RQC GROUP

RQC Group Quarterly Regulatory Newsletter October 2021

Introduction

Welcome to our Q3, 2021 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 U.S.

At time of writing, the UK is experiencing what could be described as a supply chain crisis, with brawls on service station forecourts as fuel becomes more difficult to obtain, plus warnings over food shortages and rising energy prices this coming winter. A number of reasons have been put forward for this, and whilst this is not the forum to discuss such matters, it's clear that the UK's resilience to stressed situations is being tested. Financial services firms might also face scenarios where it is important for their resilience, including their financial resilience, to be robust. This is one of the key themes underpinning the new prudential regime for investment firms – the 'IFPR' - which takes effect on 1 January 2022. Among other things, the regime seeks to bolster a firm's financial and logistical planning in the event of either a stressed scenario or where the firm is winding down its business operations. This is to reduce the impact of 'harms' to a firm's clients and the wider financial services industry. The FCA wants IFPR to be a game-changer, and firms will need to ensure that their resilience and contingency plans, including having appropriate capital and liquid assets, are suitably robust.

In the U.S. we continue to see enforcement actions brought by the SEC addressing a broad range of issues ranging from disclosure and accounting violations to insider trading to market manipulation. During the quarter the SEC announced awards of approximately $110 million and $4 million to two whistleblowers which resulted in the program crossing the $1 billion in payments threshold. A cautionary note, however, to those seeking a quick payday – the SEC also announced during the quarter that it has barred two individuals from the whistleblower award program, "each of whom has filed hundreds of frivolous award applications"! The SEC typically releases its annual report in November. During its 2020 fiscal year, the SEC obtained judgments and orders totalling approximately $4.68 billion in disgorgement and penalties – a record amount – and we are curious to see if the 2021 results will break that record further.

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.

© Robert Quinn Consulting Limited t/a RQC Group

Contents Page

Click on any of the below topics to go directly to that section of the newsletter

UK/EU - Ongoing developments

IFPR – key components and things to consider – Page 4
Avacade – clarifying the parameters of 'Arranging deals in investments' – Page 8
Honesty, integrity and SMCR – lessons from recent FCA sanctions - Page 9
Insider dealing, temptation, addiction and Covid – a cautionary tale – Page 10

UK/EU - Regulatory News

Firms reminded about potential financial crime risks linked to Afghanistan – Page 13
FCA publishes final rules to strengthen investor protections in SPACs – Page 13
FCA proposing changes to streamline decision-making – Page 14
Financial promotions quarterly data 2021 Q2 – Page 14
FCA consults on post-Brexit divergence for PRIIPS regulation – Page 14
Guiding principles on design, delivery and disclosure of ESG and sustainable investment funds – Page 15
FCA Published Business Plan, 2021/22 and Annual Report and Accounts – Page 16
FCA Publishes Annual Reports on Data Items – Enforcement, Investment Management, Data Transparency and Market Liquidity – Page 17
Market Cleanliness statistics 2020/21 – Page 17
FCA reviews the Derivatives Trading Obligation – Page 17
FCA and Bank of England publish review of open-ended investment funds – Page 18
Diversity and inclusion in the financial sector – Page 18
Authorised fund managers' assessments of their funds' value – Page 18
Primary Markets Effectiveness Review CP21/21 – Page 18

UK/EU - Enforcement

Dolfin Financial – Page 20
FCA published Decision Notice against Geoffrey Armin for lack of skill, care and diligence – Page 20
FCA publishes Decision Notice against Markos Markou for lack of oversight – Page 20
Ian Hudson sentenced to 4 years imprisonment for fraudulent trading and carrying on regulated activities without authorisation – Page 20
FCA publishes final notice and bans fraudster from regulated activities – Page 21

USA - Ongoing Developments

SEC releases observations regarding fixed income principal and cross trades by investment advisers – Page 23
SEC releases observations from examinations of investment advisers managing client accounts that participate in wrap fee programs – Page 23

USA - Regulatory News

NFA proposes amendment to the Branch Office definition – Page 26

USA - Enforcement

SEC settles fraud charges with two former executives of TCA Fund Management Group Corp – Page 28
SEC charges quant analyst in multimillion dollar front-running scheme – Page 28
SEC surpasses $1 billion in awards to whistle-blowers – Page 28
SEC announces three actions charging deficient cybersecurity procedures – Page 28
SEC obtains emergency relief, charges investment adviser and principal with operating $110 million Ponzi scheme – Page 29

© Robert Quinn Consulting Limited t/a RQC Group

RQC GROUP

UK/EU - Ongoing Developments

IFPR – key components and things to consider

The Investment Firms Prudential Regime ('IFPR') takes effect on 1 January 2022. It is a major overhaul of the prudential framework for investment firms and certain asset managers. This article sets out the key components of IFPR, and for each of these a list of things to consider in the coming months.

