RQC Group Quarterly Regulatory Newsletter January 2021

Introduction

Welcome to our Q4, 2020 newsletter. This is part of a series that aims to provide you with a quarterly update of key regulatory issues affecting the UK/EU and the USA.

First and foremost, we would like to wish you, your families, friends and colleagues, a happy and safe New Year.

In our previous newsletter, we made an analogy between the last few months of 2020 and the 'business end' of a sporting season. As at the start of October there were a number of uncertainties: the state of play regarding Covid including whether a vaccine would become available; the outcome of the Brexit negotiations; and the US presidential election.

Some, but not all, of these uncertainties have abated, and it is hoped that 2021 will be a relatively 'stable' year, notwithstanding the longer-term economic consequences of Covid.

Regulators and legislators will plough on with their initiatives; there are several lined up for the coming 12 months. In Europe this includes topics such as: ESG; financial resources; conduct, culture and accountability; the transition from LIBOR; cryptocurrency regulation; and updating existing legislative programmes. The UK will have greater flexibility to follow its own regulatory path now that the Brexit transition period has ended, albeit the UK's regulatory framework may continue to closely follow that of the EU, in certain aspects at least. The ability of UK financial institutions to access EEA clients, investors and markets remains unresolved.

In the US, along with regulatory focus areas such as cryptocurrency and cybersecurity, discussions on diversity and inclusion will continue, as the industry moves to structurally acknowledge the benefits of diverse thought and better represent the investors that it serves. Soon the Division of Examinations, formerly the Office of Compliance Inspections and Examinations or OCIE, will release its annual examination priorities. These priorities are expected to contain familiar themes around conflicts of interest and risk, guiding the SEC's reviews for the coming year.

The focus of financial services regulators might shift from 'firefighting' (as was the case in particular in the early months of the Covid outbreak) to a more regular workload of supervisory and enforcement action. Enforcement remains a powerful deterrent when used correctly. If 2020 represented a 'grace period', 2021 could see compliance sanctions re-emerge with a vengeance, for both financial institutions and individuals.

As ever, we hope that you enjoy reading our newsletter and that you find it helpful. If you have any feedback please share it with your consultant.

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UK/EU - Ongoing Developments

Brexit – uncertainties remain for financial services

Just before Christmas, the EU and the UK emerged from the 'last chance saloon' and announced that they had agreed a trade and cooperation agreement (the "**Agreement**"). This follows from the UK referendum on leaving the European Union in June 2016, the emergence of the term 'Brexit', the UK formally leaving the EU in January 2020, the heated debates, political posturing and legal arguments, let alone the sheer cost of what is essentially a transitional exercise.

The draft text of the Agreement amounts to 1,246 pages. Much of the focus is on trade in goods. However with respect to services, including financial services, uncertainties remain.

Whilst the Agreement provides for tariff-free movement of goods between the EU and the UK, there is no provision in the Agreement that guarantees the free and unfettered right of UK financial institutions to provide services in the European Economic Area (**"EEA**"), either via establishment of a branch in the EEA or on a cross-border basis.

The same applies with respect to EEA financial institutions providing services in the UK. This is notwithstanding unilateral initiatives from the UK that provide short-term continuity of access to such institutions, such as the FCA's Temporary Permissions Regime. Whilst generally hailing the success of the Agreement, UK Prime Minister Boris Johnson conceded that the Agreement "perhaps does not go as far as we would like" regarding financial services. Rishi Sunak, the UK's Chancellor of the Exchequer, made some bullish remarks on Brexit providing the UK financial services sector with the opportunity to "do things a bit differently". He also cited an aim to set up agreements on the basis of 'equivalence' and establishment of a memorandum of understanding between the UK and the EU in the next few months; measures aimed to facilitate access to the EU marketplace for UK financial institutions.

'Equivalence', in this context, refers to an agreement between two jurisdictions with different regulatory frameworks, but where the frameworks are similar or substantially similar, thereby enabling a financial institution in one jurisdiction to provide services into another jurisdiction.

Mr. Sunak intimates that the Agreement acts as a 'stepping stone' in setting up 'equivalence' decisions since it makes reference to a stable cooperative regulatory framework. For example, per the Agreement: "The Parties shall make their best endeavours to ensure that internationally agreed standards in the financial services sector for regulation and supervision, for the fight against money laundering and terrorist financing and for the fight against tax evasion and avoidance, are implemented and applied in their territory."

Whilst Mr. Sunak's remarks, combined with the 'goodwill' between the EU and the UK as a result of reaching a trade agreement, indicates that at some point the status quo of market access will be maintained, fundamental issues remain.

Shorter term disruption

There are certain rights that UK financial institutions could historically benefit from that were made unavailable at 11pm UK time on 31 December 2020.

To cite one example, the cross-border and branch passports to which UK investment firms had a right under the Markets in Financial Instruments Directive framework ("**MiFID**") disappeared.

The extension of cross-border passporting rights to financial institutions outside of the EEA can be granted per the MiFID legislation, where the EEA client is an eligible counterparty or a professional client i.e. a 'non-retail' client. The granting of this extension is subject to certain conditions, including an 'equivalence' decision having been made.

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A similar mechanism is in place for extending passports under the Alternative Investment Fund Managers Directive (AIFMD), including the marketing passport that is currently only available where the AIFM (fund manager) and the AIF (fund) are both in the EEA.

Hence whilst there might be a mechanism for 're-activating' historical rights and benefits, these will not apply straight away. As a result, UK financial services firms are obliged to consider their relationships with EU clients and taking appropriate action on a case-by-case basis, for instance considering the client type and the specific jurisdiction of the client. There is no consistency of approach among EEA jurisdictions and certain ambiguities remain. One 'worst case' scenario is that a firm will have to cease the provision of services to a client, notwithstanding that it might be able to re-activate these services on some – as yet undetermined – future date.

Equivalence v independence

From an EU perspective, and with reference to MiFID, 'equivalence' refers to the third-country having prudential and conduct of business regulatory requirements that have an equivalent effect to those of the EU. Although MiFID provides additional detail on what equivalent effect means, there remains much subjectivity in this regard. As a starting position the UK is 'onshoring' EU financial services legislation; hence theoretically at least establishing equivalence should be relatively straightforward.

However going forward, there will inevitably be some divergence between the respective regulatory frameworks.

For example, the UK has advised that it will not be adopting the EU's Sustainable Finance Disclosure Regulation, the first provisions of which take effect in March 2021. The UK will be adopting a similar regime to the EU's new prudential regime for investment firms, albeit 6 months' later.

Politically, commercially and economically, adopting future EU legislation as a matter of routine will not work for the UK. The question then becomes: To what extent can the UK diverge from the EU's financial services framework whilst preserving the principle of 'equivalence'?

Equivalence decisions can be withdrawn at short notice. This may mean longer term uncertainty for UK firms doing business in the EU; a scenario of intermittently being able and unable to provide services to an EU client is a possibility.

The content of the Agreement with respect to financial services only came to light when the Agreement was published, which was a week before the end of the Brexit transitional period. The long-standing regulatory message is that firms are expected to put in place contingency arrangements given the (potential) disruption after 31 December 2020. Whilst some financial services firms (in particular larger firms with an international presence) were able to do this, for others, taking appropriate action in such a short timeframe (approximately 1 week between the Agreement being published and the end of the transitional period) was impractical. Such firms – and their stakeholders which could include their European clients - may be justified in feeling that they have been 'hung out to dry'.

ESG round-up

UK climate disclosure framework announced

On 9 November 2020, the UK's 'TCFD Taskforce' published an interim report and an accompanying roadmap that outline the UK's proposed framework for making climate-related financial disclosures.

