new product launches, once the implementation date has passed.

**Matthew Baker**
Partner, Investment Management

**Nileena Premchand**
Associate, Investment Management

# THE TWO-PRONGED EFFECT OF MiFID II AND MAR:

## FEW FINANCIAL MARKETS FIRMS WILL REMAIN UNSCATHED

MiFID II and MAR were prepared in tandem with the aim of improving confidence in the integrity of the financial markets. MiFID II's seismic changes take effect on 3 January 2018, and will activate delayed provisions in MAR. Sara Evans considers the significant challenges ahead for the firms that will need to meet MiFIR's strengthened transaction reporting requirements.

### MiFID II and MAR go hand in hand

The MiFID II package significantly extends the reach of financial services regulation in Europe, in a legislative overhaul that dwarfs the ambitions of the original MiFID. The package comprises the following:

- a directive repealing and recasting the original MiFID (the 'MiFID II Directive'); and
- a regulation specifying the rules and guidelines on execution venues, transaction execution, transaction reporting as well as pre- and post-trade transparency ('MiFIR').

The Market Abuse Regulation ('MAR'), which sits alongside MiFID II, is a comprehensive and directly applicable overhaul of the original Market Abuse Directive.

**Sara Evans**
Knowledge Development Lawyer, Financial Regulation

MAR and MiFID II are drafted to interact with one another despite their differing transposition dates, meaning that, although MAR has been in effect since July 2016, some of its provisions will not be switched on until 3 January 2018, which is the transposition date of MiFID II. As a result, on this date the range of financial instruments and venues covered by MAR will be expanded significantly.

### Transaction reports under MiFIR

Obliging firms to submit transaction reports enables the FCA to engage in effective conduct of business supervision, to share information with other regulators and to detect (and subsequently investigate) potential market abuse.

It is important to note that such transaction reports are distinct from suspicious transaction or order reports ('STORs') which firms use to report suspected market abuse to the FCA. Such transaction reports are also distinct from pre- and post-trade transparency reports, which are disseminated to the market (and therefore become publicly available).

MiFIR will considerably expand the data set that will need to be submitted to the regulators, with almost triple the number of fields firms are currently required to submit under the FCA's transaction reporting rules in Chapter 17 of the Supervision Manual (SUP 17).

### How MAR and MiFID II interact

MAR and MiFID II combine to both enhance the availability of regulatory information and impose sanctions for abuse. MAR's scope has the same reach as that of MiFID II, and it provides both the obligation to provide STORs and the civil penalty regime for abusive behaviour picked up by regulators. MiFIR's transaction reporting requirements will allow MAR's provisions to operate fully, by ensuring that a much wider range of transactions are rendered visible to the FCA and other competent authorities.

### What transactions will be reportable?

Current SUP 17 requirements apply to transactions involving any instrument that is admitted to trading on a regulated market, or on a prescribed market, and for transactions in OTC derivatives referenced to an instrument admitted to trading on a regulated market or a prescribed market. The exception is for transactions in commodity, interest rate and foreign-exchange OTC/listed derivatives, which are not reportable.

MiFIR will extend the reporting requirements to all those transactions executed on Multilateral Trading Facilities (MTFs) and Organised Trading Facilities (OTFs). Significantly, this expands reporting requirements into non-equities, affecting many bonds and derivatives that are not exchange traded.

### How will firms cope with the new requirements?

While MiFIR raises the stakes, firms have not coped particularly well with the existing, simpler, transaction reporting regime. In the last five years, the FCA has imposed fines in excess of £24 million for transaction reporting failures. In Market Watch 50, the FCA complained of poor quality reports and felt it necessary to remind firms of their obligations, stating that 'the ability of firms to submit accurate and complete transaction reports is essential if they are to be in a strong position to meet the more complex requirements of MiFID II and MiFIR'.

ESMA recently published guidelines that should go some way in helping firms get to grips with the new data fields they must report.

