In Principle

10 Things Authorised Firms Need To Know For 2020

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Introduction

Welcome to the 2020 edition of In Principle. With the United Kingdom (UK) leaving the European Union (EU) on 31 January 2020, and moving into a transition period which will last until 31 December 2020, Brexit of course looms large over this publication. During the transition period, most people – including authorised firms – are unlikely to feel the practical effect of Brexit; what comes after, however, depends on the outcome of bilateral trade talks which will be taking place throughout the year. Before the end of the transition period, however, there are many other pressing issues that firms will have to prepare for. For example, both the UK and EU financial services regulators have shown particular interest in enhancing firms' attitudes towards environmental, social and governance issues, and as the global interest in climate change continues to accelerate, the trend towards requiring additional disclosures in relevant areas is set to continue throughout 2020. In the UK, the Financial Conduct Authority concluded a number of significant enforcement cases, and we expect this to continue in 2020. After its rollout to all UK-authorised firms in December 2019, this year will see the Senior Managers and Certification Regime come into full force and effect, with individuals taking on greater personal liability, and firms assuming a greater responsibility for assessing their employees' fitness and propriety. With proposals to amend the EU market abuse regime, new securities financing transaction reporting requirements, and changes to the Benchmarks Regulation, to preview just a few, here are ten things authorised firms need to know in 2020.

Executive Summary

1. Sustainability and Asset Management

Environmental, social and governance matters have emerged as a key policy focus in the financial services sector. The EU has adopted ambitious plans in relation to climate change and sustainability, and different national requirements applicable to certain types of institutional investors have been enacted in a number of EU member states. The UK itself has enacted its own rules partly in response to its international commitments, and partly as a matter of domestic priority. Investment managers will need to pay close attention to this new landscape that includes new obligations, including disclosure requirements, and greater scrutiny both from regulators and investors.

2. Market Abuse

Market abuse continues to be an area of very significant interest for the Financial Conduct Authority (FCA), and of growing interest across the rest of the EU. Recent action taken by the regulator – including 91 enforcement investigations, custodial sentences and a fine for a person discharging managerial responsibility – serves as a reminder that the FCA expects firms and individuals alike to take their obligations under the EU Market Abuse Regulation (MAR) seriously and that it is prepared to enforce against them where there are instances of non-compliance. In late 2019, The European Securities and Markets Authority (ESMA) concluded a consultation about proposed significant amendments to MAR which could potentially lead to substantial changes in both scope and, to an extent, have consequences to firms in practice. ESMA is expected to issue a report following the consultation to the EU Commission in H1 2020.

3. Brexit

There has been much speculation regarding the ultimate practical outcome of the 2016 Brexit vote, and the fundamental uncertainty of the political negotiations domestically and with the EU has seen the UK's Constitution tested and scrutinised more thoroughly than at any time since the 17th century. Now Boris Johnson commands a majority in the House of Commons, the first stage of Brexit is clear: on 31 January 2020, the UK will leave the EU with a transition period. What will happen before the next potential cliff-edge on 31 December 2020, however, remains unclear. We recap the key issues for investment managers considering whether they are prepared for Brexit.

4. Senior Managers and Certification Regime

On 9 December 2019, the Senior Managers and Certification Regime (SMCR) was extended to the remainder of the financial services sector. Firms have a year after the commencement of the new regime to assess the fitness and propriety of all members of

certified staff and, if found suitable, issue them with a certificate setting out the affairs of the firm with which that individual will be involved. In requiring them to do so, the FCA has passed this burden, and potential liability, onto firms themselves. Firms will also be required to scrutinise employees' behaviour and misconduct away from their professional environment. While this represents a broadening of scope of issues covered by the fit and proper assessment, this is a consistent direction of travel for both the FCA and other regulated professions in the UK.

5. Enforcement Trends

The FCA continues to be active in commencing enforcement cases, albeit with still only one successful action brought under the SMCR. With the extension of this regime to the remainder of the financial services industry, one would expect this number to increase in the not too distant future. In the last year, the number of open investigations has increased across the board and the quantum of fines levied has increased when compared with last year's statistics. Particular areas of focus continue to include retail conduct, insider dealing, financial crime and culture and governance. The 2018/2019 Annual Report does, however, indicate a slight change in direction, with increased focus expected to fall upon operational resilience, cryptoassets and data security. In a small piece of good news for firms, the FCA has noted that the average time taken to conclude an investigation has fallen year-on-year.

6. Data Protection and Cybersecurity

A number of enforcement cases under the General Data Protection Regulation (GDPR) during 2019 have illustrated the importance of careful GDPR compliance, including by entities which are not physically established within the EU but which are nevertheless caught by the scope of the GDPR as a result of their EU activities. Enforcement – and significant fines for breach of the GDPR – is expected to be a continued theme in 2020. The European Commission is due to report on the GDPR in 2020 which may result in amended rules and updated guidance in due course. Brexit may present issues where EU and/or UK-based "EU representatives" are used. In light of the expanding scope of non-EU regulatory regimes addressing data protection (in the Cayman Islands and California, for example), firms operating internationally will need to take care to ensure compliance in all relevant jurisdictions in which they operate, reflecting the development of the relevant rules and guidance.

7. EMIR and SFTR

2019 saw an overhaul of the European Market Infrastructure Regulation (EMIR) under the so-called "EMIR Refit", with significant impacts on asset managers in particular reflecting amendments to rules on counterparty classification and the scope of the clearing obligation. In 2020, a number of further changes (including with regard to the initial margin exchange requirement) are expected to take effect. The changes will also extend current exemptions under EMIR and implement latest internationally-agreed standards.

2020 will also see the obligation to report securities financing transactions commence under the EU Securities Financing Transactions Regulation (SFTR). The reporting obligations will represent an additional and not insignificant compliance burden on EU investment managers, and will directly affect non-EU managers that manager EU funds, and may indirectly affect non-EU investment managers with EU clients depending on the scope of their contractual obligations. In-scope firms should take active steps to establish reporting systems and contractual arrangements (including delegated reporting arrangements, as applicable) to cater for the new requirements. Brexit is unlikely to affect the shape of the SFTR in the UK, other than insofar as reporting will be required to both UK and EU trade repositories, rather than EU trade repositories only.

8. AIFMD

New rules were adopted in 2019 relating to the cross-border distribution of investment funds, and these will enter into effect in mid-2021. The rules introduce a harmonised definition of "pre-marketing" across the EU, which will have an impact on, among other things, the availability of reverse solicitation and the promotional materials used. The rules are not expressed to apply to non-EU managers, although a number of EU member states may apply them to non-EU managers in due course to ensure a level playing field with EU managers. Post-Brexit, the rules in the UK-domesticated version of the Alternative Investment Fund Managers Directive (AIFMD) are expected to be largely consistent with the current scope of the reforms, at least in the short term.

9. EU Benchmarks Regulation/LIBOR

Providing some relief for industry, the end of 2019 saw the extension of the transitional period under the EU Benchmarks Regulation, under which benchmarks

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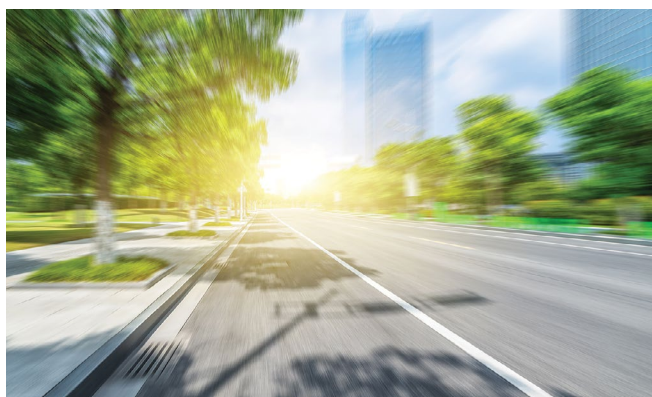
that are not yet authorised by ESMA may continue to be used until the end of 2021. These had been due to expire at the end of 2019.

The London Inter-bank Offered Rate (LIBOR) is expected to cease to exist from the end of 2021, so preparations to cater for its cessation will continue throughout 2020. Industry solutions are expected to emerge in 2020 to assist with the transition to alternative risk-free rates as fallbacks in securities documentation. Appropriate alternative risk-free rates will also need to begin to be used for internal operational processes, including front office calculations, models and risk systems.

10. Key Cases and Enforcement Round-Up

The FCA issued 265 Final Notices (243 against firms and individuals trading as firms, and two against individuals) and secured 288 outcomes (276 regulatory/civil and 12 criminal) using its enforcement powers during 2018/2019. While the number of financial penalties imposed remained the same as last year – 16 in both cases – the quantum increased significantly. A large number of the actions brought by the regulator related to the failure of firms to (a) treat customers fairly, (b) organise and control affairs responsibly and effectively, and (c) deal with regulators in an open and cooperative manner. A number of these cases are discussed in more detail in Section 10 below.

1. Sustainability and Asset Management



Introduction

Environmental, social and governance (ESG) issues are currently at the forefront of EU legislators' and regulators' minds. Both the EU and member states are engaged in efforts to redirect capital flows to support a sustainable economy.

The EU has played a significant role on the world stage in developing climate change policies, particularly with respect to the financial services industry.[1] It is broadly acknowledged, however, that the targets set and agreed to in international accords will not be met through government initiatives alone, and the co-operation of the private sector, including finance, is required in order to achieve the objectives. With this in mind, the EU has committed to realigning the financial services sector with the object of achieving a lower-carbon and climate protecting economy.

In March 2018, the EU issued its Action Plan for Financing Sustainable Growth. This plan has given rise to a selection of legislative proposals which seek to increase firms' transparency obligations in relation to ESG issues as relevant to the investment process. These additional transparency requirements will further build on the implementation of the amendments to the Shareholder Rights Directive (Directive 2007/36/EC, or SRD) which came into effect in June 2019. Under the revised SRD, as implemented in the UK, FCA-authorised investment managers are now required, on a "comply-or-explain" basis, to establish shareholder engagement policies and to make public disclosures about their activities as shareholders, including in relation to significant votes. The increase in transparency in all these areas is intended to enhance firms' activities to foster sustainable governance and to attenuate short-termism in capital markets. This transparency is in turn intended to be a tool to provide investors with a benchmark to compare managers' approach and track record on issues material to them, including climate change. Similar obligations also apply to certain categories of institutional investors, who are also required to consider their external investment managers' performance.