The TCFD Taskforce is chaired by HM Treasury and also includes regulatory organisations such as the Financial Conduct Authority and the Bank of England. Its role is to look into how the UK can most appropriately implement the recommendations of the Task Force for Climate-related Financial Disclosures (TCFD), which is mandated by the Financial Stability Board, an international body that monitors and makes recommendations about the global financial system. The recommendations, first published in 2017 and which are summarised in **Table 1**, establish a set of disclosure standards whilst providing some flexibility to organisations regarding the form and content of the disclosures.

The interim report follows on from the UK's 'Green Finance Strategy' from 2019, which is an ambition to use the UK's status as a global financial hub to drive the 'greening' of the international financial system. The UK aspires to introduce climate-related disclosures across the UK economy by 2025, with most action in the first 3 years. This impacts upon both the financial sector and the non-financial sector, thereby creating an aligned set of disclosure requirements across multiple industries. For example, where an asset manager invests in a UK listed company, the disclosure of information from company to asset manager to the asset manager's clients and end-investors is consistent. The roadmap in this regard is set out in **Table 2**.

Larger asset managers, representing circa 75% of total assets under management, will be required to implement the regime in 2022. Merely by way of illustration, the interim report states that this comprises asset managers with assets under management of greater than £50 billion. The regime will then be implemented for the remaining asset managers in 2023. The FCA will consult on the disclosure framework for asset managers, most likely in the first half of 2021, with final rules published before the end of 2021. It is envisaged that this framework will include: disclosure of strategy; policies and procedures; and covering recommended disclosures complemented by more targeted disclosures at the fund or portfolio level.

Table 1 - TCFD Recommendations

Governance	Strategy	Risk Management	Metrics and Targets
Disclose the organisation's governance around climate-related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material.	Disclose how the organisation identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

Table 2 - Roadmap towards mandatory TCFD-aligned disclosures (financial and non-financial institutions)

2021	• Occupational pension schemes with value of >£5 billion • Banks, building societies and insurance companies • Premium listed companies - covering two-thirds of the market capitalisation of equities on the UK Official List (£1.9 trillion)
2022	• Occupational pension schemes with value of >£1 billion • Largest UK-authorised asset managers, life insurers and FCA-regulated pension providers (merely by way of illustration, the interim report states that this comprises asset managers with assets under management of >£50 billion) • UK-registered companies • Wider scope of listed companies
2023	• Other UK-authorised asset managers, life insurers and FCA-regulated pension providers
2024/5	• Other occupational pension schemes (subject to review)

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Divergence from EU disclosure?

The EU's ESG-themed disclosure regime, the Sustainable Finance Disclosure Regulation (SFDR) has been in the planning for some time and takes effect from 10 March 2021. Click here to read our earlier article on this and other EU initiatives in our previous Quarterly Newsletter. The timing of the aforementioned TCFD publications came at a time of Brexit uncertainty. The UK is not obligated to adopt any EU legislation that takes effect after the end of the Brexit transitional period on 31 December 2020. The UK's proposed regime whilst sharing some characteristics with SFDR, differs in many ways most pertinently scope – whilst SFDR has a focus on sustainable finance in the wider sense, the UK's regime focuses on the narrower concept of climate change. A UK financial institution that is obligated to implement both regimes may encounter challenges due to the inconsistencies between the regimes.

The UK government and the financial services regulators have indicated that the UK will not be adopting SFDR. As a result, SFDR will not apply as a matter of course to UK financial institutions including asset managers and investment advisers. However, SFDR appears to have an extra-territorial scope; non-EEA firms seeking to promote a product into the EEA may therefore be subject to certain aspects of SFDR, including product-level disclosures. Furthermore, individual EEA countries may insist on compliance with SFDR as a pre-requisite to accessing their national private placement regime. This might mean that in due course, UK asset managers and advisers will be subject to both the UK's climate-related disclosure regime plus the EU's sustainable finance disclosure regime.

It may also be the case that the UK will not adopt other EU legislative initiatives concerning ESG, such as the 'taxonomy' framework and amendments to existing frameworks such as AIFMD, MiFID and UCITS.

ESG remains a multi-dimensional puzzle

It could be contended that 2020 has been a crucial year for ESG. If 2019 was characterised – in the public's imagination at least – by the emergence of Greta Thunberg as a powerful advocate, the events of 2020 further turbo-charged the debate. In 2021 the US will re-join the Paris Accord on Climate Change; a far cry from the viewpoint of the outgoing 45th President who once tweeted: 'It's freezing in New York – where the hell is global warming?'

Organisations, including financial institutions, have an increased commercial imperative to place ESG front and centre, and non-binding (from a legal or regulatory standpoint) initiatives could play a key role. The UK's TCFD Taskforce appears to acknowledge this. Their interim report envisages that putting in place climate-related disclosures will have the knock-on effect of changing how organisations think about climate-related risks and opportunities. Therefore, some initiatives could be industry-led, with regulatory standards in place to provide investor protections, including improving transparency and preventing wrongdoing, for instance, 'greenwashing'.

However, challenges remain for firms seeking to put in place an appropriate ESG framework.

There are a number of global initiatives on ESG, such as the high-level United Nations Principles for Responsible Investment, the Sustainable Accounting Standards Board (SASB) standards, the IFRS Foundation's Consultation Paper on Sustainability Reporting and the World Economic Forum's White Paper on Common Metrics and Consistent Reporting of Sustainable Value Creation produced by the World Economic Forum in conjunction with Deloitte, PwC, KPMG and EY; which overlap without wholly aligning. There are also initiatives that focus on a particular aspect of ESG, in particular with respect to governance, such as the G20/OECD Principles Of Corporate Governance, first published in 1999.

Certain national regimes will differ – for example the UK's climate-related disclosures versus the EU's SFDR, as discussed above – adding to the complexities for organisations doing business globally. Even within a national regime, ESG concepts might be introduced over time and embedded into a number of initiatives, and this might complicate matters further. Even the implementation of a single initiative could contain challenges. The 'regulatory technical standards' that accompany EU SFDR will be finalised after the primary legislation takes effect, thereby forcing affected firms to apply the regime using their best judgements in the first instance.

It may transpire that ESG standards, practices and mandatory requirements will converge over time, as ESG becomes further embedded into the mainstream activities of many firms. In the meantime many asset managers and investment firms will be performing the dual role of keeping abreast with legal and regulatory developments whilst considering their commercial imperatives regarding ESG.

The UK's prudential regime for investment firms

During the quarter there were two key developments in shaping the UK's Investment Firms Prudential Regime ("**IFPR**"). The first is that the date upon which IFPR takes effect will be 6 months later than anticipated. The second is that the FCA published its first consultation paper on IFPR.

The new regime will streamline and simplify the prudential requirements for solo-regulated investment firms in the UK, including MiFID investment firms and fund managers including alternative investment fund managers. At present, there are many different regimes which apply depending on size of firm and type of investment business.

1 January 2022 implementation announced

On 16 November 2020 HM Treasury plus the UK's financial services regulators – the Prudential Regulation Authority and the Financial Conduct Authority – issued a joint statement in which they set a target date for implementation of IFPR of 1 January 2022.

In June 2020, the FCA published a discussion paper (DP20/02) that sets out proposals regarding IFPR, which affects MiFID investment firms and other asset managers including certain alternative investment fund managers. Per the FCA proposals, IFPR shall closely replicate the EU's equivalent legislative package, the Investment Firms Regulation and Investment Firms Directive which shall take effect in EU Member States on 26 June 2021. It had been envisaged that the IFPR would take effect at the same time. However industry feedback expressing concern at the volume of regulatory reform in 2021 prompted the UK authorities to establish a later target date.