1. Firms in scope

Broadly speaking, IFPR applies to a firm that is classified as a MiFID investment firm i.e. a firm that performs MiFID activities and one or more of the exemptions from this classification do not apply.
IFPR also applies to certain firms that are not classified as a MiFID investment firm but they perform activities that are equivalent to MiFID activities. This includes a 'Collective Portfolio Management Investment' ('CPMI') firm that falls under the Alternative Investment Fund Managers Directive ('AIFMD') and as well as managing an AIF can also conduct certain 'top-up' activities.

ACTION ITEMS

- Determine whether IFPR applies to the firm
- Determine whether the firm should apply to the FCA to vary its permission, for example where IFPR is deemed to be too onerous, and an alternative prudential regime is available

2. Prudential category

Under IFPR, broadly speaking, most investment firms are divided into 'small and non-interconnected' firms ('SNI firm') and firms that cannot be classified as such ('Non-SNI firm'). The firm is classified as an SNI firm if all of the following criteria are fulfilled:

1. Assets under management (AUM) (which may include advisory mandates) is under £1.2 billion.
2. Client orders handled (COH) (including reception and transmission of orders) is under £100 million per day (cash trades) and is under £1 billion per day (derivatives).
3. The activity of safeguarding and administering assets is not conducted.
4. The activity of holding client money is not conducted
5. The firm does not have permission to deal on own account
6. On- and off-balance sheet total is under £100 million.
7. Total annual gross revenue from investment services and/or activities is under £30 million.
8. The firm's 'daily trading flow' is zero (this relates to dealing on own account or executing orders on behalf of clients in the firm's own name).

Non-SNI firms are subject to additional requirements, compared to SNI firms.

Some of the criteria are applied on a 'group' basis. The purpose of this is to ensure that groups do not split their activities among firms in order to avoid the 'Non-SNI' categorisation.

ACTION ITEMS

- Determine the firm's prudential status as at 1 January 2022
- Put in place a process to re-appraise the firm's ongoing prudential status. This is particularly relevant where a firm is close to one or more of the stated thresholds, meaning that a change in prudential status might be required after 1 January 2022

3. Group considerations

There are additional requirements for IFPR where an 'investment firm group' has been established.

The definition of an 'investment firm group' covers a parent undertaking that is incorporated in the UK or has its principal business in the UK, and its subsidiaries, at least one of which must be a MIFIDPRU investment firm. Broadly speaking, a subsidiary is an

undertaking where the parent undertaking exercises (or can exercise) dominant influence or control over it.

It also covers connected undertakings, which are relevant financial undertakings that are not subsidiaries, but which form part the investment firm group.
Where an 'investment firm group' is identified, the Firm should determine whether it is likely to be subject to the prudential consolidation regime or, where the structure is sufficiently simple, whether an application to the FCA to apply the 'group capital test' should be made.

- **Prudential consolidation regime**

The consolidated framework under IFPR places obligations on a parent undertaking even where it is not FCA regulated.
A 'consolidated situation' is established where certain requirements under IFPR apply to a UK parent entity, as if it and the relevant financial undertakings in its investment firm group, form a single MIFIDPRU investment firm.

© Robert Quinn Consulting Limited t/a RQC Group

Specifically, the UK parent entity must comply with the following on the basis of its consolidated situation:

- Own funds, or
- Own funds requirements, or
- Concentration risk, or
- Liquidity, unless the FCA has granted an exemption, or
- Disclosure, and
- Reporting

- **Group capital test**

The purpose of the group capital test is to ensure that a parent entity holds sufficient regulatory capital to support its capital investment in its subsidiaries, and therefore to create a stable group capital structure.

The requirements are more straightforward compared to the prudential consolidation regime. FCA pre-approval to apply the group capital test is required. However, firms transitioning into IFPR that seek permission to apply the group capital test by **1 February 2022**, can automatically apply the group capital test pending the FCA's decision.