As well as these general transparency requirements, a number of EU member states have introduced

1 This has included contributing to and adopting the UN 2030 agenda, as well as agreeing to ambitious targets under the 2015 Paris Climate Change Agreement. In particular, the EU has agreed to ensure a 40% cut in greenhouse gas emissions by 2030.

specific statutory duties and/or investment criteria which must be considered by institutional investors such as insurance companies or pension schemes.[2] These institutional investors will be under specific obligations requiring them to consider actively their ESG objectives, and assess how these are reflected in their investment decisions and portfolios. Some are in effect required to invest a certain proportion of their assets in "sustainable" investments. The policy objective is to create binding requirements on key institutional investors to incorporate ESG considerations into their investment processes, and that investors will in turn reflect these requirements in their expectations of asset managers' preparedness to give effect to the institutional investors' ESG and climate change policies. This is a move from the narrow focus on short-term returns achieved, and for some investment managers the process of reconciling their investors' expectations with their investment approach will be complicated.

As well as disclosure requirements, the EU is also soon to introduce an EU-wide taxonomy to help investors and other market participants to assess which investments can be considered to be sustainable. This is also intended to further the development of a market where ESG matters can be used effectively to discriminate between products and firms.

Legislative Initiatives

Disclosure Regulation

On 27 November 2019, the EU Commission and EU Parliament adopted a new regulation (Regulation 2019/2088, or the Disclosure Regulation), and this was published in the Official Journal on 9 December 2019. The Disclosure Regulation will mandate enhanced disclosure requirements in relation to the integration of ESG factors in the investment decision-making process, including in relation to risk assessment. Most of the requirements in the Disclosure Regulation will take effect from 10 March 2021, although some of the provisions regarding more granular asset-level transparency will be phased in over a slightly longer time period. The Disclosure Regulation will apply to "financial market participants", including the Markets in Financial Instruments Directive (MiFID) investment firms providing portfolio management and alternative investment fund managers (AIFMs).

Under the Disclosure Regulation, investment managers (and other financial market participants) will be required to publish on their website a statement regarding the due diligence policies the firm has in place with respect to potential adverse impacts of investment decisions on sustainability factors, or explain why the firm has not made such a statement. This statement must include details about the identification and prioritisation of adverse sustainability impacts, a description of those impacts, a brief summary of the relevant portion of the engagement policy (see discussion of SRD below). These disclosures should also make reference to relevant business conduct codes and internationally recognised due diligence standards which are adhered to, including the extent to which the firm has aligned its activities with the objectives of the Paris Agreement. A similar statement will need to be provided in relation to adverse sustainability impacts at the level of a financial product.

Further new responsibilities on in-scope firms include disclosures to be made on websites and in pre-contractual stages in relation to:

- how sustainability risks are integrated into investment decisions
- how such sustainability risks are likely to affect returns (or an explanation of why such risks may not be considered relevant, i.e. on a "comply-or-explain" basis)
- how remuneration policies are consistent with the integration of such risks.

In practice, investment managers will need to actively consider whether they are required to adapt existing business practices and procedures, create new processes where they do not already exist, and take steps to ensure sufficient resources to assess sustainability risks adequately.

The Disclosure Regulation also imposes specific reporting and disclosure requirements on those who purport to manage products which are promoted based on their environmental and/or

2 For example, the revised Occupational Pension Schemes (Investment) Regulations require trustees of occupational pension schemes to have in place policies relating to "financially material considerations" over the "appropriate time horizon" of their investments, including how those considerations are taken into account in the selection, retention and realisation of investments; and how and to what extent "non-financial matters" are taken into account in the selection, retention and realisation of investments. The definition of "financially material considerations" in the revised regulations states that these include (but are not limited to) ESG considerations which the trustees regard as financially material, including, but not limited to, climate change. Further, trustees are required to have a policy setting out the basis on which they engage with issuers that are investee companies in light of their stewardship and other objectives.

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social characteristics, or which have "sustainable investment" as their objective. Required disclosures relate to the environmental, social or sustainable investment objectives themselves, how such objectives are met, and to what extent. The availability of reliable and complete data regarding underlying companies and products will continue to be a critical concern for investment managers on whom such requirements will be imposed.

Taxonomy Regulation

At the beginning of December 2019, the EU Commission and EU Parliament agreed a compromise text of another new regulation, the "Taxonomy Regulation". This compromise text was then rejected by the EU Council soon afterwards, before a political agreement was reached between the Parliament and the Council on 17 December 2019. The Taxonomy Regulation is intended to "establis[h] the criteria for determining whether an economic activity is environmentally sustainable for the purposes of establishing the degree of environmental sustainability of an investment" (Article 1). The Taxonomy Regulation will allow market participants to determine, based on a common, EU-wide framework whether an investment can be considered "sustainable" or not.

Assuming that the current text is passed, the Taxonomy Regulation will come into force 20 days after it is published in the Official Journal of the European Union, but certain transparency/disclosure obligations will only enter into force on 31 December 2021 and 31 December 2022.

The Taxonomy set out in the Taxonomy Regulation will apply to any domestic measures adopted by any EU member state which set out any requirements in respect of financial products or corporate bonds that are marketed as environmentally sustainable, as well as to firms that offer financial products characterised as sustainable (or similar concepts).

The Taxonomy Regulation lays down certain "environmental objectives", and activities are to be judged based on whether they "contribute substantially" to one or more of these, or whether they "do not significantly harm" one or more of the objectives. Activities will also be assessed based on whether they comply with certain "minimum safeguards" (relating to certain international social, governance and labour standards), and whether they comply with "technical screening criteria" (criteria which further explain what is meant by each of the environmental objectives). The technical screening criteria will be determined in delegated legislation, and until these are in force, it will not be known precisely how the Taxonomy Regulation will work.

The environmental objectives are:

- climate change mitigation
- climate change adaptation
- sustainable use and protection of water and marine resources
- transition to a circular economy
- pollution prevention and control
- protection and restoration of biodiversity and ecosystems.

In relation to investments which are determined to be environmentally sustainable, or which are promoted as having environmental characteristics, there will be specific disclosure requirements in pre-contractual disclosures and the firm's periodic reports. These disclosures will dovetail with those required by the Disclosures Regulation (see above). Where a firm is not required to make disclosures under the Disclosures Regulation in relation to a particular product, the firm will have to state (in specified language) that the EU criteria for environmentally sustainable investments have not been taken into account. Further disclosures are required by certain large public interest entities.

By providing companies and financial instruments with objective, recognised credentials, the EU aims to open the market up to a much broader range of potential participants, as well as encouraging or requiring current participants to take note. Investment managers and other firms making investments are not required to use the framework in the Taxonomy Regulation when making investment decisions or considering whether an investment meets the internal sustainability standard or criteria, and there are a number of other initiatives under development by industry bodies and others. However, the Taxonomy is expected to become a widely used tool, potentially underlying other, more applied tools, which will allow investors to better compare products and evaluate ESG performance between investment managers.

BMR Amending Regulation – Low-carbon Benchmarks

Another new regulation which has recently been adopted by the EU Commission and EU Parliament

is the "BMR Amending Regulation" (Regulation 2019/2089). The BMR Amending Regulation amends the Benchmarks Regulation (Regulation 2016/1011, or the BMR).[3] The BMR Amending Regulation introduces a new definition for a category of "low-carbon" or "positive carbon impact" benchmarks. These amendments seek to improve the uniformity of low-carbon indices, and investors' ability to use benchmarks reliably to compare the low-carbon attributes of investments and portfolios. The requirements applicable to low-carbon benchmarks will be effective from 30 April 2020. As with the Taxonomy Regulation above, the BMR Amending Regulation seeks to establish an effective framework which will allow market participants to make decisions based on ESG factors.

Low-carbon and positive carbon benchmark administrators and administrators of benchmarks that incorporate ESG factors will be required to explain their methodology regarding the measurement and reconciliation of ESG or low-carbon factors. The information to be disclosed is intended to include an explanation as to how the underlying assets were selected and weighted, as well as explaining why other assets were excluded. It is expected that the market response to the new rules introduced by the BMR Amending Regulation will be positive, and it is thought that new products will be developed to assist investors and managers in establishing operational parameters for green and other ESG investing. MSCI Inc. has already announced the creation of provisional indices meeting the minimum standards of the BMR Amending Regulation which are currently being evaluated and tested by clients, and we would expect others to follow suit in the near future.

Revised Shareholder Rights Directive

The revised Shareholder Rights Directive II (SRD II) amended the SRD from 10 June 2010. As a directive, EU member states are required to implement its provisions into their domestic law, and in almost all cases one has to look to national law to determine precisely what is required. The aim of the SRD is to increase transparency over how firms engage across all professional entities engaged in investment.

In the UK, several government departments had to issue amendments to their rules or statutory instruments to implement SRD II, and this was undertaken by the FCA for investment managers and certain institutional investors. In line with the global nature of the UK's investment management industry, the FCA has adopted a broader geographical scope for its rules than was strictly required by the SRD itself. Consequently, the FCA's SRD rules applies not only to all investments managed in, or shares traded on, European Economic Area (EEA) markets (the minimum requirement of SRD II), but also those managed in or traded on markets outside of the EEA. For the time being, such requirements have been implemented on a "comply-or-explain" basis.

Under the new rules, investment managers and institutional investors are required to publish a "shareholder engagement policy" which sets out how the firm:

- integrates shareholder engagement in its investment strategy
- monitors investee companies on certain listed matters (strategy, financial and non-financial performance and risk, capital structure and ESG)
- conducts dialogues with investee companies
- exercises voting rights/other rights attached to shares
- cooperates with other shareholders
- communicates with investee company stakeholders
- manages actual and potential conflicts of interest relating to the firm's engagement as a shareholder.

Investment managers are also required to provide an annual disclosure explaining how their shareholder engagement policy has been implemented. This will include setting out how the firm has cast votes in significant general meetings of companies in which it holds shares, excluding only votes that are insignificant due to the subject matter or the size of the firm's shareholding in the company. There must also be a description of the voting behaviour undertaken by or on behalf of trustees and any use of the services of proxy advisors. The regulators' efforts to increase transparency with respect to voting behaviour is intended to enable market participants to evaluate more effectively whether a firm's actions in practice accord with its published shareholder engagement policy, as well as demonstrating the utilisation of shareholder/investor engagement as an effective tool for ensuring responsible investment.

Certain institutional investors now must disclose how the main elements of their equity investment strategy are consistent with their liability profile and duration (in particular long-term liabilities) and how these elements

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3 See also Section 9 below on the Benchmarks Regulation and LIBOR.