IFPR is intended to simplify the prudential framework for investment firms, including – for most firms – de-coupling this framework from the prudential regime for banks and other credit institutions. It affects various aspects of an investment firm's regulatory requirements including: regulatory capital and the regulatory capital requirement; liquidity; concentration risk; consolidation; governance; remuneration; disclosures; and regulatory reporting.

As a result of this development, the UK and the EU will operate under significantly different prudential frameworks (for investment firms) in the latter half of 2021.

FCA publishes first consultation on new prudential regime for UK investment firms

The FCA followed up on this on 14 December 2020 by publishing Consultation Paper CP20/24, in which it seeks views on its proposed rules for IFPR.

This is the first of 3 consultations that the FCA is issuing in advance of the regime taking effect in January 2022. Final rules will be published over the course of next year.

CP20/24 tackles certain aspects of IFPR including:
- Categorisation of investment firms
- Prudential consolidation
- Own funds – definition, composition of capital and requirements
- Concentration risk monitoring
- Reporting requirements

Follow-on consultations will cover aspects of IFPR including liquidity, risk management, governance, remuneration and disclosure.

The FCA is keen to receive feedback from stakeholders through this and later consultations. Feedback will allow the FCA to develop final rules that achieve its, and Parliamentary, objectives for the regime, and that are also workable for FCA investment firms.

The consultation period for this first consultation closes on Friday 5 February 2021.

Senior Managers and Certification Regime Round-up

Publication of Directory Persons data

Directory Persons data for FCA and PRA regulated firms is currently being published on the Financial Services Register.

Solo-regulated firms (i.e. firms that are authorised and regulated by the FCA) are require to submit data on Directory Persons by 31 March 2021. Therefore, some but not all data pertaining to such firms is appearing on the Register currently.

Directory Persons data includes data with respect to certified staff and directors who are not performing Senior Manager Functions, such as non-executive directors.

In due course, the Directory itself will go live, and the data currently on the Register will be transferred to the Directory.

SMCR and coronavirus: regulatory expectations

The FCA has updated solo-regulated firms on certain flexibilities previously afforded when applying SMCR, due to the onset of the Covid-19 pandemic.

In the update, dated 18 December 2020, the FCA takes the general view that firms have adapted to the impact of Covid-19 and therefore these flexibilities are no longer necessary.

- **Senior Management responsibilities**

It continues to be the case that the FCA does not require firms to have a single Senior Manager responsible for their coronavirus response. However with respect to the risks in their areas of responsibility, Senior Managers should consider:

- where the current situation might lead to emerging risks
- how it affects existing risks, along with the controls used to manage them

- **Statements of Responsibilities and 'significant changes' to Senior Manager Responsibilities**

The FCA previously advised that in certain circumstances, where a firm needs to make temporary arrangements in direct response to the pandemic, and this affects the responsibilities of Senior Managers, there is not a requirement to submit updated Statements of Responsibilities ("**SoRs**") to the FCA.

This provision ended on 7 January 2021. Firms should apply the notification requirements as normal and submit a 'Form J' when significant changes are made to SoRs after this date. Changes made before this date and were not previously notified to the FCA, should be clearly documented internally.

- **Temporary arrangements for Senior Management Functions**

The FCA previously issued a Modification by Consent to the 12-week rule. As a result, firms could make temporary arrangements as a result of the pandemic (for example, to cover the prolonged absence of a Senior Manager) for longer than 12 weeks, by sending a notification to the FCA.

A firm cannot consent to the modification after 30 April 2021 and all modifications consented to before then will come to an end on that date

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- **Furloughed staff**

The FCA advised that there may be cases where firms decide to furlough Senior Managers if they are unable to fulfil their responsibilities, e.g. due to illness, caring responsibilities or if they have no current practical responsibilities. Unless a furloughed Senior Manager is permanently leaving their post, the manager retains their approval during their absence and will not need to be re-approved by the FCA when they return.

It remains the case that individuals performing 'required functions' – e.g. Compliance Oversight and the money laundering reporting officer (MLRO) – should only be furloughed as a last resort.

Funds Round-Up

- **ESMA consults on fund marketing communications**

On 9 November 2020, the European Securities and Markets Authority ("**ESMA**") published a Consultation Paper, 'Guidelines on marketing communications under the Regulation on cross-border distribution of funds'.

EU regulation on facilitating cross-border distribution of collective investment undertakings was published in June 2019. This specifies that marketing communications addressed to investors are identifiable as such and describe the risks and rewards of purchasing units or shares of an AIF or units of a UCITS in an equally prominent manner, and that all information included in marketing communications is fair, clear and not misleading.

This also mandates ESMA to develop guidelines on the application of these requirements for marketing communications, taking into account the on-line aspects of such marketing communications.

The Consultation Paper represents the first step in developing these guidelines, which include:

- The identification as such of marketing communications
- The description of risks and rewards in an equally prominent manner
- The fair, clear and not misleading character of marketing communications

It is expected that the final guidelines will be published before 2 August 2021.

- **Public Consultation on AIFMD**

On 22 October 2020, the European Commission launched a public consultation on AIFMD.

The consultation seeks views on how to achieve a more efficiently functioning EU AIF market as part of a stable financial system. The deadline for completing the questionnaire is 29 January 2021.

- **ESMA report on sanctions under AIFMD**

On 12 November 2020, ESMA published its first annual report on the use of National Competent Authorities (i.e. national financial services regulators) under AIFMD.

In 2018, 11 regulators imposed 63 penalties amounting to around EUR 4.5 million.

In 2019, 13 regulators imposed 45 penalties amounting to around EUR 9 million.

Over the two years, the total value of penalties was highest in Poland, followed by France.

UK/EU - Regulatory News

ESMA Newsletter No 19

22 December 2020

The European Securities and Markets Authority ("ESMA") published the 19th edition of their newsletter on 22 December 2020.

The newsletter covers various items of interest to investment firms and fund managers, including:

- The continued application of the EU trading obligation for derivatives after the end of UK's transition from the EU on 31 December 2020
- Updated Q&As on MiFID costs and charges, and EMIR reporting
- A significant increase in fines under the Market Abuse Regulation ("**MAR**") and accepted market practices under MAR
- Consultation on the impact of algorithmic trading
- Guidelines on cloud outsourcing
- Final guidance on leverage risk for alternative investment funds.

FCA establishes Temporary Registration Regime for cryptoasset businesses

16 December 2020

On 16 December 2020, the FCA announced that it has established a Temporary Registration Regime to allow existing cryptoasset firms, who have applied to be registered with the FCA, to continue trading.

The FCA became the anti-money laundering and counter terrorist financing (AML/CTF) supervisor for such firms on 10 January 2020. From this date, cryptoasset firms operating before this date ('existing firms') have had to comply with the Money Laundering Regulations and be registered with the FCA by 10 January 2021. (Businesses who began operating after 10 January 2020 are required to obtain full FCA registration before conducting business.)

The Temporary Registration Regime is for existing firms which have applied for registration before 16 December 2020. Such firms are able to trade after 9 January 2021 and up until 9 July 2021, pending the FCA's determination of their application.

Firms that did not submit an application by 15 December 2020 will not be eligible for the temporary registration regime. They will need to return cryptoassets to customers and stop trading by 10 January 2021.

Cryptoasset firms include firms that exchange money to and from cryptoassets and those that safeguard their customers' cryptoassets.