## OUR TOP FIVE TIPS FOR ENSURING A SMOOTH TRANSITION:

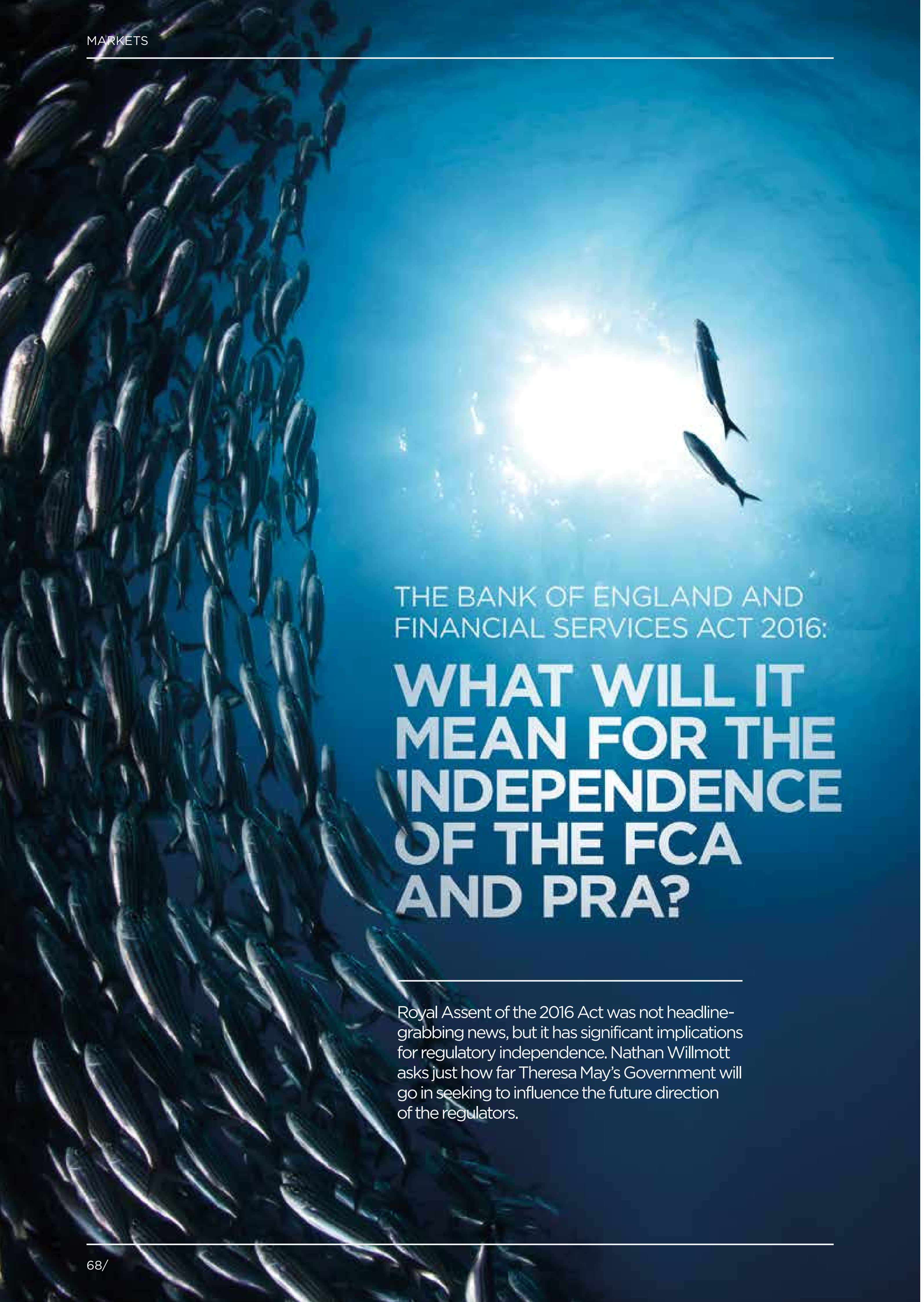
1. Don't underestimate the complexity of MiFIR's requirements. Ensure you have a clear picture of how MiFIR brings brand new obligations.