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contribute to the medium to long-term performance of their assets. Additionally, institutional investors are required to disclose information on how their external investment managers implement their policies in the course of discretionary investment management arrangements. This information must include:

- how the arrangement with the investment manager incentivises the investment manager to align its investment strategy with the profile and duration of the investor's liabilities (particularly long term liabilities)
- how the arrangement with the investment manager incentivises the investment manager to make investment decisions based on assessments of medium- to long-term financial and non-financial performance of investee companies, and for the investment manager to engage with investee companies in order to improve medium- to long-term performance
- how the method and time horizon of the evaluation of the investment manager's performance and the remuneration it receives for services are in line with the investor's liabilities, in particular its long-term liabilities
- how the investor monitors portfolio turnover costs incurred by the investment manager, and how it defines and monitors a targeted portfolio turnover/ range of turnovers
- the duration of the arrangement with the investment manager.

In turn, investment managers must disclose to the institutional investors for whom they invest how their investment strategy and its implementation complies with the arrangement with the institutional investor, and how it contributes to the medium to long-term performance of the assets of the institutional investor or fund. This disclosure to an institutional investor must include reporting on key medium- to long-term risks associated with the investments; portfolio composition; turnover and turnover costs; the use of proxy advisors in engagement activities; the firm's policy on securities lending (and how this supports the firm's engagement activities if applicable, particularly at the time of general meetings); whether/how the investment manager makes investment decisions based on the evaluation of medium- to long-term performance of an investee company (including non-financial performance); and whether conflicts of interest have arisen in connection with engagement activities, and (if so) how the firm has dealt with them.

Revised Stewardship Code

As part of the review of the framework for shareholder engagement and measures to tackle perceived excessive short-termism, the UK Financial Reporting Council has revised the 2012 Stewardship Code. The new 2020 Stewardship Code ("2020 Code"), which took effect on 1 January 2020, imposes a number of voluntary "comply-or-explain" principles for signatories, including asset managers, asset owners and service providers. The FCA has said that while the implementation of SRD II sets an important baseline in a continuum of measures aimed to drive effective stewardship, the 2020 Code is intended to encourage higher standards beyond that baseline, particularly in relation to how asset owners are mobilised to hold investment managers accountable to stated investment policies and considerations. Signatories are expected to take account of material ESG factors both when making investment decisions and when undertaking stewardship of the assets. Signatories are also expected to make public reports of information regarding issues they have prioritised when assessing investments, and to explain how the integration of stewardship and investment has differed for different funds, asset classes and geographies.

The 2020 Code introduces 12 principles for asset managers and owners concerned with purpose and governance, investment approach, and the engagement with and exercise of rights and responsibilities over investee companies.

- Principle 1 provides that signatories should explain how their purpose and investment beliefs have guided their stewardship, investment strategy and decision-making, and an assessment of how effective they have been in serving the best interests of clients and beneficiaries.
- Principle 2 says that a firm should disclose how effective its chosen governance structures and processes have been in supporting stewardship, and how these may be improved.
- Principle 3 asks signatories to disclose examples of how they have addressed actual or potential conflicts of interest.
- Principle 4 says that signatories should disclose an assessment of their effectiveness in identifying and responding to market-wide and systemic risks and promoting well-functioning financial markets.

- Principle 5 provides that a firm should explain how internal reviews have led to continuous improvement in the firm's stewardship policies and procedures.
- Principle 6 says that firms should explain how they have taken into account client and beneficiary needs and communicated the activities and outcomes of their stewardship activities and investments to them.
- Principle 7 states that firms should explain how information gathered through stewardship has informed acquisition, monitoring and exit decisions, whether acting directly or on the firm's behalf, and how this has best served clients/beneficiaries.
- Principle 8 says that firms should explain how the services provided by service providers meet the firm's needs, and/or the actions which have been taken when their expectations from service providers have not been met.
- Principle 9 asks signatories to describe the outcomes of its shareholder engagement activity, whether it is ongoing, or activities which have concluded in the preceding 12 months.
- Principle 10 provides that signatories should describe the outcomes of collaborative engagement activities.
- Principle 11 says that firms should describe the outcome of any escalation of their stewardship activities which has been undertaken to influence issuers.
- Principle 12 states that, in relation to listed equity assets, firms should provide examples of the outcomes of resolutions on which they have voted in the preceding year.

Conclusion

The legislative initiatives and policy shifts are likely the nascent form of what is intended by European legislators and regulators to be a systemic change in the financial sector. While ESG considerations are not new to institutional investors or investment managers, the objective of the changes is to bring about a paradigm shift which directs capital flow away from investee companies with operations or practices that are incompatible with the ESG goals, particularly sustainability, and to make capital available to companies with a business model that is better compatible with the new focus on climate change and other ESG issues.

The discourse on the relevance of climate change to the financial sector leaves little room for doubt that the regulators consider climate change to be a live issue for all participants in the financial markets as it underpins broader systemic stability concerns.

However, this paradigm shift is still gaining momentum and the lack of generally accepted vocabulary or industry-standard concepts for setting criteria and assessing performance has delayed the introduction of pragmatic and practice-shifting binding rules. Whilst the introduction of the Taxonomy is helpful, legislators, regulators, investors and managers alike are still working on how best to quantify and compare different aspects of ESG performance in investments. Initiatives to follow in this area will include EU rules on enhanced issuer transparency reflecting ESG, specifically climate change, related performance and key risks.

The EU has not been shy about introducing these new provisions, and there is a clear intention to encourage, or sometimes compel, firms to do more. Regulated firms should consider whether their existing policies and procedures are consistent with the new rules, and start meaningful engagement with the issues that, in the not too distant future, are likely to become key items to resolve in the investment process to ensure compliance with the new standards.

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2. Market Abuse

Brexit

When the UK leaves the EU on 31 January 2020, the market abuse regime will continue during the transition period largely in the same way as it does now until "Implementation Period Completion Day" ("Final Brexit Day") on 31 December 2020. Thereafter, the market abuse regime will be domesticated in the UK (see Section 3 on Brexit below).

As discussed in detail below, ESMA has been consulting on whether there should be amendments to MAR. Until ESMA provides its recommendations, and indeed until the EU Commission and legislators give their views on any proposed amendments, it is not known whether – or on what timescale –MAR may be amended in the coming years. It is unlikely however, that any changes would be in place before Final Brexit Day, and as such, any amendments to MAR would not be domesticated automatically into UK law if or when they come into force. Unless the UK actively decides to follow any amendments which may be made to MAR (or indeed the UK has adopted them independently), MAR and the UK regime could deviate in the next few years.

FCA Enforcement and Practice

Combatting market abuse continues to be a priority for the FCA. In 2018/2019, the FCA made 29 supervisory visits to firms in relation to Suspicious Transaction and Order Reports (STORs), and opened 484 preliminary market abuse investigations. Of these 484 investigations, 91 have led to full enforcement investigations, and 72 to non-enforcement action (e.g. interventions and education letters). Several Final Notices and penalties relating to market abuse have been issued.

Significantly, this year the FCA successfully brought criminal proceedings against two individuals: a senior compliance officer in the London office of UBS AG used her position within the bank to gather inside information which she then passed to a family friend who was a day trader. The trader made a profit of approximately £1.4 million from using this inside information, whereas the compliance officer appears only to have benefited from a few expensive nights out in London. Notwithstanding this difference in personal gain, the judge sentenced both to three years in prison, recognising that the compliance officer's breach of her position of trust was an aggravating factor.

Since these prosecutions, the FCA has issued further guidance on the importance of firms restricting access to inside information to only those in the business who actually need to have access. Firms should be alive to the importance of reviewing insider lists and access to insider information periodically, and taking particular care when members of staff change jobs or locations. The FCA has particularly noted that some firms have policies that generally give "support staff", such as compliance officers and members of risk teams, access to all inside information at the firm even when this access is not needed. The FCA has emphasised that firms need to challenge the assumption that support staff should have access to all inside information, and narrow access to only what is necessary.

Individual liability in the market abuse context is something which looms large: it does not only arise in circumstances where there are, effectively, "rogue employees", but firms should be mindful that under the provisions of the Financial Services and Markets Act 2000 (FSMA), directors involved with transactions found to constitute market abuse can also be held personally liable. In the first such action to be made fully public, the FCA recently fined a managing director of a listed company for failing to notify share trades in the listed company, as is required under MAR. The FCA's action was particularly notable because the individual was not a director of the listed company, but a managing director sitting on the company's executive

committee (and therefore a person discharging managerial responsibilities under MAR). This is in addition to any liability individuals may accrue under the Senior Managers Regime (see Section 4 below).

ESMA Consultation

In the latter part of 2019, ESMA consulted on various proposed changes to MAR. It is expected that ESMA will report to the EU Commission on the consultation and its proposals during the first half of 2020. Even if the Commission and EU legislators agree to any amendments ESMA suggests, it is likely that it will be some time before these come into force given the comparatively long time it can take for EU legislation to be agreed and enacted. Given the significance of some of the amendments ESMA has consulted on, however, it is worth understanding the potential "directions of travel", particularly as these are likely to inform the regulators' interpretations of MAR itself as well as their approach to assessing market behaviour.

Proposed Amendments – General

Inside Information

One of the more controversial proposals that ESMA has consulted on is to amend the definition of "inside information" in Article 7 of MAR. ESMA itself acknowledges that the formulation in Article 7 remains comparatively new, and there is not huge evidence to suggest that it is dramatically either under- or over-inclusive, or otherwise unworkable. Currently, information is "inside information" if (i) it is precise, (ii) it is not public, and (iii) if it were made public it would likely have a significant effect on the price of the relevant financial instrument/other covered contract. This definition builds on the previous definition under the former EU Market Abuse Directive, and it incorporates some of the intervening judgments issued by the Court of Justice of the European Union. To change the definition at this stage might appear premature, only adding confusion rather than alleviating it.

ESMA does not propose clear statutory text which might replace the current definition, but rather asks three general questions:

- Have market participants experienced any difficulties with identifying what information is inside information and the moment in which information becomes inside information under the current MAR definition?
- Do market participants consider that the definition of inside information is sufficient for combatting market abuse?
- In particular, have market participants identified information that they would consider as inside information, but which is not covered by the current definition of inside information.

ESMA has also been consulting on whether amendments would be beneficial to deal with certain specific behaviour, notably front running and pre-hedging.

ESMA has also asked for specific feedback on the definition of "inside information" in the specific context of spot commodity contracts.

Insider Lists

As discussed above, the FCA has recently provided guidance on what it expects firms to do in relation to restricting access to inside information: only those who actually need to know should have access, and access should be policed regularly. It is clear from the consultation that ESMA has similar concerns in relation to insider lists: it has proposed amending MAR to require insider lists to name individuals who have "effectively accessed" a particular piece of insider information, rather than listing everyone who *could* access the information. Accordingly, the role of a "permanent insider" would likely need to be amended.