Notification Thresholds under the Short Selling Regulation

15 December 2020

Following the end of the Brexit transitional period, HM Treasury intends to lay an Statutory Instrument under **the Short Selling Regulation (SSR),** amending the initial notification threshold under Article 5(2) for the reporting of net short positions to the Financial Conduct Authority (FCA), in relation to the issued share capital of a company that has shares admitted to trading on a trading venue, from 0.2% to 0.1%. This change will come into force on 1 February 2021. The FCA will provide information to reporting persons with respect to notifications in the interim period.

EU Commission: Regulation amending MiFID II on threshold for weekly position reporting published

15 December 2020

The EU Commission has **published** a regulation amending the Markets in Financial Instruments Directive II (MiFID II), such that the minimum threshold that requires weekly position reporting will be reduced from a relative threshold to 10,000 lots.

The minimum threshold regarding the size of open positions should be amended to provide transparency to stakeholders on a broader range of commodity derivatives. The publication of weekly position reports should no longer depend on the size of open interest in comparison with the size of deliverable supply but should instead be based on simpler criteria, namely the size of open interest in that commodity derivative.

As regards the open interest threshold, weekly position reports should be published where the total combined open interest in spot contracts and other months' contracts is equal to, or exceeds, 10,000 lots, so as to ensure that there is sufficient interest in a commodity derivative to justify the publication of weekly position reports.

In order to reduce the risk of a breach of confidentiality concerning position holders, for contracts where a category of persons includes fewer than five active position holders, the weekly position report published should include no information regarding that category of persons.

FCA consults on Fees

19 November 2020

On 19 November 2020, the FCA published a **consultation paper** on regulatory fees and levies.

The proposals include fee amendments related to certain regulatory submissions that require FCA approval, including:

- Increases to the fees for applying to be authorised by the FCA. For example, the fee for an agency asset manager to increase from £5,000 to £10,000 and the fee for an investment adviser to increase from £1,500 to £2,500
- Certain variation of permissions fees to increase, dependent upon the nature of the variation
- A fee of £500 for a 'change in control' application (there is no fee currently)
- A fee of £250 for an application under the Senior Managers Regime (there is no fee currently)

The FCA invites feedback from stakeholders prior to 22 January 2021. The FCA will then publish its feedback and final rule amendments in March 2021.

Financial Services Bill introduced to Parliament

26 October 2020

On 21 October, the **Financial Services Bill** ("**FSB**") was introduced to Parliament.

Forming part of the Government's wider **Future Regulatory Framework** (**FRF**) initiative, the FSB is the first step towards HM Government's objective of maintaining the competitive position of the UK financial services industry and capitalising on new opportunities following the end of the Brexit transitional period.

The FSB initially proposes a limited number of measures which are aimed at avoiding functional issues with rules introduced during the UK's membership of the EU. More significant reforms are expected in due course as part of the FRF.

Among the measures suggested are:

- Implementing the remaining Basel 3 standards and Investment Firms Prudential Regime (IFPR)
- Clarifying and extending the FCA's powers to ensure the wind-down of the LIBOR benchmark
- Extending the transitional period for the use of third country benchmarks to 2025, avoiding the risks associated with the sudden loss of access by UK users
- Updating the MiFIR regime, which regulates the activities of third country investment firms in the UK, following an equivalence decision. This will ensure the FCA has an appropriate degree of oversight over firms registering under the regime
- Amending the Market Abuse Regulation to enhance the effectiveness of the regime and reduce some of the administrative burden on issuers. Criminal penalties for market abuse will be increased

- Completing the implementation of the EMIR REFIT, to ensure that clearing members and those offering clearing services do so on a fair, non-discriminatory and transparent basis. The measures also aim to improve the quality of trade repository data and make it easier for firms to switch between trade repositories
- Amending the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation, to enable the FCA to make clarificatory rules regarding its scope and remove reference to performance scenarios. HM Treasury will be given the power to extend the current exemption for UCITS funds

ESMA publishes review of MAR

15 November 2020

The European Securities and Markets Authority ("**ESMA**") published, on 23 September 2020, a review of the EU Market Abuse Regulation ("**MAR**"). The report contains various discussions and proposals for enhancing and developing the MAR. For example, the report proses more clarity on what constitutes 'inside information, how long to keep insider lists, clarification of the market sounding regime, among other items.

Although MAR will continue to apply (in a modified form) in the UK once EU law ceases to apply, any changes arising from ESMA's report will not occur until 2021 at the earliest and so will not track through into the UK version of MAR. It will be for the Financial Conduct Authority to decide whether to implement similar changes in the UK.

FCA publishes final rules banning sale cryptoasset derivatives and ETNs to retail consumers

6 October 2020

The FCA has published final rules banning the sale of derivatives and exchange traded notes ("**ETNs**") that reference certain types of cryptoassets to retail consumers.

The FCA considers these products to be ill-suited for retail consumers due to the harm they can pose, such as extreme volatility in price and an inadequate understanding of cryptoassets by retail consumers.

Unregulated transferable cryptoassets are tokens that are not 'specified investments' or e-money, and can be traded, which includes well-known tokens such as Bitcoin, Ether or Ripple. Specified investments are types of investment which are specified in legislation, and firms that carry out particular types of regulated activity in relation to those investments must be authorised by the FCA. The FCA is seeking to address the potential harms of cryptoasset derivatives – instruments that are regulated – by making rules banning the sale, marketing and distribution to all retail consumers of any derivatives (contract for difference, options and futures) and ETNs that reference unregulated transferable cryptoassets by firms acting in, or from, the UK.

UK/EU - Enforcement

FCA fines Charles Schwab UK over safeguarding and compliance failures

21 December 2020

The FCA has fined Charles Schwab UK ("**CSUK**") £8.96 million for failing to adequately protect client assets, carrying out a regulated activity without permission and making a false statement to the FCA.

Client money was swept across from CSUK to its affiliate Charles Schwab & Co., Inc. ("**CS&C**"), a firm based in the United States. The client assets, which were subject to UK rules, were held in CS&C's general pool, which contained both firm and client money and which was held for both UK and non-UK clients.

Failing to adequately protect client assets

CSUK failed to arrange adequate protection for its clients' assets under UK rules. Specifically, the firm:

- did not have the right records and accounts to identify its customers' client assets
- did not undertake internal or external reconciliations for its customers' client assets
- did not have adequate organisational arrangements to safeguard client assets
- did not maintain a 'CASS resolution pack', which would help to ensure a timely return of client assets in an insolvency

Carrying out a regulated activity without permission

CSUK did not at all times have permission to safeguard and administer custody assets, and failed to notify the FCA of the breach when applying for the correct permission.

Making a false statement to the FCA

Without making adequate enquiries to check whether this was

correct, the firm inaccurately informed the FCA that its auditors had confirmed that it had adequate systems and controls in place to protect client assets.

There was no actual loss of client assets.

Compliance professional's insider dealing conviction upheld by the Court of Appeal

16 December 2020

The UK Court of Appeal has upheld the criminal insider dealing convictions for Fabiana Abdel-Malek, formerly a senior compliance officer at UBS and Walid Choucair, a day trader.

Ms Abdel-Malek was convicted of passing inside information to Mr Choucair in respect of five transactions; which she had no business reason to access. Mr Choucair's profit was approximately, £1.4 million from the trading that was the subject of the five charges.

Mark Steward, Executive Director of Enforcement and Market Oversight at the FCA, commented: "The case… demonstrates the FCA's determination to ensure those who abuse our markets, like these defendants, are held to account in accordance with the law, especially given deliberate abuse of trust and the use of sophisticated tactics to avoid detection."