ACTION ITEMS

- Determine whether an investment firm group has been established
- If so, either:
- Ensure that the group complies with the prudential consolidation regime, or
- Seek FCA permission to apply the simpler group capital test and ensure compliance with this framework. Seek FCA approval to apply this framework by 1 February 2022 in order to be able to automatically apply the framework pending the FCA's decision

4. Own funds requirement

'Own funds' refers to an investment firm's eligible regulatory capital. The own funds requirement is a quantitative calculation that established the 'base' or 'minimum' amount of regulatory capital that must be held at all times.

The own funds requirement for a SNI firm is the higher of:

- The permanent minimum capital requirement ('PMR'); to
- The fixed overheads requirement ('FOR')

The own funds requirement for a non-SNI firm is the higher of:

- The permanent minimum capital requirement ('PMR');
- The fixed overheads requirement ('FOR'), or
- The K-factor requirement ('KFR')

- **PMR**

The PMR is either £75,000, £150,000 or £750,000 dependent upon activities conducted. Many agency asset managers and investment advisers will have a PMR of £75,000.

- **FOR**

The fixed overheads requirement is one-quarter of the firm's annual expenses, subject to certain deductions

- **KFR**

The purpose of the K-factors is to cover 'potential harms' arising from conducting various activities. There are 9 separate K-factors, and some or all may apply to a Non-SNI firm. Many firms that historically have been classified as a 'BIPRU' firm or an 'Exempt CAD' firm are likely to be subject to one of more of the following K-factors:

- K-AUM requirement (assets under management) – 0.02% of the firm's average AUM, and
- K-COH requirement (client orders handled) – 0.1% of average COH attributable to cash trades and 0.01% of average COH attributable to derivatives trades

There are various transitional provisions in place to enable firms to ease into the new regime. Among these, the PMR will be introduced gradually. For example, firms subject to a PMR of £75,000 will initially have a PMR of £50,000, with this amount rising by £5,000 per year until 2027.

For exempt CAD firms, there are also transitional provisions that phase in the FOR and (as applicable) the KFR. This recognises that historically such firms have been subject to a 'fixed' regulatory capital requirement only.

For CPMI firms, the aforementioned shall apply in tandem with the existing prudential requirements as set out in AIFMD. Among other things this means that, effectively, the minimum requirement shall remain €125,000.
Various sources of capital can be treated as own funds, including share/members' capital, audited reserves and subordinated loans. The categorisations of eligible capital might not be the same as per a firm's legacy regime.

ACTION ITEMS

- Determine the firm's permanent minimum requirement (£75k, £150k or £750k)
- Determine the firm's fixed overheads requirement
- As applicable, determine the firm's K-factor requirement
- Determine which sources of capital are eligible to be treated as 'own funds', and whether these differ from the legacy prudential framework
- Based upon the foregoing, determine whether the firm is required to alter its capital structure, for example, increase its 'own funds', as a consequence of the implementation of IFPR
- Establish ongoing processes (or amend existing processes) to

© Robert Quinn Consulting Limited t/a RQC Group

5. Liquid assets requirement

Many investment firms have historically been subject to a qualitative liquidity requirement, for instance a requirement to be able to meet liabilities as they fall due. For these firms, IFPR introduces a quantitative liquid assets requirement.

A firm must hold an amount of core liquid assets equal to the sum of:

- One third of the amount of its fixed overheads requirement (i.e. 1 month of fixed expenses), and
- 1.6% of the total amount of any guarantees provided to clients.

Core liquid assets include cash at bank, and trade receivables subject to certain conditions.

Note that for CPMIs, this liquid assets requirement shall operate alongside the equivalent requirement that forms part of the AIFMD prudential regime.

ACTION ITEMS

- Determine the firm's liquid assets and liquid assets requirement
- Establish ongoing processes to monitor liquid assets and the liquid assets requirement

6. The ICARA

The Internal Capital Adequacy and Risk Assessment ('ICARA') is a process that considers whether the systems and controls in place to identify, monitor and, where appropriate, reduce potential material harms, are appropriate. This is with respect to both the ongoing operation of the business and the winding down of its business.

Furthermore, the ICARA seeks to ensure that the financial resources (own funds and liquid assets) held by a firm are adequate for the business it undertakes. This is with respect to the firm's financial viability as it conducts its business activities, and to enable it to conduct an orderly wind down.

The ICARA process is multi-faceted and includes both qualitative and quantitative aspects. It has some similar characteristics to the ICAAP which has historically been a key facet of the prudential regime for certain investment firms. However, for such firms it is not necessarily the case that there will be a 'smooth transition' from the ICAAP regime to the ICARA regime.