In conjunction with this, ESMA has proposed that there should be a clearer and broader statement of which entities are obliged to maintain insider lists. In particular, ESMA has suggested extending the obligation to any person performing tasks which give them access to insider information – this would include, for example, professional advisors.

The FCA's guidance and ESMA's proposed approach are clearly not identical, but they both show a clear direction of travel: in the coming years, firms are likely to have to become much more rigorous in their policing of access to inside information, and with this will come both procedural and substantive burdens. ESMA is aware that some issuers already view the insider list requirements as overly burdensome, and has suggested that the information required to be kept might be streamlined, but the overall trend appears to be towards greater regulatory obligations rather than fewer.

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Market Soundings

The market soundings regime under Article 11 MAR and delegated regulations is comparatively formulaic. Disclosing market participants, in particular, are given a strict checklist of steps that need to be taken. ESMA notes, however, that some member states/market participants have understood Article 11 to be more like an optional safe harbour programme, rather than a set of mandatory provisions.

In light of this, ESMA has proposed to simplify the market sounding checklist to lighten the burden on issuers. At the same time, ESMA proposes to make this less stringent regime mandatory for all market soundings. As part of this, ESMA has also suggested clarifying exactly what is and is not a market sounding.

Benchmarks

As the Group of 10 (G10) spot foreign exchange (FX) enforcement cases were too late to affect the final text of MAR, so too was the Benchmarks Regulation 2016/1011, which was only enacted in 2016. The Benchmark Regulation, however, does itself refer back to MAR, for example in Article 14(2) which requires the reporting of any conduct that may involve "manipulation or attempted manipulation of a benchmark under [MAR]".

ESMA has proposed making clear in MAR itself that administrators of benchmarks, contributors of input data and submitters (all terms found in the BMR) are subject to MAR. ESMA has also proposed the unification of the definition of benchmark itself, which differs slightly in the different texts.

Spot FX Contracts

Under MAR as originally drafted, and as currently in force, spot FX contracts are not in scope. By contrast, spot commodity contracts are within scope. ESMA has provided several reasons for and against extending the scope to spot FX contracts within its consultation paper. On the one hand, the spot FX market has seen misconduct: ESMA points notably to the fines issued by the UK, Swiss and US authorities relating to the G10 spot FX market in November 2014, only some seven months after MAR was adopted. On the other, ESMA notes that comparatively recently the FX Global Code of Conduct has been adopted by a significant proportion of the market, and there may be a benefit in waiting to see what, if any, effect this has. The FCA has already formally recognised the FX Global Code, and any authorised firm not following its dictates is likely to be falling foul of the FCA's rules, not least Principle 5 and Conduct Rule 5 that mandate observing proper standards of market conduct.

National Competent Authorities and Sanctions

ESMA's consultation also seeks feedback on the role of the national competent authorities in market surveillance, with a particular proposal in relation to the establishment of a framework for cross-market order book surveillance. This suggestion would require a harmonisation of reporting methodologies. The framework would be designed to prevent or limit behaviours such as withholding tax arbitrage.

Further, MAR currently establishes a minimum standard of sanctions which must be available to regulators. ESMA has proposed that these minimum standards should be raised leading to greater consistency across the EU and simpler mechanisms to enforce sanctions across borders.

Proposed Amendments – Relevant to Issuers

Delayed Disclosure of Inside Information

Under Article 17 MAR, issuers are permitted to delay disclosure of inside information if (a) immediate disclosure would be likely to prejudice the legitimate interests of the issuer, (b) the delay is not likely to mislead the public, and (c) in the interim, the issuer can ensure the continuing confidentiality of the inside information.

ESMA has consulted on whether these conditions are sufficiently broad, and whether they have been found to be workable. Particular questions have been raised as to whether there should be clearer procedural requirements on issuers to identify, handle and disclose inside information. Further, ESMA has asked whether, in circumstances where there has been a delay in disclosure, and before disclosure has happened the information has ceased to be inside information, an issuer should be obliged to inform the national competent authority of this fact.

Also with respect to Article 17(5) MAR, ESMA is consulting on the special ground of delay available to credit and financial institutions where delay is

permitted to preserve broader systemic financial stability, for example in circumstances where there is a temporary liquidity problem.

Buy Back Programmes

Article 5(3) of MAR provides a safe harbour for share buybacks that meet certain criteria. ESMA has proposed that the reporting obligations associated with the safe harbour may be simplified, to the benefit of issuers. In particular, ESMA has suggested that issuers should only have to make notifications to one national competent authority, rather than multiple authorities, which would be a welcome change.

Managers' Transactions

Currently persons discharging managerial responsibilities (PDMRs) at an issuer are required to make notifications to the national competent authority and the issuer when the value or the transactions they conduct in relation to the issuer's shares or debt instruments reaches €5,000 (at the national competent authority's discretion this can be raised to €20,000). ESMA has consulted as to whether this threshold should be raised or varied. ESMA has also requested feedback as to whether the more limited obligation to report transactions concerning interests in a collective investment undertaking which is exposed to the issuer's shares or debt instrument only where the exposure exceeds 20% of the collective investment undertaking's assets should be varied.

Under Article 19(11) of MAR, there is also a restriction on PDMRs conducting transactions in the period 30 days before an announcement of interim or year-end financial reports. ESMA has asked for comment on whether any other similar restrictions should be added to the prohibition, or whether the exemptions to this prohibition in Article 19(12) should be changed.

Summary

While the proposed amendments are technical in nature, clear themes emerge from the proposals which point to ESMA's focus.

Extending Scope

ESMA is proposing to modify the scope of MAR as it considers necessary. Expanding the scope of relevant financial instruments to include spot FX contracts, for example, and extending the requirement to keep insider lists beyond issuers, speak to ESMA's concern that MAR may not currently provide an adequate framework of oversight in light of some practices in the market.

Reducing Complexity

ESMA has also suggested that various requirements should be simplified where possible. This simplification aims to streamline processes where it is appropriate, including by requiring fewer reporting fields in the buy-backs, introducing less prescriptive requirements for market soundings, and aiming for greater consistency of monitoring and enforcement across the EU.

Whilst Brexit may mean that some of the proposals put forward by ESMA will not become directly effective in the UK (if they go into effect after Final Brexit Day), it is likely that many of the above proposals will correspond to the FCA's priorities and preferences as well. Many of the proposed amendments may therefore be adopted by the UK Parliament and the FCA. The expansion of the FCA's perimeter in response to experience and market events, and the simplification of unnecessary regulatory burdens, are both aims that are likely to find favour even after Brexit.

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3. Brexit

Overview

After three and a half years of uncertainty, there now appears to be a clear path forward for Brexit – at least until 31 December 2020. The UK has now ratified the Withdrawal Agreement and enacted the necessary domestic legislation, and having already received assent from the EU Commission and Council, the EU Parliament gave its assent to the agreement on 29 January 2020, in preparation for the UK's departure at 11 pm on 31 January 2020 ("exit day"). Under Article 127 of the Withdrawal Agreement, from exit day until the end of the transition period, EU law will continue to apply in the UK, subject to some technical amendments in areas such as immigration and intellectual property law.

The end of the transition period is expected to be 11 pm on 31 December 2020 – a date which is now to be codified in UK legislation as the "implementation period completion day" ("Final Brexit Day"). The UK Government has signified that it intends to enshrine this date in law preventing the UK from accepting any extensions to the transition period.

The UK Government has said that it intends to negotiate a trade agreement with the EU during the transition period. The EU has indicated that it views this as optimistic given the relatively short timeline, but negotiations are likely to be sought apace to avoid a "no-deal" scenario on Final Brexit Day.

Subject to any such new agreements between the EU and the UK during the transition period, at Final Brexit Day, under UK law as it currently stands, EU legislation will be "domesticated": that is, EU law will become UK law, with some consequential and necessary amendments. Under the European Union (Withdrawal) Act 2018, the Government has had the power to issue "Exit Regulations" to draft secondary legislation implementing these amendments so that they are ready to come into force on Final Brexit Day. These amendments are largely (but not completely) mechanical, removing references to "Member States" or the "EU Commission", for example, and where relevant, replacing them with references to UK institutions.

What this means is that, if there is going to be a dramatic cliff-edge for UK businesses, it will now be on 31 December 2020 rather than 31 January 2020. Whilst perhaps this gives welcome respite for some in the short term, the difficulties and consequences of Brexit are set to continue be unclear and unknown for many more months yet whilst negotiations continue. Quite what, if any, trade deal may be agreed between the EU and the UK before Final Brexit Day, as well as what, if any, equivalence decisions are in force, will affect what sort of transition will take place at the end of this year.

What Does this Mean for UK Investment Managers?

Existing Investment Management Clients

The key areas of uncertainty for UK investment managers relate to their continued ability to provide services to existing clients in the long term. There has been no coordinated EU response to date indicating the treatment of existing investment management arrangements. However, a number of EU member states have made transitional provisions permitting the continuation of existing arrangements by UK investment managers to provide investment management services to EU managed accounts and to EU funds. These have principally been enacted to ensure the investors in the relevant EU member states are not unduly affected by a rupture in their commercial arrangements brought about by the uncertainty of the Brexit terms and the consequently comparably short preparation period. It is unclear whether the transitional arrangements will be permanently enshrined in local law in all jurisdictions. Further, while it seems that in the short term the

provision of investment management services on a sub-investment manager basis as a delegate of an EU AIFM will continue to be permissible, were the EU and UK supervisory regimes diverge materially, it is possible that such "grandfathered" arrangements could be subject to further scrutiny.

New Investment Management Clients

Additionally, it is unclear whether UK investment managers will be permitted to enter into new investment management relationships with EU clients. In particular, the provision of investment management services to retail clients or, in some cases, elective professional clients, may prove complicated in certain jurisdictions. Providing services to high net worth individuals or to family offices, or accepting them as investors in a fund, will likely require careful consideration of the arrangements and the application of the local rules, including any restrictions.

Marketing

Similar considerations also apply to marketing. The activities of marketing of investment services or investment products (as defined under the revised MiFID and the corresponding Markets in Financial Instruments Regulation) are, in some EU jurisdictions, considered to constitute MiFID investment activities which, when performed in the relevant jurisdiction, are only permitted to be carried on by an investment firm authorised under MiFID. While it is likely that the ramifications of such a classification of marketing activities have not been fully considered, in some EU jurisdictions a UK FCA-authorised investment manager may not be able to lawfully market its services or interests in funds under its management following Brexit.