FCA fines and prohibits hedge fund Chief Investment Officer for market abuse

15 December 2020

The FCA has fined Corrado Abbattista, formerly a portfolio manager, partner and Chief Investment Officer at Fenician Capital Management LLP, £100,000 for market abuse and prohibited him from performing any functions in relation to regulated activity.

The FCA found that Mr. Abbattista creating a false and misleading impression as to the supply and demand for equities. On multiple occasions he placed large misleading orders for Contracts for Difference (CFDs), referenced to equities, which he did not intend to execute. At the same time, he placed smaller orders that he did intend to execute on the opposite side of the order book to the misleading orders. Through his large misleading orders, Mr Abbattista falsely represented to the market an intention to buy/sell when his true intention was the opposite.

Mr Abbattista was aware of the risk that his actions might constitute market manipulation, but recklessly went ahead with those actions anyway. On account of this recklessness, the FCA concluded that he acted with a lack of integrity.

The trading patterns were identified by the FCA's surveillance systems. A key take-away for firms is the risk that the FCA might detect activity constituting market abuse that has not been picked up by a firm's internal compliance system. This could lead to the FCA taking action against a firm over a systems and controls failing.

FCA fines investment advisory firm

10 December 2020

On 10 December 2020, the **FCA fined LJ Financial Planning Ltd** £107,200 for providing its customers with unsuitable pension switching and transfer advice and failing to manage its conflicts of interest. The firm recommended that 114 customers transfer their pensions into self-invested personal pensions (SIPPs), without providing any advice on the underlying investments which were to be held in those SIPPs. These investments were often high-risk, esoteric and illiquid.

In addition to the FCA fine, the firm has to date paid redress of £2,668,819.97 to 41 customers who have been impacted by this failing.

This case demonstrates that oftentimes, the detrimental impact of FCA enforcement action on a firm goes beyond the regulatory sanction.

ICO issues fine to British Airways for data breach affecting more than 400,000 customers

26 October 2020

The UK data protection regulator, The Information Commissioner's Office ("ICO"), **has fined British Airways (BA) £20m** for failing to protect the personal and financial details of more than 400,000 of its customers.

The ICO found that the airline was processing a significant amount of personal data without adequate security measures in place. This failure broke data protection law and, subsequently, BA was the subject of a cyber-attack during 2018, which it did not detect for more than two months.

Notably, the incident commenced with a "supply chain attack" where BA's network was accessed by an attacker using the stolen remote login of a third-party supplier.

After access, the attacker altered web forms to redirect customer payment card data to a website owned and controlled by the attacker.

The attacker is believed to have potentially accessed the personal data of approximately 429,612 customers and staff, some of which are believed to have included names, addresses, payment card numbers and CVV numbers.

ICO investigators further found that BA did not detect the attack on 22 June 2018 themselves but were alerted by a third party more than two months afterwards on 5 September. Once they became aware BA acted promptly and notified the ICO.

It is not clear whether or when BA would have identified the attack themselves. This was considered to be a severe failing because of the number of people affected and because any potential financial harm could have been more significant.

Although this is not a sanction against a financial services firm, the FCA expects such firms to have an appropriately robust framework in place regarding data security, and this remains a regulatory 'hot topic'.

The FCA charges Richard Jonathan Faithfull with one offence of money laundering.

25 November 2020

Following a joint investigation by the FCA and City of London Police, the FCA has charged **Richard Jonathan Faithfull** with one offence of money laundering, contrary to Section 327 of the Proceeds of Crime Act.

Mr Faithfull is due to appear at Westminster Magistrates Court on 26 January 2021.

The offence relates to activity between 1 June 2017 and 1 August 2018.

The FCA will not make any further comment pending Mr Faithfull's first appearance in court.

FCA fines broker for market misconduct

23 November 2020

The FCA **has fined TFS-ICAP**, an FX options broker, £3.44 million for communicating misleading information to clients.

Between 2008 and 2015, brokers at TFS-ICAP carried out the practice of 'printing' trades. This involved brokers communicating to their clients that a trade had occurred at a particular price and/or quantity when no such trade had actually taken place. TFS-ICAP brokers, across multiple broking desks, did this openly and over a prolonged period. Printing trades sought to encourage clients to trade when they might not have done, to generate business for TFS-ICAP. As such, TFS-ICAP did not observe proper standards of market conduct.

Furthermore, TFS-ICAP did not react to warning signs that printing might be taking place or act to address the risk of it, and so failed to act with due skill, care and diligence.

Neither were there any records to evidence the practice which, in turn, meant the investigation had to establish the existence of a practice that was opaque and unrecorded in any of TFS-ICAP's records.

TFS-ICAP also had shortcomings in its oversight and compliance arrangements to detect and counter the risk of brokers providing price or quantity information on the basis that it was based on actual trades when these had not taken place.

TFS-ICAP agreed to resolve this case with the FCA, thereby qualifying for a 30% discount to the overall financial penalty imposed. Without this discount, the FCA would have imposed a financial penalty of £4.92 million.

FCA bans three individuals over non-financial criminal convictions

06 November 2020

The FCA has **banned three individuals** from working in the financial services industry, following their convictions of serious non-financial criminal offences.

In each instance, the individual was found to be not fit and proper. Under the **Senior Managers and Certification Regime** ("**SMCR**") the 'fit and proper test' applies to Senior Managers, Certification Function Holders and Non-executive Directors.

The offences included the making, possession and distribution of indecent images of children, voyeurism and sexual assault. In each case the individual was required to sign the sex offenders' register.

This is a significant development regarding the FCA's approach in determining when the 'fit and proper test' has been breached, with reference to activity conducted either outside of the workplace and/or where the activity is unrelated to financial services.

In the past, the FCA has focussed on fraud or dishonesty outside of the workplace. This included an individual who was banned from the industry for persistent train fare evasion.

However, this demonstrates that the FCA may also sanction an individual for other offences and in particular those where it is demonstrated that the individual lacks 'moral character'. It is possible that this mirrors social trends such as the '#MeToo' and '#BlackLivesMatter' movements.

This presents some challenges for firms that are obliged to assess the fitness and propriety of certain members of staff when they first perform the role in question, and on an ongoing basis.

The parameters of activity that may constitute a lack of fitness and propriety are arguably now more ambiguous. For example, what would the position of a firm, or the FCA, be should a member of staff be convicted of a serious racist of religious hate crime? Possession of illegal drugs?

Furthermore, under SMCR, Certification Function Holders are not vetted by the FCA, which places a further onus on firms to make appropriate fitness and propriety assessments.
Improving conduct, culture and accountability at financial institutions is a key regulatory initiative. These three enforcement cases demonstrate an expectation that conduct outside of the workplace is embedded into this, and that an appropriate standard of conduct is expected at all levels within a FCA regulated firm.

FCA and PRA fine Goldman Sachs International £96.6m for risk management failures in connection with 1MDB

25 November 2020

The FCA and the Prudential Regulation Authority (PRA) have fined Goldman Sachs International ("**GSI**") a total of £96.6 million (US$126 million) for risk management failures connected to Malaysian sovereign wealth fund, 1Malaysia Development Berhad ("**1MDB**"), and for its role in three fund raising transactions for 1MDB.

The FCA and PRA fines are part of a US$2.9 billion globally coordinated resolution reached with the Goldman Sachs Group Inc. ("**GSG**") and its subsidiaries. The global resolution includes, among others, the US Department of Justice and the US Securities and Exchange Commission ('SEC').

US regulators have previously fined both GSI and its former employee Tim Leissner for their involvement in the 1MDB fraud.

1MDB is a Malaysian state-owned development company that has been at the centre of billion-dollar embezzlement allegations. GSI underwrote, purchased and arranged three bond transactions for 1MDB in 2012 and 2013 that raised a total of US$6.5 billion for 1MDB. The 1MDB transactions were approved by global GSG committees that GSI participated in, and were booked to GSI.