2. Avoid a provider bottleneck. Some firms may consider outsourcing their transaction reporting in order to avoid significant IT and systems spend. Finalise arrangements with any third party providers as far in advance of MiFID II implementation as possible. Buy side firms should consider carefully whether they can take advantage of MiFIR's new 'transmitting firm' exclusion that would enable them to continue to use sell side brokers to report on their behalf.

3. Look carefully at the scope of instruments covered. Instruments typically traded OTC, such as bonds and derivatives, will be likely to be reportable instruments. Especially in relation to derivatives, equivalent reporting obligations are likely to exist under the European Market Infrastructure Regulation (EMIR).

4. Consider ESMA's guidelines and identify transaction scenarios that map to your business model. ESMA also proposes to maintain a publicly accessible list of all reportable instruments within a new Financial Instrument Reference Data (FIRD) system.

5. Where the firm is, or will be, transaction reporting through an Approved Reporting Mechanism (ARM), ensure that the terms of the agreement between the firm and the ARM enable the firm to meet its transaction reporting obligations.



THE BANK OF ENGLAND AND FINANCIAL SERVICES ACT 2016:

# WHAT WILL IT MEAN FOR THE INDEPENDENCE OF THE FCA AND PRA?

Royal Assent of the 2016 Act was not headline-grabbing news, but it has significant implications for regulatory independence. Nathan Willmott asks just how far Theresa May's Government will go in seeking to influence the future direction of the regulators.

### Government and regulators – what's the relationship status?

In last year's publication we highlighted a shift in the dynamic between the UK regulators and central government, with a strong sense that the government was keen to lean on the PRA and FCA to adopt a more business-friendly approach to exercising its supervisory and enforcement activities.

This approach of the regulators was something that the Treasury purposefully rejected in 2012 when the 'twin peaks' structure was devised, determining that the independence of the newly created UK regulators was paramount and that they should not be distracted by wider considerations. As a result the statutory duty of the discredited Financial Services Authority to have regard to the desirability of maintaining the competitive position of the UK was deleted from the legislation upon the creation of the PRA and FCA.

Yet just a few years later the government is plainly regretting this decision. Even before the EU referendum result - which will no doubt add pressure on the regulators in this area - the Treasury decided that it was quite prepared to undermine the independence of both the PRA and FCA in favour of assuming greater control over how the regulators exercise their powers.

This new governmental control over the approach of the UK financial regulators has been enacted through the Bank of England and Financial Services Act 2016, which received Royal Assent in May last year. These changes have received little coverage in the regulatory press but are potentially very significant for the future approach and areas of focus of the UK regulators.

Under the 2016 Act, the Treasury is given the power at any time to issue 'recommendations' to the PRA and to the FCA on 'aspects of the economic policy of Her Majesty's Government to which the PRA / FCA should have regard' when considering how to act in accordance with their relevant statutory objectives and regulatory principles. The Treasury is required to issue these recommendations to each regulator at least once in each Parliament (i.e. annually), and to make those recommendations public.

Although the language of the legislation is couched in terms of 'recommendations' rather than mandatory requirements, the reality is that when the Treasury issues these remit letters to the PRA and FCA it would be highly unusual if either regulator chose to defy them.

### So, is the government going to 'take back control' over financial regulation?

The Treasury's power to issue these recommendations to the FCA was brought into force in July last year, but at the time of writing no such recommendations have yet been published. The equivalent provision in the 2016 Act in relation to the PRA has not yet been brought into force – it is expected to be implemented at the same time that the PRA becomes subsumed as a Committee of the Bank of England, believed to be some time in the year ahead.