Among other things, the ICARA:

- Reviews the effectiveness of a firm's risk management processes
- Identified material harms as applicable to the firms and steps taken to mitigate them
- Sets out the firm's business model assessment and capital and liquidity planning
- Summarises stress testing conducted by the firm
- Sets out the potential recovery actions that the firm has identified, for example in times of financial stress
- Provides an overview of a firm's wind-down planning
- Explains how the firm is complying with the overall financial adequacy rule ('OFAR'). This is an obligation to hold adequate own funds and liquid assets, with reference to the firm's ongoing business activities and wind-down arrangements. This analysis includes determining whether the base own funds requirement (calculated above) is sufficient or whether this needs to be increased to cover the identified material harms (taking into account the steps taken to mitigate these). The analysis also considers liquid assets required in times of stress or to wind down the firm. These liquid assets can be core liquid assets (as described above) or non-core liquid assets including certain investments that can be converted into cash.

The FCA has stated that a firm should have completed an initial ICARA assessment by 1 January 2022. The reason for this is so that a firm can make the adjustments to its own funds and liquid assets, as per the OFAR analysis, in advance of this requirement taking effect. Firms should therefore commence this process sooner rather than later, if they have not already done so.

ACTION ITEMS

- Consider what is required in order to complete the initial ICARA assessment by 1 January 2022
- Where it is concluded that the firm should increase its own funds or liquid assets as a result of the ICARA analysis, ensure that this is enacted by 1 January 2022
- Put in place ongoing processes to review the ICARA at least annually (and more frequently as applicable)

7. Remuneration

IFPR introduces remuneration requirements that standardises the remuneration framework for investment firms.

It replaces existing remuneration frameworks that apply to certain firm types, including the IFPRU remuneration code and the BIPRU remuneration code.
Other firm types, such as Exempt CAD firms, will become subject to a prudential remuneration framework for the first time.

The new framework features a 'tiered' approach. SNI firms will be subject to 'basic' requirements only. Most non-SNI firms will be subject to 'basic' and 'standard' requirements. The largest non-SNI firms will in addition be subject to 'extended' requirements which include the so-called 'pay-out process rules' (for example deferral of variable remuneration and part-payment of variable remuneration in shares).

The new requirements apply with respect to the first remuneration period that commences after 1 January 2022.

For further information on the new remuneration framework, refer to our earlier article Click here.

© Robert Quinn Consulting Limited t/a RQC Group

ACTION ITEMS

- Determine which elements of the new remuneration framework apply to the firm
- Where the firm is not currently subject to a prudential remuneration framework (e.g. an Exempt CAD firm) analyse the requirements and determine the measures that should be put in place
- Where the firm is subject to a prudential remuneration framework (e.g. the IFPRU or BIPRU remuneration code) conduct a gap analysis between the existing and new requirements to determine the changes that should be made to the firm's internal remuneration arrangements
- Where the firm is subject to both the new prudential framework and also an existing remuneration framework (e.g. CPMI firms) determine how the respective frameworks align

8. Concentration risk

IFPR introduces a requirement to monitor and control concentration risk, which includes the risk arising from trading and non-trading book exposures, cash deposits and earnings.

Non-SNI firms are required to submit 'concentration' returns to the FCA. The first of these is for the period Q1, 2022, to be submitted at the end of April 2022.

ACTION ITEMS

- Ensure the firm has in place processes to monitor and control concentration risk
- Non-SNI firms should ensure that they are able to collate the data required for the FCA returns on concentration risk

9. Disclosure

For certain firms, the public disclosure requirements replace the 'Pillar 3' disclosure which is a feature of the IFPRU and BIPRU frameworks. For other firms, for example Exempt CAD firms, public disclosure is a new concept. The FCA has not yet finalised the rules regarding disclosure. However, it is envisaged that there will be a tiered approach, with a greater scope of topics applying to non-SNI firms compared to most SNI firms.

Non-SNI firms are – as a minimum – required to disclose on the following topics:

- Risk management objectives
- Governance arrangements
- Own funds
- Own funds requirement
- Remuneration

Conversely, SNI firms (unless they issue capital instruments that are classified as 'additional tier 1 capital') will be required to make a remuneration-based disclosure only. The disclosures must be made available in an easily found and accessible section of the firm's website.