The 1MDB transactions involved clients and counterparties in jurisdictions with higher financial crime risk. GSI was also aware of the risk of involvement of a third party that GSI had serious concerns about. GSI failed to assess and manage risk to the standard that was required given the high risk profile of the 1MDB transactions, and failed to assess risk factors on a sufficiently holistic basis.

GSI also failed to address allegations of bribery in 2013 and failed to manage allegations of misconduct in connection with 1MDB in 2015.

Mark Steward, FCA Executive Director of Enforcement and Market Oversight, said: "Firms have a crucial role to play in tackling financial crime, and in helping to maintain the integrity of the financial system. GSI's failure to take appropriate action in this case shows that it did not take this responsibility seriously. When confronted with allegations of bribery and staff misconduct, the firm's mishandling allowed severe misconduct to go unaddressed. There is no amnesty for firms that tackle financial crime poorly, and the size of GSI's fine reflects that".

First FCA fine over short selling reporting

25 November 2020

The FCA has fined Asia Research and Capital Management Ltd ("**ARCM**") £873,118 over short selling reporting failures.

The firm failed to notify the FCA and disclose to the public its net short position in Premier Oil Plc built between February 2017 and July 2019.

From 24 February 2017 to 5 July 2019, ARCM failed to make 155 notifications to the FCA and 153 disclosures to the public of its net short position in Premier Oil. By 5 July 2019, ARCM had built a net short position equivalent to 16.85% of the issued share capital in Premier Oil, which was then held by ARCM for a further 106 trading days before being notified to the FCA and disclosed to the public.

This is the first time the FCA has taken enforcement action for a breach of the 'Short Selling Regulation'.

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

"Failure to report disclosable short positions undermines the integrity and efficiency of financial markets. ARCM repeatedly breached reporting rules and failed to provide important information to us and to the market. This fine reflects the seriousness of these breaches."

USA - Ongoing Developments

SEC adopts modernized marketing rule for investment advisers

On 22 December 2020, the SEC announced modernized rules governing investment adviser advertisements and payments to solicitors, creating a single rule that replaces the current advertising and cash solicitation rules.

The final rule, which includes an extended transition period, has been designed to comprehensively and efficiently regulate investment advisers' marketing communications.

The rule replaces the current advertising rule's broadly drawn limitations with principles-based provisions designed to accommodate the continual evolution and interplay of technology and advice. Examples include:

- Advisers will be required to standardize certain parts of a performance presentation in order to help investors evaluate and compare investment opportunities
- Advertisements that include third-party ratings will be required to include specific disclosures to prevent them from being misleading
- The rule also will permit the use of testimonials and endorsements, which includes traditional referral and solicitation activity, subject to certain conditions

Summary

On 22 December 2020, the SEC announced modernized rules governing investment adviser advertisements and payments to solicitors, creating a single rule that replaces the current advertising and cash solicitation rules.

The Marketing Rule under the Act

The amendments to Rule 206(4)-1 will replace the broadly drawn limitations and prescriptive or duplicative elements in the current rules with more principles-based provisions, as described below:

1. Definition of advertisement

The amended definition of "advertisement" contains two prongs: one that captures communications traditionally covered by the advertising rule and another that governs solicitation activities previously covered by the cash solicitation rule.

2. General prohibitions

The marketing rule will prohibit the following advertising practices:

- Making an untrue statement of a material fact, or omitting a material fact necessary to make the statement made not misleading
- Making a material statement of fact that the adviser does not have a reasonable basis for believing it can substantiate
- Including information that would reasonably be likely to cause an untrue or misleading implication or inference to be drawn
- Discussing potential benefits without providing fair and balanced treatment of all associated material risks or limitations
- Referencing specific investment advice provided that is not presented in a fair and balanced manner
- Including or excluding performance results in a manner that is not fair and balanced
- Including information that is otherwise materially misleading

3. Testimonials and endorsements

The marketing rule prohibits the use of testimonials and endorsements in an advertisement, unless certain disclosure, oversight, and disqualification provisions are satisfied:

- Disclosure. Advertisements must clearly and prominently disclose whether the person giving the testimonial or endorsement (the "**promoter**") is a client and whether the promoter is compensated. Additional disclosures are required regarding compensation and conflicts of interest. The rule will eliminate the current requirement that an adviser obtain from each investor acknowledgements of receipt of the disclosures
- Oversight and written agreement. An adviser using testimonials or endorsements in an advertisement must oversee compliance with the marketing rule, and must enter into a written agreement with promoters, except where the promoter is an affiliate of the adviser or the promoter receives de minimis compensation
- Disqualification. The rule prohibits certain "bad actors" from acting as promoters

4. Third-party ratings

The rule prohibits the use of third-party ratings in an advertisement, unless the adviser provides disclosures and satisfies certain criteria pertaining to the preparation of the rating.

5. General performance information

The rule prohibits including in any advertisement:

- Gross performance, unless also presenting net performance;
- Any performance results, unless provided for specific time periods in most circumstances
- Any statement that the SEC has approved or reviewed any calculation or presentation of performance results
- Performance results from fewer than all portfolios with substantially similar investment policies, objectives, and strategies as those being offered in the advertisement
- Performance results of a subset of investments extracted from

a portfolio, unless the advertisement provides the performance results of the total portfolio

- Hypothetical performance, unless the adviser adopts and implements policies and procedures designed to ensure that the performance is relevant to the financial situation and investment objectives of the intended audience and the adviser provides certain information underlying the hypothetical performance
- Predecessor performance, unless there is appropriate similarity with regard to the personnel and accounts at the predecessor adviser and the personnel and accounts at the advertising adviser

Amendments to the Books and Records Rule and Form ADV

The SEC also adopted amendments to the books and records rule, and amended Form ADV to require advisers to provide additional information regarding their marketing practices to help facilitate the SEC's inspection and enforcement capabilities.

In conclusion

The aforementioned amendments will be published on the SEC's website and in the Federal Register, and will all be effective 60 days after publication in the Federal Register.

The SEC has adopted a compliance date that is 18 months after the effective date to give advisers a transition period to comply with the amendments.

The complete final rule can be read here.

USA - Regulatory News

Observations from examinations of broker-dealers and investment advisers: large trader reporting obligations

16 December 2020

The SEC released observations from the Office of Compliance Inspections and Examinations ("**OCIE**") examinations of SEC-registered investment advisers and broker-dealers for compliance with Rule 13h-1.

Rule 13h-1 (the "**Rule**") was adopted to assist the SEC in both identifying and obtaining information on market participants that conduct a substantial amount of trading activity, as measured by volume or market value, in national market system ("**NMS**") securities (such persons are referred to as "**Large Traders**").

The Rule requires investment advisers, whose transactions in NMS securities meet or exceed the daily or monthly thresholds identified by the Rule to self-identify to the SEC on Form 13H. During examinations, OCIE observed that some investment advisers were either not aware of the Rule or were not familiar with certain requirements.

Background

Rule 13h-1 defines a Large Trader as a person whose transactions in NMS securities equal or exceed 2 million shares or $20 million during any calendar day, or 20 million shares or $200 million during any calendar month.

A Large Trader must file and periodically update Form 13H, which provides the SEC with general information about its business, regulatory status, affiliates, governance, and broker-dealers where the Large Trader has an account. Upon receipt of Form 13H, the SEC will assign to each Large Trader a unique identification number ("**LTID**"), which must then be disclosed to all broker-dealers effecting transactions on its behalf.