What therefore remains to be seen is how prescriptive and detailed the Treasury intends to be when communicating to the UK regulators as to how they should be carrying out their activities. My expectation is that the initial sets of recommendations will be fairly high level in nature and therefore uncontroversial, but that over time the Treasury will become bolder in the way that it directs the regulators as to how to exercise their powers in specific circumstances.

The more prescriptive the Treasury becomes, the more the independence of the PRA and FCA will be compromised. While many have been unhappy with the aggressive and enforcement-led style of both UK regulators in recent years, most would recognise the more fundamental value of them being able to operate independently and free of governmental control.

At least for the moment it seems that any government pressure that is applied will be in favour of more business-friendly policies, but as ever there remains a risk that in the years ahead the pendulum will swing back the opposite way.

**Nathan Willmott**
Head of Financial Regulation

# CHANGE OF SEASONS AT THE FOS: AN INSIDER'S PERSPECTIVE

With the PPI saga finally coming to an end, what's next for the FOS? Drawing on her experience working as an Adjudicator, Lianna Chan provides some insights into the current restructuring project and how firms can effectively engage with the FOS against a background of change.

## What's going on at the FOS?

The Financial Ombudsman Service (FOS) is currently in the throes of a major restructuring project, which involves two main changes:

1. The convention under which cases were allocated to Adjudicators with specific technical expertise in a particular financial product is being scrapped – all Adjudicators will effectively need to become generalists.
2. Ombudsmen (whose role is to decide on cases where the firm or the complainant does not accept the view put forward by the Adjudicator) will be given responsibility for managing a team of Adjudicators, in addition to servicing their caseloads as Ombudsmen.

## What will this mean for firms?

Although the FOS believes this new structure will help 'answer complaints more quickly' and will make the service 'better and quicker but quality will not be sacrificed', as a former Adjudicator, I have some concerns about this new structure.

In my view, having generalist Adjudicators who do not pursue a particular sector or product specialism is likely to be unhelpful. Financial services is a vast and complex sector, and the FOS already has some issues maintaining consistency across its Adjudicators.

The FOS has also been widely criticised in the past for being too complainant-friendly. I think there is a risk that having generalist Adjudicators is likely to make it more, rather than less, difficult for them to take an objective view of the case and take the firm's perspective into account.

Further, the new management responsibilities for the Ombudsmen are bound to have an impact on the size of the caseloads they are able to maintain.

It is also worth bearing in mind that, in the short term, there is likely to be an impact on Adjudicators' productivity as the structural changes play out.

## How to deal with FOS-eligible complaints effectively against this background

Aside from the structural issues going on at the FOS, remembering how to deal with customer complaints before they get to the FOS is important.

## Before the FOS: Getting the basics right

Do not start on the back foot - make sure that you comply with the basic requirements of complaints handling:

- Acknowledge receipt of the complaint and keep the complainant updated on the progress.
- Issue a final response within 8 weeks of receiving the complaint and make sure you address every issue.
- Enclose a copy of the FOS leaflet, provide the website address of the FOS and inform the complainant of their right to refer the complaint to the FOS.
- Look at the facts in the round - the approach of the FOS is to provide an outcome that is fair and reasonable in all the circumstances. This is a different test to the one that a court of law would apply. The FOS expects firms to look at all of the facts surrounding a complaint, including facts that have not been specifically referred to in the complaint letter itself, in reaching a determination.
- Courtesy - if calls are being recorded, the FOS may request a copy. Being courteous and sympathetic over the phone is often forgotten, but goes a long way to reducing a complainant's distress, and ultimately may reduce the compensation you pay for distress and inconvenience.

## Dealing with the FOS

If a complaint does progress to the FOS, understand that your Adjudicator is not your adversary. If information is being requested, or questions are being asked, it is because the Adjudicator thinks that they need it to decide what has happened.