Conclusion

The ultimate result of the EU-UK negotiations on withdrawal terms may ultimately cause a material rupture in the access to EU markets by EU managers and, if the financial services regulatory framework does not align with the EU regulatory framework, this will likely mean that the EU will be reluctant to agree to consider the UK an equivalent jurisdiction, which is the prerequisite for a smooth transition, and the exit terms will be followed by a period of material legal uncertainty for UK investment managers.

4. Senior Managers and Certification Regime

The SMCR was extended to the remainder of the financial services sector on 9 December 2019. The regime had previously applied to banks and insurers from 2016. Some helpful guidance has been issued by the FCA, which sets out its findings from a review of how deposit-taking and dual-regulated investment firms had embedded the regime and we recommend that firms take a moment to consider this feedback.

Before 9 December 2020, firms that have not already done so will need to assess the fitness and propriety of all members of certified staff, and if found suitable, issue them with a certificate setting out the affairs of the firm in which the individual will be involved. Further, authorised firms will have to ensure that all members of "conduct rules staff" – which will be almost everyone, except for employees in specifically excluded roles, such as cleaners, caterers and receptionists – have been trained on the importance and impact of the conduct rules.

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Broader Scope of Behaviour Relevant to Fit and Proper Assessments

Firms must be clear about with whom responsibility for certain activities and areas of the business lie. There will certainly be increased regulatory scrutiny on individuals. The FCA has been increasingly focusing in recent years on the culture in a firm, and one of the key drivers behind the roll out of the SMCR was the increased accountability of individuals, and a consequential improvement in "tone from the top". One good example that the FCA has been particularly clear about is that bullying and harassment at work must be taken seriously and actively considered when assessing an employee's fitness and propriety.

As previously, firms will be obliged to consider professional conduct, any financial misconduct or similar behaviour indicating dishonesty, whether it has taken place at work or outside. In addition, there is a new emphasis on behaviour and misconduct outside the regulated or professional environment.

The shift to a more comprehensive consideration of fitness and propriety is consistent with the FCA's approach demonstrated for many years by the enforcement cases it has brought against individuals on the grounds of poor behaviour outside of the professional context. For example, in a case from 2014, the FCA banned an individual from working in the financial services sector after he was caught evading train fares. The increasingly broadening scope of relevant conduct in one's professional and personal capacities will have particular relevance to firms under the SMCR, as the role of the arbiter of an employee's fitness and propriety fall on the firms themselves. Firms will need to consider factors such as breaching the firm's policies or standards, as well as dishonesty (including in matters such as tax evasion or misrepresentation to achieve a financial advantage), bullying and sexual or other harassment, where this has taken place outside of work, as well as at work.

This move towards adjudging staff in FCA-authorised firms in relation to their standards of conduct both in professional and private spheres is consistent with the trends and supervisory attitudes taken by other professional regulators. Recently, the Solicitors Disciplinary Tribunal found that a (now former) partner at Freshfields Bruckhaus Deringer had acted without integrity when he engaged in sexual conduct with a junior employee after the firm had laid on a celebratory event involving a lot of alcohol. This is one of several recent high profile cases which have been brought against solicitors for sexual misconduct. The partner was fined £35,000 and ordered to pay costs of £200,000. Whilst in this case the firm was not held to be at fault, there was substantial negative press for the firm both during the hearing and afterwards.

How Are Firms Reacting?

Whilst firms may find it difficult, and perhaps distasteful or unpalatable, to take steps to obtain information of relevant conduct taking place in the private lives of their staff members, there are steps that firms are taking or considering to address potential liability to the firm arising from social events with work colleagues. Examples of measures taken include introducing sober chaperones, seeking to curtail excessive alcohol consumption at social events by introducing behaviour codes for staff, and even prohibiting organised social events such as ski trips with colleagues.

Such steps reflect the gravity of the issue to firms whose ability to conduct their business appropriately could be compromised if key staff members cannot be certified as fit and proper, or whose regulatory risk and employer liability is likely to increase if they cannot show how the risk of poor conduct has been managed, or where they have certified an employee as fit and proper when the firm knew, or should have known, that the employee's conduct was problematic.

5. Enforcement Trends

The SMCR (see Section 4 above) has been in force for certain firms, such as banks, since 7 March 2016. In almost four years, however, only one sanction has been issued against a senior manager – in 2018, the FCA and the Prudential Regulatory Authority (PRA) both fined Jes Staley, the CEO of Barclays, a combined total of £642,430 for breach of the obligation to act with due care, skill and diligence in relation to a whistleblower.

We expect with the roll-out of the SMCR to FCA solo-regulated firms, which took place on 9 December 2019, that the FCA will be keen to show in the near future that the new regime "has teeth". Consequently, we expect there to be more cases brought against individuals – whether senior managers or certified staff – as well as against firms. On the last available data in mid-2019, the FCA had opened 15 investigations into senior managers and eight investigations into certified staff. It is not known, however, how long it will take the FCA to conclude the cases, but we would be slightly surprised if Mr. Staley's case remains the only successful SMCR enforcement action by the end of 2020.

Beyond specifically SMCR enforcement, the FCA's most recent enforcement statistics showed the number of open investigations has increased in almost every category used by the FCA. For example, the number of open cases involving "culture/governance" increased from 61 to 70 in the year to 31 March 2019, 97 to 129 for market manipulation and insider dealing and 76 to 88 for financial crime. This is a familiar story: there were also increases in the number of open investigations in almost every category in the year to 31 March 2018 as well.

One positive matter for firms which is worth noting is that, after a fairly steady increase in the time it has taken the FCA to resolve cases on average for the last few years, there has been a slight drop in the lengths of all investigations, other than those (comparatively few) cases which are referred to the Tribunal. Although only a small improvement, this is a welcome change for firms given the financial and temporal cost of investigations: the average length of a case determined by the Regulatory Decisions Committee (RDC) was nearly five years in 2017/2018, whereas it was closer to four years in 2018/2019. With the increasing case load, however, whether this trend can continue remains to be seen.

In 2018/2019, the FCA issued 265 Final Notices (243 against firms and individuals trading as firms, and two against individuals), secured 288 outcomes using its enforcement powers (276 regulatory/civil and 12 criminal). These figures are largely commensurate with last year. Whilst the number of financial penalties imposed remained the same as last year (16 in both cases), the quantum increased significantly: up from approximately £70 million to £227 million. Whilst this is a substantial difference, the amount of financial penalties has varied hugely in past years depending on the types of cases brought in any particular year. This said, since 1 April 2019 the FCA has already issued fines totalling approximately £255 million, with a number of months until the end of the 2019/2020 year still to go.

In the 2018/2019 Annual Report, the FCA identified several specific areas which are of interest and in relation to which we expect the FCA will be looking to take action in the near- to medium-term. Many of these areas have some connection to firms' interaction with technology, such as operational resilience (whether in response to cyber-attacks or other technology incidents), cryptoassets and data security. Other areas the FCA has expressed a particular interest in are more familiar and relate to financial crime and anti-money laundering, market abuse, culture and governance, the treatment of existing customers and outsourcing functions to third party service providers.

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6. Data Protection and Cybersecurity

During the Brexit transitional period until 31 December 2020, the GDPR will continue to apply in the UK in the same manner as it currently applies. While the state of the law after the transition period remains uncertain, as regards data protection in particular, there are significant efforts by the UK and the EU to achieve an equivalence-based outcome after Final Brexit Day, as anything else would likely cause material disruption to services received and goods sold to EU individuals at a significant scale. Assuming an equivalency based Brexit, the scope of the required changes UK businesses will need to make at the end of the transitional period will largely be technical rather than substantial.

EU/UK Representatives

One significant matter which some firms will need to consider is in relation to representatives. Under the GDPR now, a firm that holds GDPR-relevant personal data, but does not have an "establishment" in the EU needs to appoint an EU representative in one of the members states in which its data subjects are located for data protection purposes unless it is able to satisfy the conditions for it to be exempt, including the requirement to only process personal data "occasionally".

UK firms that hold EU individuals' personal data are not currently required to have appointed an EU representative. It is likely that this will change after Final Brexit Day, and UK firms may have to appoint a representative in one of the EU member states where the data subjects whose personal data they hold are located.

The representative's primary role is to facilitate communication between the EU data protection regulators and non-EU controllers and processors. Under Article 27(5) of the GDPR, it is clear that the appointment of an EU representative does not affect a controller or processor's individual liability for any breaches of GDPR. That said, EU supervisory authorities may address corrective measures (e.g. financial penalties) to a representative in the stead of the non-EU controller or processor, and the EU supervisory authorities may hold the representative personally liable if it fails to provide information to the supervisory authority upon request or if it fails to keep adequate records of processing activities.

Many firms have appointed representatives in the UK, and this will continue to be adequate until the end of the transition period. After 31 December 2020, however, UK-based representatives will be suitable for the domesticated UK GDPR for a firm without an establishment in the UK. In addition, another representative will need to be appointed which is based in the remaining 27 EU member states. The reverse will also be true – if a firm currently relies on a representative in one of the EU member states, and that firm holds personal data for UK individuals but does not have an establishment in the UK, that firm will need to consider whether it is required to appoint a representative in the UK.

Enforcement and Review of the GDPR

Under Article 97 of the GDPR, the EU Commission is required to submit a report evaluating the application of the GDPR by 25 May 2020, which may result in further amendments to the legislation being proposed. In particular, the Commission has been directed to look at how the provisions relating to data transfers outside of the EU have worked, and how supervisory authorities have cooperated with each other (including in relation to requests for mutual assistance). Given that, without an equivalence decision, the UK would become a third country for GDPR purposes after Final Brexit Day, any comments regarding or amendments to the international transfer provisions will be carefully watched in the UK.

GDPR has been vigorously enforced by the EU data protection authorities since it became effective.

2019 saw a number of significant fines by the UK Information Commissioner's Office for breach of the GDPR[4] with, in some cases, extra-territorial impacts. This trend is expected to continue into 2020.

In light of the expanding scope of extra-EU regulatory regimes addressing data protection (including, for example, the Cayman Islands and California), firms operating internationally should pay close attention to ensuring compliance in all relevant jurisdictions in which they operate in light of relevant rules and guidance as it develops. The increasingly fragmented data protection landscape globally may be challenging to navigate. Proper implementation of appropriately drafted data protection policies which reflect the way in which the firm operates, and take into account the firm-specific data flows and processing arrangements, are a prerequisite for complying with the relevant data protection laws.

4 British Airways (7 August 2019, £204,600,000 (fine not final)); Marriott International, Inc. (7 September 2019, £110,390,200 (fine not final)); Doorstep Dispensaree Ltd. (20 December 2019, £320,000).

7. EMIR and SFTR

EMIR

A number of amendments were made to EMIR during 2019 with impacts on counterparty classification and the scope of the clearing obligation. Asset managers are particularly affected by these changes.