Staff Observations

During a number of examinations focused on compliance with Rule 13h-1, staff observed numerous instances of potential non-compliance with the Rule including where Large Traders may not have self-identified with the SEC and/or may not have filed their annual Form 13H as required by the Rule.

OCIE observed that firms were responsive and improved their procedures, processes and controls to help ensure compliance with the Rule. Firms that missed filing obligations took steps to address those issues, including the submission of Forms 13H for prior years. OCIE encourages investment advisers to thoroughly review and, where appropriate, amend their supervisory and compliance policies and procedures to ensure compliance with the Rule.

In particular, investment advisers transacting in NMS securities are encouraged to review their compliance policies and procedures around:

- Identifying situations that could lead to becoming a Large Trader under the Rule e.g. where an investment adviser enters into a new discretionary client or customer agreement
- Timely filing of Form 13H, with respect to both the annual filing and obligations to provide amended filings
- Promptly amending Form 13H following the end of a calendar quarter in which any of the information contained within the filing becomes inaccurate for any reason
- Notifying any broker-dealers through which the investment adviser executes transactions of its Large Trader status

The full Risk Alert can be read here.

OCIE observations: investment adviser compliance programs

19 December 2020

The SEC's Office of Compliance Inspections and Examinations ("**OCIE**") issued a Risk Alert providing an overview of notable deficiencies and weaknesses identified by staff related to Rule 206(4)-7 (the "Compliance Rule") under the Investment Advisers Act of 1940. In summary, these include:

A. General prohibitions

OCIE observed advisers not devoting sufficient resources to their compliance programs. For example:

- Chief Compliance Officers ("**CCOs**") with numerous other professional responsibilities, either internally or with outside firms, appearing not to devote sufficient time to fulfilling their responsibilities as CCO
- Compliance staff with insufficient resources to implement an effective compliance program e.g. a lack of adequate training or insufficient staff
- Advisers with significant growth in size or complexity who had not hired additional resources or sufficiently tailored their compliance policies and procedures

B. Insufficient authority of CCOs

Staff observed CCOs with insufficient authority within the adviser to develop and enforce appropriate policies and procedures. For example, instances were noted where:

- CCOs were restricted from accessing critical compliance information
- Senior management appeared to have limited interaction with the CCO
- CCOs were not consulted by senior management and employees of the adviser regarding matters that had potential compliance implications

C. Annual review deficiencies

Staff observed advisers that were unable to demonstrate that an annual review had been performed, or where the annual reviews failed to adequately identify existing compliance or regulatory problems. In addition, advisers frequently failed to review significant areas of their business, such as policies and procedures surrounding the oversight and review of recommended third-party managers, cybersecurity, and the calculation of fees and allocation of expenses.

D. Implementing actions required by written policies and procedures

Staff observed advisers failing to implement or perform actions required by their written policies and procedures, for example:

- Not training employees
- Not implementing compliance procedures regarding trade errors, advertising, best
- execution, conflicts, disclosure and other requirements
- Not reviewing advertising materials
- Not following compliance checklists and other processes, including the testing of business continuity plans
- Not reviewing client accounts to assess consistency of portfolios with investment objectives

E. Maintaining accurate and complete information in policies and procedures

The staff observed policies and procedures that contained outdated or inaccurate information, including off-the-shelf policies containing unrelated or incomplete information.

F. Maintaining accurate and complete information in policies and procedures

The staff observed advisers that failed to maintain formal, written policies and procedures or did not establish, implement, or appropriately tailor written policies and procedures reasonably designed to prevent violations of the Advisers Act.

Where firms had maintained written policies and procedures, the staff observed deficiencies or weaknesses in the following areas:

- Portfolio management
- Marketing
- Trading practices
- Disclosures
- Advisory fees and valuations
- Safeguarding of client privacy
- Books and records
- Safeguarding of client assets
- Business continuity plans

The full Risk Alert can be read here.

Observations from OCIE's examinations of investment advisers: supervision, compliance and multiple branch offices

09 November 2020

The SEC's Office of Compliance Inspections and Examinations ("**OCIE**") issued a Risk Alert describing its observations resulting from a series of examinations focusing on investment advisers operating from numerous branch offices. This exam initiative included nearly 40 examinations of advisers' main offices combined with one or more examinations of each adviser's branch offices. These advisers collectively managed approximately $110 billion in assets for about 185,000 clients, the majority of whom were retail investors.

The staff observed that the branch office model may pose certain risk factors that advisers should consider in designing and implementing their compliance programs and in supervising personnel and processes occurring in branch offices.

The observations were categorized by OCIE as follows:

A. Compliance and supervision

1. Compliance Programs

The vast majority of the examined advisers were cited for at least one deficiency related to the Compliance Rule. The staff observed that more than one-half of these advisers had compliance policies and procedures that were:

- Inaccurate because they included outdated information
- Not applied consistently in all branch office
- Inadequately implemented
- Not enforced

The Compliance Rule issues were most often related to:

- **Custody of client assets**
  Advisers did not have policies and procedures limiting the ability of supervised persons to process withdrawals and deposits in client accounts, change client addresses of record, or both. In many instances, the issues related to advisers failing to recognize that they had custody of clients' assets.

- **Fees and expenses**
  Advisers did not have policies and procedures that included identifying and remediating instances where undisclosed fees were charged to clients. In addition, policies and procedures governing such fees were not enforced, and most fee billing issues were related to the lack of oversight over fee billing processes.

2. Oversight and supervision of supervised persons

Supervision deficiencies related to:

- Failure to disclose material information, including disciplinary events of supervised persons
- Portfolio management, such as the recommendation of mutual fund share classes that were not in a client's best interest; and
- Trading and best execution, including enforcing policies and procedures the adviser had in place

3. Advertising

Advisers often had deficiencies related to advertising, both generally and specifically regarding the materials prepared by supervised persons located in branch offices.

Examples of problematic advertisements included:

- Performance presentations that omitted material disclosures
- Superlatives or unsupported claims
- Professional experience of supervised persons or the advisory firm that were falsely stated
- Third-party rankings or awards that omitted material facts regarding these accolades

4. **Code of Ethics**
   Several of the advisers were cited for code of ethics deficiencies as a result of failure to:
   - Comply with personal trading reporting requirements
   - Review transactions and holdings reports
   - Properly identify access persons
   - Include all required provisions in their own codes of ethics

   Examples of provisions omitted from codes of ethics include those requiring a review and approval process prior to supervised persons investing in limited or private offerings; initial and annual holdings report submissions and quarterly transaction report submissions.

B. Investment advice

More than one-half of the examined advisers were cited for deficiencies related to portfolio management practices, most often were related to:

1. Oversight of, or reasonable basis for, investment recommendations

- **Mutual fund share class selection and disclosure issues.**
  Advisers frequently purchased share classes of mutual funds that charged 12b-1 fees instead of lower cost share classes of the same mutual funds. The advisers stood to benefit from the clients paying for higher cost share classes, which created a conflict of interest that was not disclosed to clients.

- **Wrap fee program issues.**
  Advisers failed to adequately assess whether programs were in the best interests of clients, erroneously charged commissions, misrepresented or failed to have appropriate disclosures regarding their wrap fee program, or failed to implement appropriate oversight of trading away practices, including monitoring whether sub-advisers traded away.

- **Rebalancing issues.**
  Advisers implemented automated rebalancing of accounts that caused clients to incur short-term redemption fees from mutual funds. Certain advisers did not consider whether these automated processes, which caused clients to pay additional fees, were in the best interest of the clients.