If you disagree vehemently with an information request, or feel that the Adjudicator is requesting a disproportionate amount of documentation, it can be appropriate to push back. However, do be prompt in responding to any requests and remember professional courtesy.

Bear in mind that your Adjudicator may be handling a case in this particular area for the first time. Do not assume a high degree of existing knowledge on the part of the Adjudicator – provide clear, full explanations of the relevant factual and industry context.

Finally, remember that your Adjudicator will be dealing with a raft of structural changes that they are not familiar with. The courtesy that you show your Adjudicator will be appreciated, perhaps now more than ever.

Lianna Chan
Associate,
Financial
Regulation

# WILL BREXIT STUNT OR AID THE UK'S MARKET ABUSE REGIME?

The UK's vote to leave the EU sets in motion a series of complex adjustments for the UK which will take many years to settle. It is not yet clear what the UK's future relationship with the EU will look like. However, it is clear that, at some point fairly soon, the UK will no longer be required to apply at least some EU legislation. Andrew Tuson and Irene Cummins examine what that means for the future of the market abuse regime.


The civil market abuse regime in the UK is derived from both EU legislation and domestic law, but its most recent growth spurt was entirely EU-driven. The EU Market Abuse Regulation (MAR), which came into force in July 2016 and is directly applicable in the UK, broadened the scope of the previous regime by bringing more markets and products into scope (principally, products traded on multilateral trading facilities or priced by reference to such products).

The scope of markets covered by MAR will broaden further to include products traded on organised trading facilities when the second EU Markets in Financial Instruments Directive (MiFID II) applies from 3 January 2018. At that point, the UK will almost certainly still be subject to EU law, and as such, its market abuse regime will need to broaden.

**Will the UK seek to implement its own bespoke regime once it secedes from the EU?**

The UK certainly has plenty of material to work with, if it wanted to do that. The Fair and Effective Markets Review (FEMR), which provided its initial report in July 2015, proposed numerous changes to the UK's market abuse regime in order to improve conduct in the Fixed Income Currencies and Commodities (FICC) markets. Those recommendations included extending the maximum sentence for criminal market abuse from seven to ten years, widening the scope of criminal sanctions for market abuse for individuals and firms, and creating a new statutory civil and criminal market abuse regime for spot FX. FEMR also called on the senior leadership of FICC market participants to create a new Global FX Code, to provide a comprehensive set of principles to govern trading practices within the FX market. It was envisaged that the Global FX Code would form the basis for an amended statutory civil and criminal market abuse regime for spot FX.

18 months on, work is well underway on the Global FX Code, with the final code expected to be published in May 2017. However, the UK Government has apparently put the implementation of the remainder of FEMR's recommendations on hold, pending determination of the UK's relationship with the EU. This is not surprising given the volume of legislation that the Government will be required to pass in the years immediately following the passage of the Great Repeal Bill on UK's secession from the EU. Any legislation not immediately necessary to disentangle the UK's legal and regulatory framework from the EU's will languish for many years at the back of the legislative queue.

**What can we expect?**

At least in the short term, the UK is likely to need to agree to keep its key financial markets regulatory provisions equivalent to those in the EU, as the basis for any future EU-UK financial services trade deal. The market abuse regime is likely to be viewed by the EU as a key tenet of an equivalent legal and regulatory framework for those purposes.

Therefore, in short, we expect to see the UK's market abuse regime continue to look very much as it would have if the UK were to have voted to remain part of the EU – at least in the short to medium term. This means it is very likely that the UK's market abuse regime will continue to track the development of the EU27 market abuse regime, notwithstanding that the UK will no longer have any say in it.

> "The UK is likely to need to agree to keep its key financial markets regulatory provisions equivalent to those in the EU, as the basis for any future EU-UK financial services trade deal."