The key changes were as follows:

- An amendment to the definition of "financial counterparty" (FC) to include all alternate investment funds (AIFs) which are established in the EU. As a result, an EU AIF that was previously a non-financial counterparty falling below the clearing threshold (NFC-) is now subject to the EMIR margin rules. This also impacts upon non-EU AIFs with non-EU managers, as non-EU AIFs are now "hypothetical" FCs.[5]
- A new threshold for FCs which have positions below all of the clearing thresholds (FC- entities). FC- entities are exempt from the clearing obligation.
- A new calculation basis for non-financial counterparties (NFC) to determine whether they exceed the clearing threshold. NFCs must now determine whether the aggregate month-end average gross notional value of over-the-counter (OTC) derivative transactions – calculated annually for the previous 12 months – exceeds any threshold established under EMIR. The old test of looking at a rolling average basis over 30 days no longer applies. The clearing thresholds themselves have not however changed from the pre-Refit position.
- NFC entities which exceed the clearing threshold (NFC+ entities) must now only clear OTC derivative transactions which are subject to EMIR to the extent that those derivatives exceed the relevant threshold – previously, triggering one threshold triggered the requirement to clear all OTC derivative transactions.

These changes are addressed in greater detail in our Client Alert[6] on the EMIR Refit.

The EMIR Refit will continue to have further impacts during 2020. From 18 June 2020, FCs which enter into OTC derivative transactions with NFC- entities will be required to report OTC derivative transactions on behalf of the NFC- entity, unless the NFC- entity elects to report for itself. This is likely to impact upon the contractual arrangements which are in place between FCs and NFC- entities for delegated reporting.

5 EMIR requires non-EU entities to consider whether they would be an FC "were they established in the EU" for the purpose of determining the applicability of the clearing obligation when entering into OTC derivative transactions with EU counterparties.

6 https://www.akingump.com/images/content/1/0/v2/104189/Emir-Refit-Redefining-a-Financial-Counterparty.pdf.

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A number of further changes to EMIR are expected to take effect in 2020, which are not strictly part of the "Refit" but are intended to extend current exemptions and implement latest internationally-agreed standards. The European Supervisory Authorities (ESAs) have recently published draft regulatory technical standards (RTS)[7] which, once published, will:

- Provide for a **permanent exemption from the requirement to exchange variation margin (VM) for physically-settled FX forwards and swaps**. The exemption applies if an entity is not captured by the definition of "institution" (broadly, banks or investment firms acting on their own behalf, or as agent for a non-institution entity). The Recitals to the EMIR Refit noted this exemption, but the RTS will now set the clear legislative basis for the exemption to be applied.
- Provide for a **12 month extension to the temporary exemption from the VM and initial margin (IM) requirement in respect of single stock equity options and index options** until 4 January 2021. The exemption was due to expire on 4 January 2020. The ESAs have indicated that the extension is currently only temporary to allow monitoring of the situation globally, with a view to re-assessing the temporary nature of the exemption in the future.
- Provide for a **temporary derogation for intragroup transactions which involve a third country group entity** absent an equivalence decision until 21 December 2020. The exemption was due to expire on 4 January 2020. It is hoped that during this time the necessary equivalence decisions in respect of third countries will be made by the European Commission.
- Split the **final phase-in date of the IM requirement** in line with the Basel Committee on Banking Supervision and International Organisation of Securities Commissions recommendations of 23 July 2019.[8] The final phase-in date of 1 September 2020 will be amended so that this date applies to entities with an aggregate average notional amount (AANA) of uncleared swaps greater than €50 billion, and the new phase 6 deadline of 1 September 2021 will apply to entities with an AANA greater than €8 billion – in effect, there is a one-year deferral of the scope of application of the €8 billion threshold for these entities, which will include many asset managers with lower trading volumes in OTC derivatives.

7 https://eiopa.europa.eu/Publications/ESAs%202019%2020%20-%20Final%20Report%20-%20Bilateral%20margin%20amendments.pdf.

8 https://www.bis.org/bcbs/publ/d475.htm.

Given that expiry of the exemptions or the implementation date (as appropriate) is quickly approaching, and the fact that the RTS are required to pass through a number of legislative steps before entering into force,[9] the ESAs have stated that they *"expect competent authorities to apply the EU framework in a risk-based and proportionate manner"* when enforcing the rules. In effect, it is expected that local financial authorities will employ a measure of regulatory forbearance to entities that are not able to comply with the requirements in light of the political and legislative intention evident from the proposed RTS.

With regards to Brexit, at the end of the transitional period, to the extent that relevant arrangements are not agreed, changes to EMIR under the Refit which have been enacted, but which are not yet applicable in the UK are effectively "on-shored" into the UK. This includes the requirement noted above for FCs to report transactions on behalf of NFC- entities which applied from 18 June 2019. Complexities may however arise with respect to counterparty classification, since OTC derivatives traded on EU markets and third country markets which are not subject to an equivalence decision by the ESMA will be treated as OTC derivatives under EMIR. There is currently no equivalence for UK trading venues.

SFTR

In 2020, the requirement to report securities financing transactions (SFTs) will enter into effect with respect to certain market participants, including investment funds and their managers. The reporting obligations under the SFTR apply to SFTs. These are defined to comprise: repurchase transactions, securities/commodities lending or borrowing, buy-sell back transactions/sell-buy back transactions, or margin lending transactions.

The SFTR explicitly excludes derivative contracts as defined under EMIR; however, it includes certain swap transactions with characteristics similar to SFTs that are not covered by EMIR; in particular, collateral swaps and liquidity swaps.

Reporting Requirements

The SFTR contains the concept of "dual-sided" reporting; unique transaction identifiers (UTIs), and certain other fields, will need to be shared between counterparties to ensure consistent reporting of

9 The relevant legislative steps involve endorsement by the European Commission and scrutiny and non-objection by the European Parliament and the European Council.

both sides of a transaction. Non-EU managers and funds may wish to consider the extent to which the reporting requirements apply to their trades, if they have not done so already, and, to the extent that managers and funds are in-scope, whether delegated reporting arrangements should be established.

Where reporting requirements do apply, the SFTR requires the counterparty to report details relating to the SFT that is concluded, modified, or terminated, to a trade repository which is registered with ESMA on a T+1 basis, i.e. no later than the working day after the SFT is entered into, modified or terminated. Reporting may be delegated, however (as under EMIR), the responsibility for reporting remains with the delegating entity. Where an AIF is counterparty to an SFT, its AIFM has the responsibility for reporting on its behalf. Unlike EMIR, however, there is no exemption under the SFTR for entities that enter into transactions in relatively low volumes.

The reporting requirements are phased in by type of counterparty as follows:

- Investment firms and credit institutions from 11 April 2020 (although the first trading day is 13 April 2020)
- Central counterparties and central securities depositories from 11 July 2020 (although the first trading day is 13 July 2020)
- AIFs and Undertakings for the Collective Investment in Transferable Securities (UCITS) are subject to the reporting rules from 11 October 2020 (although the first trading day is 12 October 2020)
- Non-financial counterparties from 11 January 2021.

Brexit

The SFTR post-Brexit UK statutory instrument[10] effectively "on-shores" the SFTR into the UK, and will enter into force on Final Brexit Day. Post-Brexit, branches of UK firms in the EU and EU firms in the UK will be required to report to both UK and EU trade repositories unless substitutive, or otherwise streamlined, compliance arrangements are available by Final Brexit Day.

Direct Application to Investment Managers

A fund that is managed by an AIFM authorised in the EU under the AIFMD is subject to the reporting requirement under the SFTR. The SFTR provides that EU AIFMs are required to comply with the reporting requirements on behalf of the funds under their management, whether the funds are EU funds or non-EU funds.

In addition, the SFTR requires an EU fund that has an investment manager that is not established in the EU (a non-EU AIFM) to comply with the reporting requirements. The non-EU AIFM is not required to undertake the reporting required under the SFTR as a matter of law, in contrast to the obligation applicable to EU AIFMs. However, typically it is responsible for reporting as part of its contractual obligations to the fund.

A non-EU fund manager with non-EU funds is not required to comply with the SFTR reporting requirements unless it has a branch in the EU, and the SFT has been "concluded" through the EU branch. This structure is unusual for most investment managers not associated with investment banks, however, ESMA has issued guidance to clarify when a SFT is considered to have been concluded through the EU branch.

Indirect Application to Investment Managers

However, EU financial institutions that are counterparties to the SFTs the non-EU manager enters into on behalf of the non-EU fund will be required to report those transactions.

Although non-EU managers will generally not be caught by the reporting requirements unless they manage EU funds (unless they have established an EU branch) a "counterparty outreach" will likely have begun by in-scope entities with respect to all of their fund counterparties. This is because the EU counterparties will need to adjust their internal systems to commence reporting from the applicable starting date, and may need to acquire relevant information required to complete the reporting fields.

10 The Transparency of Securities Financing Transactions and of Reuse (Amendment) (EU Exit) Regulations 2019.

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On 1 August 2019, a new cross-border directive on distribution of collective investment undertakings (CBDF Directive)[11] and a related regulation (CBDF regulation)[12] (collectively the "cross-border distribution rules") entered into effect. There is a two-year implementation period, meaning that AIFMs will have to comply with the rules from 2 August 2021.

The principal aim of the new rules is to harmonise regulatory and supervisory approaches to "pre-marketing" activities undertaken by EU AIFMs with respect to EU AIFS – i.e. the promotional activities which an AIFM is permitted to undertake with respect to a fund before being required to register to "market" the relevant fund for the purposes of the AIFMD. EU member state rules currently diverge significantly with respect to permitted "pre-marketing" activities.

Although harmonisation is likely to achieve greater certainty as to the range of permitted activities, the rules will likely amount to a more restrictive environment overall, and impose additional administrative burdens on AIFMs. There are furthermore additional uncertainties created by some key definitional elements of "pre-marketing".

The new pre-marketing rules are not drafted to directly apply to non-EU managers promoting their funds in the EU in accordance with the applicable national marketing restrictions. However, EU member states are likely to adopt a substantially similar, or more restrictive, approach with regard to non-EU managers to the extent that excluding non-EU managers from the scope of the new rules would create a competitive advantage for such entities compared with EU-established AIFMs seeking to promote funds in the jurisdiction. The intended harmonisation of rules across the EU may therefore not be achieved insofar as non-EU managers are concerned.