2. Conflicts of interest disclosures
Several advisers were cited for issues related to conflicts of interest that were not fully and fairly disclosed, such as expense allocations that appeared to benefit proprietary fund clients over non-proprietary fund clients. Other advisers did not fully and fairly disclose financial incentives for the advisers and/or their supervised persons to recommend certain investments.

3. Trading and allocation of investment opportunities
Advisers were cited for:
- Lack of documentation demonstrating the advisers' analysis of best execution
- Completing principal transactions involving securities sold from the firms' inventory without prior client consent
- Inadequate monitoring of supervised persons' trading

C. Observations regarding compliance practices

During the course of the examinations, the staff observed a range of practices with respect to branch office activities that advisers may find helpful in their compliance oversight efforts. The staff observed instances where advisers:
- Had policies and procedures in place to oversee all of their office locations (i.e., main and branch offices) and to address the specific activities taking place at their branch offices. Regardless of whether the advisers had policies and procedures tailored specifically for their branch offices, many firms had policies and procedures for compliance monitoring and oversight of branch offices
- Performed compliance testing or periodic reviews of all branch offices at least annually, with some conducting reviews more frequently
- Established compliance policies and procedures to check for prior disciplinary events when hiring supervised persons and periodically confirming the accuracy of disclosure regarding such information
- Required compliance-related training for branch office employees, targeting areas identified as needing improvement based on branch office reviews

The full Risk Alert can be read here.

SEC Division of Enforcement publishes annual report for fiscal year 2020

02 November 2020

The SEC's Division of Enforcement has issued its annual report for fiscal year 2020. The report provides a comprehensive view of the Division's accomplishments over the past year, discusses significant actions and key areas of strategic change, and details the Division's COVID-19-related enforcement efforts.

The report discusses how the Division took affirmative steps to prevent potential fraud related to the COVID-19 pandemic and bring actions against wrongdoers who attempted to capitalize on it, while at the same time continuing to focus on the multitude of existing and new non-COVID-related enforcement issues arising in the normal course.

During fiscal year 2020, the SEC brought 715 enforcement actions (2019: 862), including 405 standalone actions. These actions addressed a broad range of significant issues, including:

- Issuer disclosure and accounting violations
- Foreign bribery
- Investment advisory issues

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- Securities offerings
- Market manipulation
- Insider trading; and
- Broker-dealer misconduct

Through these actions, the SEC obtained judgments and orders totalling approximately $4.68 billion (2019: $4.3 billion) in disgorgement and penalties – a record amount – and returned more than $600 million to harmed investors.

The full annual report can be read here.

CFTC expands exemptive relief for certain non-U.S. commodity pool operators

15 October 2020

The CFTC has adopted rule amendments expanding the exemptive relief available to non-U.S. commodity pool operators ("**CPO**s") and other foreign intermediaries that have only foreign located persons and international financial institutions as clients or participants. For CPOs, the three key changes are:

1. **The introduction of a pool-by-pool exemption approach**
   A non-U.S. CPO may rely on the exemptive relief in respect of a qualifying pool even if it serves as a CPO to other pools in which U.S. persons are invested.

2. **Excluding certain seed capital investments by US affiliates of the CPO when determining whether the relevant pool is limited to non-US participants**
   Initial capital contributions to a pool made by U.S. affiliates of a non-U.S. CPO may be disregarded in determining whether participation in that pool is limited to only foreign located persons.

3. **The inclusion of a safe harbor mechanism**
   The CFTC acknowledged that some non-U.S. CPOs may not have full visibility into the beneficial ownership of pool interests and may not be able to represent with certainty that they are acting only on behalf of foreign located persons participating in their offshore pools.

As such, the Final Rule incorporates a "safe harbor" with respect to inadvertent U.S. participants in offshore pools. A non-U.S. CPO that satisfies certain conditions with respect to its marketing, sale and administration of a non-U.S. pool may rely on this safe harbor mechanism by which the pool will be deemed to satisfy the "foreign located persons" requirement.

USA - Enforcement

SEC orders BlueCrest to pay $170 million to harmed fund investors

08 December 2020

UK-based investment adviser BlueCrest Capital Management Limited agreed to pay $170 million to settle charges arising from inadequate disclosures, material misstatements, and misleading omissions related to the transfer of top traders from its flagship client fund, BlueCrest Capital International ("**BCI**"), to a proprietary fund, BSMA Limited ("**BSMA**"), and replacement of those traders with an underperforming algorithm.

The settlement highlights the conflicts of interest that may arise when investment firms have separate funds for their employees and external investors.

According to the SEC's order, BlueCrest created BSMA to trade the personal capital of BlueCrest personnel using primary trading strategies that overlapped with BCI's. The order finds that, over more than four years, BlueCrest made inadequate and misleading disclosures concerning the existence of BSMA, the movement of traders from BCI to BSMA, the use of the algorithm in BCI, and all associated conflicts of interest.

The order also finds that BlueCrest failed to disclose that it reallocated the transferred traders' capital allocations in BCI to a semi-systematic trading system, which was essentially a replication algorithm that tracked certain trading activity of a subset of BlueCrest's live traders. Additionally, BlueCrest did not disclose certain material facts about the algorithm to BCI's independent directors. According to the order, the algorithm generated significantly less profit with greater volatility than the live traders, and BlueCrest was able to keep more of any performance fees generated by the algorithm than by live traders.

The SEC's order finds that BlueCrest violated antifraud provisions of the Securities Act of 1933 and Investment Advisers Act of 1940 as well as the Advisers Act's Compliance Rule. Without admitting or denying the SEC's findings, BlueCrest agreed to a cease-and-desist order imposing a censure, and must pay disgorgement and prejudgment interest of $132.7 million and a penalty of $37.2 million, all of which will be returned to investors.

SEC charges private equity fund manager for failing to reduce management fees as a result of write downs

22 October 2020

The SEC announced settled charges amounting to just over of $1.2m against EDG Management Company, LLC, a Virginia-based private equity fund manager for failing to adjust management fee calculations to account for write downs of certain portfolio securities, resulting in them charging inflated management fees of $900,000 to limited partners.

According to the SEC's order, the Limited Partnership Agreement (LPA) for the private fund allowed the manager to charge the fund, on a quarterly basis, a management fee based on total invested capital contributions. Further, the LPA provided that the fee be calculated using an amount that should be reduced if certain triggering events occur, including write downs of portfolio securities.

The SEC's order found that, during the period from January 1, 2016 through October 1, 2019, certain portfolio securities were subject to write downs under the terms of the fund's LPA. However, as stated in the order, the manager did not adjust thirteen quarterly management fee calculations to account for these write downs, causing the fund and, ultimately, its limited partners to pay approximately $900,000 more in management fees than they should have paid.

The order charged the manager with violating Sections 206(2) and 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-8 thereunder. Without admitting or denying the SEC's findings, the manager agreed to a cease-and-desist order, to be censured, to pay disgorgement and prejudgment interest totalling $1,026,642, and to pay a $175,000 civil penalty. The manager also agreed to distribute over $1 million to harmed limited partners.

NFA orders Colorado commodity pool operator to withdraw from and not reapply for NFA membership

20 October 2020

The decision, issued by an NFA Hearing Panel, is based on a complaint issued by NFA's Business Conduct Committee and a settlement offer submitted by the Member. The Complaint alleged that the Member engaged in a course of conduct that furthered its interests over the interests of participants in a commodity pool operated by the Member.

Specifically, the Member permitted one of the funds it managed to make improper advances and a prohibited loan to an affiliated non-Member company. The complaint also alleged that, among other things, the Member failed to diligently supervise the firm's operations.

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Thank you for taking time to read our quarterly regulatory newsletter. Please contact us if you have any questions or feedback.

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