**Andrew Tuson**
Partner, Financial Regulation

**Irene Cummins**
Senior Associate, Financial Regulation

# REGULATORY CALENDAR

## EXPECTED DURING QUARTER ONE

### JAN 2017

1 January – EBA final guidelines apply on sound remuneration policies under CRD IV and disclosures under CRR.

EBA final guidelines apply on sound remuneration policies under UCITS V and amended guidelines on sound remuneration policies under the AIFMD.

PRA rules on buy-outs of variable remuneration take effect. The rules will apply to buy-out contracts concluded on, or after, 1 January 2017.

4 January – Deadline for comments on FCA's third consultation on UK implementation of MiFID II (with the exception of proposals in chapter 16 relating to the FCA's Supervision manual (SUP), authorisation and approved persons for which the deadline is 31 October 2016).

9 January – Deadline for responses to FCA discussion paper (DP16/4) on overall responsibility and the legal function under the Senior Managers Regime.

Deadline for responses to FCA consultation (CP16/26) on proposed guidance on how FCA will enforce the duty of responsibility under the Senior Managers Regime. The guidance will be located in the Decision Procedure and Penalties manual (DEPP).

Deadline for responses to PRA consultation paper on applying whistleblowing rules to UK branches of overseas banks and insurers (CP35/16) and FCA consultation paper on applying whistleblowing rules to UK branches of overseas banks (CP16/25).

25 January – European Parliament committee vote scheduled for 'MLD5' – the European Commission's proposed revisions to the fourth Money Laundering Directive (MLD4).

### FEB 2017

By 1 February – EIOPA expected to provide final technical advice to the European Commission on possible delegated acts under the Insurance Distribution Directive (IDD).

17 February – Closing date for comments on FCA's fourth consultation (CP 16/43) on MiFID II implementation.

By 23 February – Deadline for EIOPA to submit final draft ITS to the European Commission under Article 20(9) of the IDD, setting out a standardised presentation format for the Insurance Product Information Document (IPID).

February – FCA expected to publish a consultation paper on UK implementation of the Benchmarks Regulation.

### MAR 2017

7 March – Deadline for firms within the SMCR to have assessed fitness and propriety of employees with scope of the certification regime, and for the issue of certificates to employees performing significant harm functions.

Date from which conduct rules in the Code of Conduct sourcebook (COCON) will apply to employees who are not within the SMR or CR.

Date from which rules relating to regulatory references will apply.

21 March – Date from which pre-2004 first charge CCA mortgages will become regulated mortgage contracts. Administration of, and activities relating to variations of, these mortgages will become regulated activities.

By end March – FCA expected to have finished assessing authorisation applications from firms with an interim permission for consumer credit-related activities.

By end March – FCA expects to publish the first of two Policy Statements on the implementation of MiFID II.

By end March – UK Government expected to activate Article 50 of the Lisbon Treaty, initiating the 2 year negotiation period for the UK's exit from the European Union.

## EXPECTED DURING QUARTER TWO

- European Commission expected to publish supranational money laundering and terrorist financing risk assessment under MLD4, to assess money laundering and terrorist financing risks affecting the EU internal market that relate to cross-border activities.
- FCA expected to launch its ageing population strategy following its discussion paper (DP16/1) published in Q1 2016. The ageing population strategy will focus on ensuring that consumers can access the financial products and services they need at every stage of their life.

### APR 2017

By April – FCA's stated timescale for it to have finalised the necessary Handbook amendments for MiFID II transposition.

By 1 April – Deadline by which ESMA to submit to the European Commission final draft RTS and ITS under the Benchmarks Regulation.

1 April – New rules in chapter 6 of the Insurance: Conduct of Business sourcebook (ICOBS) will apply. The rules relate to increasing transparency and engagement at renewal in general insurance markets.

6 April – Changes to rules in the COBS sourcebook will apply in relation to pension products. The rules relate to key features documents, preparing and providing product and charges information, communications to clients, and pension transfer, conversion and opt-outs.