- The cross-border distribution rules introduce a **new definition of "pre-marketing"**:

  the provision of information or communication, direct or indirect, on investment strategies or investment ideas, by an EU AIFM or on its behalf, to potential professional investors domiciled, or with a registered office, in the EU, in order to test their interest in an AIF (or a compartment) which is not yet established; or in an AIF (or a compartment) which is established but not yet notified for marketing under […] the AIFMD […] and which does not amount to an offer or placement to the potential investor to invest in the units or shares of that AIF (or compartment).

- Pre-marketing is **permitted subject to conditions**, namely, except where the information presented to potential professional investors:
  - is sufficient to allow investors to commit to interests in the fund (in other words, to commit to acquiring interests in a particular AIF)
  - amounts to subscription forms or similar documents (whether in a draft or a final form)
  - amounts to the constitutional documents, a prospectus, or offering documents of a not-yet-established AIF which are in a final form.

Although pre-marketing is limited to the provision of information on "investment strategies" or "investment ideas", it is unclear whether this prohibits the provision of other fund-related information, to investors as part of the pre-marketing, such as structure of a fund or certain key terms of the fund. If so, the impacts would be significant.

Any draft prospectus or offering documentation that is sent to a potential investor must also clearly state that the document does not constitute an offer or an

11 Directive (EU) 2019/1160 of the European Parliament and of the Council of 20 June 2019 amending Directives 2009/65/EC and 2011/61/EU with regard to cross-border distribution of collective investment undertakings

12 Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014.

invitation to subscribe to units or shares in the AIF, and the information presented in the documents should not be relied upon because it is incomplete and subject to change.

- **A subscription within 18 months of the commencement of any pre-marketing will be deemed to have resulted from active marketing**, thus triggering a requirement to register the fund for marketing – this will likely have a significant impact on the ability for AIFMs to rely on reverse solicitation. As the rules apply on an EU-wide basis, it is therefore possible that pre-marketing in the Netherlands, for example, could make it impossible to rely on a reverse solicitation from an unrelated German investor, for example, during this "moratorium".
- Within two weeks of commencement of pre-marketing an activities, an AIFM is required to send an **informal letter or email to the relevant home regulator** specifying, among other things, the EU member states and the periods during which the pre-marketing has taken place, or is taking place. The home regulator is then obliged to inform the national competent authority in each EU member state in which pre-marketing is taking, or has taken, place. This notification represents a key change for UK AIFMs who typically undertake promotional activities under the UK Financial Services and Markets Act 2000 without notifying the FCA, before they start "marketing" under the AIFMD.
- The cross-border distribution rules introduce **conditions for the use of intermediaries** – including the requirement that a third party marketing a fund in the EU on behalf of an EU AIFM is a licensed MiFID firm or another EU AIFM.
- **De-registration of a fund** is likely to become more difficult as a result of new conditions. Some of these conditions – for example, the requirement to open the fund for universal redemptions for a 30-day period (not applicable to closed-ended funds) – may potentially be unattractive. The cross-border distribution rules also introduce a 36-month blackout period on any further marketing once a de-notification of a fund is made. The blackout period extends to funds that have a similar "investment strategy" or "idea". There is no guidance yet on what constitutes an "investment strategy" or "idea".

Post-Brexit, UK-headquartered AIFMs looking to market into the EU are likely to use their EU-domiciled platforms (for example, in Ireland) if they have one established. It is unlikely that post-Brexit UK marketing or financial promotions rules will materially change as a result of the new cross-border distribution rules.

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9. EU Benchmarks Regulation/LIBOR

On 8 November 2019, the European Commission published a regulation amending the BMR in the Official Journal of the EU. This amending regulation, the BMR Amending Regulation, came into force on 10 December 2019, with several different effective dates for different provisions.[13] In addition to changes to climate-related benchmarks and sustainability disclosures (discussed specifically above in Section 1, above, Sustainability and Asset Management), the BMR Amending Regulation made important changes to the transitional provisions under the EU Benchmarks Regulation which are applicable to critical and third-country benchmarks.

The BMR provides that during a transition period, entities which are subject to the Regulation may continue to use a benchmark, even if the benchmark is not compliant with the requirements of BMR, and particularly that it has not been authorised. Originally the transition period had been set to end on 31 December 2019.

It is comparatively difficult for a benchmark to become authorised under the BMR, and ESMA's register of approved administrators shows that, as of the end of 2019, only a very small number of third country administrators had become authorised to provide an EU benchmark for use in the EU.[14] Further, the alternative routes which would permit use of benchmarks, namely "endorsement" and "recognition", both require a legal representative in Europe who is willing to take on legal liability for the production of a benchmark, and firms are reluctant to take on this liability. Market participants were therefore concerned that, from 1 January 2020 (after the transition period), it would cease to be permissible to use non-approved benchmarks, and there would be comparatively few benchmarks, particularly benchmarks administered outside of the EU, which had the requisite authorisation from ESMA.

To address these issues, the BMR Amending Regulation has now provided some comfort in extending the transition period for a further two years in relation to "critical benchmarks" (e.g. LIBOR, Euro Interbank Offered Rate (EURIBOR) and Euro OverNight Index Average (EONIA)), and benchmarks provided by third-country administrators, provided that the benchmark in question is in fact in current use. These benchmarks may therefore continue to be used until 31 December 2021.

LIBOR Transition

At the end of 2021, the FCA will no longer compel panel banks to submit to LIBOR, and LIBOR will therefore cease to exist. Regulators are increasingly focused on the risk implications of transition away from LIBOR. At the very beginning of 2020, the FCA, the Bank of England and the Working Group on Sterling Risk-Free Reference Rates described 2020 as a "critical year" in the LIBOR transition process, and they have published documents setting out various milestones which will need to be met. These milestones include ceasing to issue cash products linked to Sterling LIBOR by the end of Q3 2020; taking steps to demonstrate that the compounded Sterling Over Night Index Average (SONIA) is easily accessible and usable; taking steps to enable a further shift of volumes from LIBOR to SONIA in derivative markets; establishing a framework for the transition of legacy LIBOR products in order to reduce the stock of LIBOR referencing contracts significantly by Q1 2021; and considering how best to address issues relating to 'tough legacy' contracts. Both buy-side and sell-side firms will therefore need to identify, monitor and manage relevant risks in documentation and in customer communications.

One further change which will need to be considered is that during 2020, the International Swaps and Derivatives Association (ISDA) is expected to publish a supplement to the 2006 ISDA Definitions to include fallbacks to the term and spread-adjusted risk-free rate on permanent cessation of the -IBORS, including with respect to LIBOR. Firms will have to be alive to this once the amendments are published.

13 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2089&from=EN.

14 https://www.esma.europa.eu/databases-library/registers-and-data.

10. Key Cases and Enforcement Round-Up

Henderson Investment Funds Limited (HIFL)

HIFL was fined £1,867,900 by the FCA for breaching Principle 3 (a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems) and Principle 6 (a firm must pay due regard to the interests of its customers and treat them fairly).

HIFL's agent and appointed investment manager, Henderson Global Investors Limited (HGIL), decided in November 2011 to reduce the level of active fund management significantly in two of its funds: one Japan fund and one North American fund. The FCA noted that, as was common practice, HIFL charged higher fees for funds that were actively managed than for those which were passively managed (the FCA pointed to Henderson's UK Index Funds as an example).

During 2012 and 2013, HGIL reduced the level of active fund management in these two accounts, as had been planned. In doing so, HGIL had informed nearly all of the institutional investors in those funds of the change, and offered to manage those investments without charge. By contrast, HGIL did not inform any of the retail investors in these funds of the change – including that it did not change the prospectus or other fund documentation – and HGIL continued to charge retail investors the higher fees. The FCA found that these funds became "closet tracker" funds.

The FCA found that, in the circumstances, retail investors had been charged £1,784,465.32 more in fees than they would have been charged if the funds had attracted Henderson's lower passive management fees. In doing so, the FCA found that HIFL had not treated all investors in the funds fairly, and had thereby violated Principle 6.

The FCA also found that HIFL was in breach of Principle 3 as it had failed to have adequate oversight of HGIL concerning how these funds were managed, and in particular, HIFL should have ensured that these sorts of issues were considered by HIFL's governing committees or compliance function. The FCA also decided that HIFL had not adequately monitored the performance of these two funds, and if it had done, it would have seen that it was not performing at the level at which it was intended to be performing. Further, there was no system in place for considering whether fees should change when investment strategy changed.

The FCA found that the nearly four and a half years it took for HIFL to identify the harm was a significant aggravating factor, particularly because it should have realised that the funds were underperforming what had been expected.

Tullett Prebon (Europe) Limited

The FCA fined Tullett Prebon £15.4 million as a result of breaches of:

- Principle 2 (a firm must conduct its business with due skill, care and diligence)
- Principle 3 (a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems)
- Principle 11 (a firm must deal with its regulators in an open and cooperative way, and must disclose to the FCA appropriately anything relating to the firm of which that regulator would reasonably expect notice).

The FCA noted that improper broker conduct was a market risk, particularly within the Rates Division of Tullett Prebon. The FCA found that, in breach of Principle 2, on a number of occasions Senior Managers had taken no action even in the face of "blatant signals" of broker misconduct. Relatedly, the FCA found that Tullett Prebon had breached Principle 3 as it had failed to have in place adequate and effective systems and controls to prevent or minimise broker

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misconduct. For these breaches, the FCA imposed a penalty of £10.5 million.

The FCA also found a breach of Principle 11, which arose in the following circumstances. The FCA issued an information requirement for certain telephone recordings from Tullett Prebon. The firm told the FCA that Tullett Prebon had a 12-month deletion protocol for recordings, and that the requested recordings had been deleted. On the day Tullett Prebon said this to the FCA, a senior manager at the firm was emailed by the voice communications department informing him that some of the requested audio was in fact available. The senior manager did not inform the FCA of this new information. Later, the FCA asked for a different recording, but again the compliance department did not check with the voice communications department, and the FCA continued with the belief that the recordings had been deleted. Almost two years later, two senior managers found out that historic audio had in fact not been deleted. Those senior managers failed to inform the FCA of this updated information for another 6 months. When the FCA was informed, an incorrect explanation for why the historic recordings had been found was given. For these breaches of Principle 11, the FCA fined Tullett Prebon £4.9 million.

Two important points emerge from this case: first, whilst not unusually so, the FCA was clear in the Final Notice that there had been certain failures of Senior Managers. Had these events taken place under the new SMCR, it is very likely that, as well as the firm, there would have been actions against Senior Managers as well.

Second, the fine for breach of Principle 11 was nearly £5 million. Firms should have procedures in place to make sure that delays in notifying the FCA do not occur. The additional 6 month delay from when the two Senior Managers knew about the audio recordings to when the FCA was informed is worth especially singling out, as it could have been avoided had the correct procedures and policies worked.

FCA Criminal Actions

As set out in the Market Abuse section (Section 2 above), the FCA successfully brought criminal actions against two individuals for insider dealing. The prosecutions of Walid Choucair and Fabiana Abdel-Malek arose after Ms. Abdel-Malek had used her position as a compliance officer to pass inside information to Mr. Choucair, a day trader and family friend.

Both Mr. Choucair and Ms. Abdel-Malek received sentences of three years' imprisonment, notwithstanding that Mr. Choucair had made some £1.4 million in profit, and Ms. Abdel-Malek had in return benefitted from enjoying some expensive nights out. The judge ruled, however, that because Ms. Abdel-Malek had acted in breach of her position of trust as a compliance officer, both defendants should receive the same sentence. Confiscation proceedings consequent to the convictions are expected.

The Choucair/Abdel-Malek prosecution is notable for the amount of time and money the FCA was willing to expend on it. After a full trial in late 2018 which led to a hung jury, the FCA sought an 11-week re-trial. The FCA is willing to pursue these types of cases, notwithstanding the expense, and even though there is very little expectation that there will be any recovery of costs – or indeed any substantial disgorgement – from the individual defendants.

This was not the only case brought by the FCA under its criminal powers in 2019, however. In September, Konstantin Vishnyak, who previously worked at VTB Capital in London, appeared in Court charged with the offence of falsifying, concealing, destroying or otherwise disposing of a document which he knows or expects would be relevant to an FCA investigation. Mr. Vishnyak's case was transferred to the Crown Court where he faces a fine and/or imprisonment for up to two years.

Mr. Vishnyak was under investigation by the FCA for insider dealing offences, and he is alleged to have deleted WhatsApp from his phone thereby destroying potential evidence. We await to hear the outcome of this prosecution, which is likely to be known during the first half of 2020.

Standard Life Assurance Limited

The FCA fined Standard Life Assurance Limited (Standard Life) £30,792,500 for breaches of Principle 3 (a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems) and Principle 6 (a firm must pay due regard to the interests of its customers and treat them fairly). The breaches were found to have subsisted between July 2008 and 31 May 2016 – almost eight years.

This was one of two similar cases brought by the FCA in 2019 against different entities relating to the sale of non-advised annuities to existing customers

who were reaching retirement age. The FCA found that front line staff were inappropriately incentivised in their remuneration structures to sell the annuities. The FCA stated that Standard Life did not have adequate systems and controls in place to ensure that customers were receiving accurate and sufficient information when being sold the annuities. In particular, it was found that customers were not given appropriate information such as that the consumer was entitled to look to other annuity providers to find a better option for them, or that, based on their health and lifestyles, they may have been entitled to purchase an enhanced annuity. The FCA noted further that the target consumers were potentially vulnerable customers and the purchases of annuities would likely affect the rest of their lives.

The FCA found that there was inadequate monitoring of the sales of these complex products to consumers, and there were not systems in place to ensure that management was provided with sufficient information to be able to identify failings. As such, Standard Life was able to place its interests above those of its customers, and at the same time was unable to identify that it was doing so.

This substantial fine was imposed notwithstanding that Standard Life had been "very co-operativ[e]" with the FCA and had already paid out approximately £25 million in redress to consumers by the date of the FCA Final Notice, and was expected in due course to pay c. £61 million to consumers.

Of particular note in this case was the lack of management oversight, and consequently the length of time it took Standard Life to identify these breaches. Whilst an effective flow of management information is not a new issue for firms, it has only become more important with the extension of the SMCR to all FCA solo-regulated firms on 9 December 2019. Now, senior managers have a duty of responsibility to ensure that the areas of the business under their purview are functioning appropriately. To discharge this responsibility, senior managers will need to show that they have taken reasonable steps to ensure that any breaches are avoided or at least prevented from continuing. To do this, senior managers will need to be sure that they are receiving the information they need to have effective oversight, and that this is documented appropriately.

Standard Chartered Bank (SCB)

The largest financial penalty of the year issued by the FCA was to SCB, which was fined £102,163,200 for money laundering breaches, particularly in relation to customer due diligence and the firm's ongoing monitoring programme.

The FCA found that there were a number of customers in the United Arab Emirates (UAE) whose transactions with SCB were inconsistent with their business profile. Further, there were customers whose source of funds for transactions was unclear. The FCA also noted that some customers of SCB had links with countries subject to sanctions, but SCB had not dealt with this appropriately.

The FCA was particularly concerned with SCB's conduct in the context where it had previously provided feedback relating to money laundering to SCB, and indeed regulators and prosecutors in the United States had already taken actions against the firm. Indeed, the FCA noted that on various occasions SCB had conducted its own internal reviews finding that there were inadequacies in the money laundering controls, yet these had not been rectified.

The FCA found that SCB had failed to conduct "enhanced customer due diligence" in circumstances that clearly required enhanced measures given the heightened financial crime risk involved. One particular example relied upon by the FCA involved a consulate opening an account with SCB using c. £500,000, which was brought into the country by the consul as cash in a suitcase. In other cases, SCB identified that a "politically exposed person" (PEP) was involved in a transaction, but failed to seek sufficient information to understand exactly how the PEP was involved.

The FCA noted that, even where adequate (or at least additional) information had been sought by SCB for an enhanced due diligence review, the information was merely gathered, and had not been assessed.

SCB was also found to have failed in its ongoing monitoring obligations, whereby there were failures to conduct periodic reviews of clients at appropriate intervals. There was also a failing to conduct reviews after "trigger events".

Another matter of note was that the FCA put weight on the fact that the money laundering standards set by the bank in the UK were used as "global standards" across its entire group. The FCA found that in failing to

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have adequate standards adhered to in the UK, SCB risked there being money laundering violations across the world.

Money laundering remains a hot topic for FCA enforcement cases, and in recent years, it has been the cause of a number of very significant financial penalties, including the one issued to SCB. With the extension of the SMCR, the vast majority of FCA solo-regulated firms are required to have a senior manager appointed to the SMF 17 position[15] – Money Laundering Reporting Officer. The individual holding this senior management function will be personally responsible for ensuring that the firm's money laundering and financial crimes controls are in place and functioning. This notwithstanding, as the FCA noted in the SCB decision notice, firms have not infrequently fallen foul of money laundering rules in circumstances where "financial crime compliance is perceived … to be the responsibility of compliance or a few key individuals". The FCA expects a culture of vigilance to the dangers of financial crime and money laundering to be instilled across the firm, and failure to do this can have very significant consequences.

Transaction Reporting

Another area of enforcement the FCA continues to show interest in is in relation to transaction reporting. In recent years, the volume and variety of reports market participants have to make has grown substantially. One repeated criticism the FCA has had, however, is that the quality of these reports is inadequate.

In 2019, the FCA fined UBS AG £27,599,400 for a number of transaction breaches contrary to SUP 17 of the FCA Handbook.[16] The FCA found that UBS AG had failed, over a nine and a half year period:

- to report c. 3.65 million reportable transactions
- misreported a further c. 83 million transactions
- to report c. 49.1 million transactions that did not in fact occur or which were not recordable.

In making these failings, the FCA found that UBS AG had also breached Principle 3 (reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems). These errors were further aggravated by the then-regulator – the FSA – having issued a previous financial penalty of £100,000 two years before the relevant period in this case for similar failings.

In a similar case, the FCA issued a financial penalty against Goldman Sachs International (GSI) of £34,344,700. Over a very similar almost nine and a half year period, the FCA found that GSI had:

- failed accurately to report approximately 204.1 million transactions
- failed to report at all an estimated 9.5 million transactions and
- failed to take reasonable steps to prevent the erroneous reporting (whether giving incorrect details, or whether the transactions in fact did not occur) for a further c. 6.6 million transactions.

The FCA noted that GSI had submitted approximately 1.5 billion transaction reports within this period, meaning that approximately 15% of all reports were incorrect in some way. As with UBS AG, the FCA found that there was also therefore a breach of Principle 3.

The Carphone Warehouse

In March 2019, the FCA announced that it had imposed a fine of £29.1 million on The Carphone Warehouse Limited (CPWL) for failings that led to the mis-selling of mobile phone insurance and technical support product called 'Geek Squad' between 2008 and 2015. The FCA found that CPWL had breached:

- Principle 3 (a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems)
- Principle 6 (a firm must pay due regard to the interests of its customers and treat them fairly) and
- Principle 9 (a firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment).

The FCA found that CPWL failed to give its sales consultants the right training to provide suitable advice to customers purchasing the Geek Squad product. In particular, sales consultants were not trained adequately to assess a customer's needs to determine whether Geek Squad was suitable. They were trained to recommend Geek Squad regardless of whether customers already had cover, for example through their home insurance or bank accounts. No training was provided on how to respond when customers gave answers indicating the policy may not

15 One of the "senior management functions" specified by the FCA.
16 The "Supervision" section of the FCA Handbook.

be appropriate and, further, staff advised customers in such a situation to take out the policy and cancel within 14 days. This created a risk that customers would purchase insurance that they did not need and would be exposed to the risk of paying for it if they did not cancel in time.

When customers complained about the sale of Geek Squad, CPWL failed to properly investigate and fairly consider their complaints. This resulted in valid complaints not being upheld in circumstances where the product had been mis-sold. As a result, management did not have an accurate impression of indicators of mis-selling.

During the period under investigation (1 December 2008 to 30 June 2015), CPWL made regulated sales of Geek Squad policies worth over £444.7 million. A high proportion of these policies were subsequently cancelled early. For example, in January 2014, 35% of policies were cancelled within the first three months from inception. The FCA noted that high cancellation rates are an indicator of a risk of mis-selling which CPWL failed to properly consider.

The FCA's enforcement action followed an investigation that stemmed from whistleblowing reports. The Final Notice is critical of CPWL's whistleblowing systems and controls, noting that during the period under investigation, whistleblowing logs were incomplete. Consequently, the firm was unable to evidence how incidents had been raised by whistleblowers, some of which were indicative of mis-selling.

CPWL did not dispute the FCA's findings, but exercised its right under the FCA's partly contested case process, to ask the FCA's RDC to assess the appropriate level of sanction. As the firm accepted the regulator's findings, it qualified for a 30% discount.

Mark Steward, executive director of Enforcement and Market Oversight at the FCA, said: "The Carphone Warehouse and its staff persuaded customers to purchase the Geek Squad product which in some cases had little to no value because the customer already had insurance cover. The high-level of cancellations should have been a clear indicator to the management of mis-selling. Without whistleblowers coming forward these practices may never have come to light. In the past few years, whistleblowers have contributed critical intelligence to the enforcement actions we have taken against firms and individuals".

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