By end April – Launch by HM Treasury/FCA of the secondary annuities market which will enable consumers to sell their annuity incomes in exchange for a lump sum.

### MAY 2017

19 May – European Commission and European Central Bank will hold a joint conference on European Financial Integration.

By end May – Fair and Effective Markets: The Markets Committee of the Bank for International Settlements is expected to finalise its FX code of conduct standards and principles, and set out its proposals to ensure greater market adherence to existing codes.

### JUN 2017

By 26 June – Deadline by which member states required to have transposed MLD4.

26 June – Revised Wire Transfer Regulation takes effect, requiring payment service providers (PSPs) to include information on the payer and payee with funds transfers and to ensure the information is transmitted through the payment chain.

By end June – FCA expects to publish the second of two Policy Statements on the implementation of MiFID II.

# EXPECTED DURING QUARTER THREE

## JUL 2017

3 July – Deadline by which Member States must transpose the MiFID II Directive into national law.

22 July – European Commission expected to have launched a review of the scope and application of AIFMD.

## AUG 2017

16 August – EMIR: Two year exemption from the central clearing obligation for pension scheme arrangements ends on this date.

## SEP 2017

September – Final PRA rules on whistleblowing in UK branches of overseas banks and insurers (as consulted on in CP35/16) expected to come into force.

# EXPECTED DURING QUARTER FOUR

- European Commission expected to adopt a legislative proposal on EU personal pension framework.

## OCT 2017

31 October – Date by which EIOPA is to submit final technical advice to the European Commission in relation to the review of the standard formula under the Solvency II Delegated Regulation ((EU) 2015/35).

By End October – First annual submissions to the FCA required from firms, notifying breaches of the conduct rules for staff outside the scope of SMCR.

## NOV 2017 DEC 2017

By end 2017 – The FCA and PRA are expected to have consulted on extending the Senior Managers and Certification Regime (SMCR) to all FSMA authorised firms.

By end 2017 – Bank of England (BoE) is expected to have published a consolidated and comprehensive policy statement on its enforcement processes, including in relation to establishment of a unified Enforcement Decision Making Committee to take decisions in respect of: (1) the PRA; (2) BoE Financial Market Infrastructure (FMI) Directorate; and (3) BoE Resolution Directorate.

# KEY DATES TO KEEP ON YOUR RADAR

## 2017

### FIRST HALF OF 2017

FCA expected to consult on new guidance for firms offering services that help consumers making their own investment decisions without a personal recommendation.

FCA expected to consult on new guidance for firms wishing to provide 'streamlined advice' on simple consumer needs.

FCA expected to consult on guidance clarifying standard information required in a portable fact find and on the key considerations for verifying a fact find performed by third parties.

FCA expected to publish a policy statement to CP16/26 (on which responses were requested by 9 January). The policy statement will provide finalised guidance in the DEPP manual on how the FCA will enforce the duty of responsibility under the SMCR.

FCA expected to publish a policy statement to CP 16/31 which set out proposals for the prohibition of restrictive contractual clauses.

FCA expected to publish its final report following the asset management market study it launched in November 2015.

FCA and The Pensions Regulator expected to publish a joint factsheet setting out the extent to which employers and trustees can assist on financial matters without falling within the regulatory regime for financial advice.

HM Treasury and FCA expected to provide a progress report to the Economic Secretary and the FCA Board on implementation of the recommendations of the Financial Advice Markets Review (FAMR).

Payday lending: FCA expected to review the HCSTC price cap imposed from January 2015.

### DURING 2017

European Supervisory Authorities expected to publish Q&A to supplement RTS on the Key Information Document (KID) under the PRIIPS Regulation.

RTS and ITS prepared by the EBA under the Payment Accounts Directive (2014/92/EU) expected to take effect, and, within three months of entry into effect, FCA must publish the final list of most representative services under the directive.

FCA expected to publish policy statement to its consultation paper (CP16/27) on its proposals to apply the Code of Conduct sourcebook (COCON) to standard non-executive directors.

FCA expected to consult on extending the time limits (up to four years) for employees to attain an appropriate financial advice qualification in the existing Training and Competence sourcebook (TC).

Financial Action Task Force (FATF) expected to carry out its fourth mutual evaluation of the UK's conformity with its AML and CTF standards.

## 2018

UK must implement the necessary measures to comply with requirements on the statement of fees, fee information document and common symbol under the Payment Accounts Directive, within nine months of the date the RTS and ITS under the directive take effect.

SMCR will be extended to all financial services firms during 2018.

### 9 MAY 2018

Member states required to implement the necessary measures to transpose the Cyber-security Directive ((EU) 2016/1148).

### 10 MAY 2018

Date from which Cyber-security Directive will apply.

### 9 NOVEMBER 2018

Date by which member state competent authorities will be required, under the Cyber-security Directive, to identify the operators of essential services within an establishment on their territory.

## 2019

### BY 2019

Date by which FCA required to review retained conduct requirements from the CCA and, where possible, to develop rule-based alternatives.

### BY 21 MARCH 2019

Deadline by which all relevant firms must be compliant with Mortgage Credit Directive requirement to issue a European Standardised Information Sheet (ESIS).

### BY END MARCH 2019

Brexit negotiation period closes.

### BY 26 APRIL 2019

FCA expected to carry out a formal post-implementation review of the impact of the mortgage market review (MMR) rules.

WORKING WITH US

# A LEADING GLOBAL INVESTMENT FIRM WAS BEING ASKED QUESTIONS ABOUT ITS FX BUSINESS...

→ Regulators in five continents were ultimately involved.

→ Forex failings were plastered across front pages.

→ This firm wanted to make sure it wasn't involved in any nefarious conduct - they came to BLP for help.

→ To date, the firm has avoided regulatory enforcement action. Here's some of the reasons why...

## FIVE STEPS TO SUCCESS

1. Proactively developing workplans with our client to investigate potential misconduct across different periods, business lines and jurisdictions. We satisfied regulators as to the thoroughness of the workplans and the rationale for our approach.

2. Earning the trust of the regulators by reporting back frequently, following up on lines of enquiry and demonstrating the rigour with which we were undertaking the investigation. We were able to convey our client's strong control framework and ethical culture.

3. Being both responsive and thorough. We had to review, understand and analyse a huge volume of data in short spaces of time - working seamlessly with contract lawyers in Asia, as well as a specialist document review team in our Manchester office.

4. Becoming experts in the business and understanding any issues that arose in the investigation. We spent a lot of time speaking to senior management, traders and salespeople, and requesting demonstrations of the trading screens and teach-ins from senior traders.

5. Offering integrated expertise across a number of different practice areas, including financial regulation, competition, data protection and employment.



**About BLP**
Berwin Leighton Paisner is an award-winning, international law firm. Our clients include over 50 Global Fortune 500 or FTSE 100 companies. Our global footprint of 14 international offices has delivered more than 650 major cross-border projects in recent years, involving up to 48 separate jurisdictions in a single case.

The Firm has won eight Law Firm of the Year titles, is independently ranked by Chambers and the Legal 500 in over 65 legal disciplines and was named a 'top 10 game changer of the past 10 years' by the FT Innovative Lawyers report 2015.

**Expertise**

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→ Commercial
→ Construction
→ Corporate Finance
→ Dispute Resolution
→ Employment, Pensions and Incentives
→ Energy and Natural Resources
→ Finance
→ Insurance
→ Intellectual Property
→ Investment Management
→ Private Client
→ Projects and Infrastructure
→ Real Estate
→ Regulatory and Compliance
→ Restructuring and Insolvency
→ Tax

**Getting in touch**
When you need a practical legal solution for your next business opportunity or challenge, please get in touch.

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