ACTION ITEMS

- Review the content requirement and ensure the firm has processes in place to capture the information required to publish the disclosure
- Determine when the initial disclosure must be published

10. FCA engagement

Investment firms have historically been required to submit prudential returns to the FCA via the RegData (formerly, GABRIEL) portal. This requirement shall continue to apply, albeit the form and content of the returns shall change. Certain returns, for instance those related to capital, liquidity and (for non-SNI firms) concentration risk, are required on a quarterly basis. There is also a dedicated return with respect to entities subject to the group capital test. In addition to the regular returns, there are a number of 'event driven' returns that include, for example:

- A change of prudential category i.e. from SNI to Non-SNI or vice versa
- An issuance or redemption of regulatory capital
- An application to reduce the fixed overheads requirement

In addition, IFPR introduces mandatory notification requirements where own funds or liquid assets fall to certain levels. This includes where own funds falls to within 110% of the own funds requirement, or when own funds or liquid assets breach the own funds/liquid assets (as applicable) requirement, or reach the 'wind-down trigger' i.e. a level where it is presumed that the firm will instigate its wind-down provisions.

ACTION ITEMS

- Review the updated schedule of RegData returns and put in place a process to complete and file these on a timely basis
- Ensure the firm is aware of the various 'event driven' FCA pre-approval and notification events of relevance to the firm

Conclusion

For many firms, IFPR implementation is a complex project, both in terms of scope and complexity. There are new ways of determining regulatory capital and liquidity requirements, from a quantitative and a qualitative perspective, a revised framework for measuring and tackling harms, business disruption and wind-down planning, and new requirements regarding remuneration, concentration risk, disclosure and FCA reporting.

With less than 3 months to go until the go-live date, firms should ensure that they have a plan in place to be in compliance with the new regime from the outset.

© Robert Quinn Consulting Limited t/a RQC Group

Avacade – clarifying the parameters of 'Arranging deals in investments

A recent UK court case has clarified the parameters of 'Arranging deals in investments' – and provides a warning to firms conducting this activity whilst unregulated.

Since 2001, a significant number of investment firms have been authorised by the FCA to conduct the activity of 'Arranging deals in investments' ('Arranging'). The parameters of this activity have caused some confusion over the years. The scope is perhaps not as obvious as 'Managing investments' or 'Dealing in investments'. The concept is sometimes confused with 'financial promotion'. Finally, there is no direct equivalent to this concept under EU legislation. This is not withstanding that there is some overlap with certain activities per the Markets in Financial Instruments Directive, such as the reception and transmission or orders, or placing of financial instruments without a firm commitment basis.

Furthermore, the concept of 'Arranging' is split into two regulated activities: 'Arranging (bringing about) investments in investments' and 'Making arrangements with a view to transactions in investments'. FCA guidance indicates that the former is aimed at arrangements that would have the direct effect that a particular transaction is concluded, whereas the latter is concerned with arrangements of an ongoing nature whose purpose is to facilitate the entering into of transactions by other parties.

From an initial glance, it would appear that the latter has a far wider scope compared to the former. Whilst the former indicates that the arrangement relates to the completion of a transaction that has already commenced, the latter could relate to a hypothetical transaction – all that is required is for there to be intent for the 'other parties' to enter into a transaction.

By way of a practical example – consider an asset manager that is launching a new fund and is seeking to attract UK investors. Whether or not this activity falls into the FCA's remit is dependent upon a number of factors, including the precise nature of the marketing activity being conducted and the identity of the organisation approving a 'financial promotion'. This has led many organisations to conclude that its UK presence does not necessarily require FCA authorisation.

However, 'Arranging' might be applicable at some point in the investor relations process. The investor and the fund are 'other parties' and therefore 'Making arrangements with a view to transactions in investments' might be conducted at a relatively early stage in the process; albeit arguably 'Arranging (bringing about) deals in investments' would not take effect until later on, for instance should the asset manager arrange for the investor to subscribe to the shares or units in the fund.

Therefore, when considering marketing or promotional activity, a firm might need to look beyond the lens of – for instance – the fund marketing registration requirements per the Alternative Investment Fund Managers Directive or the FCA's 'financial promotions' requirements, and also consider the parallel concept of 'Arranging'.

© Robert Quinn Consulting Limited t/a RQC Group

Avacade

The FCA guidance on the parameters of the 'arranging' activity, per the FCA Handbook, are relatively brief. However, over the years some additional clarification has been provided via the courts. Last August, the UK Court of Appeal handed down its judgment for the pension mis-selling case of FCA v Avacade. The Court of Appeal concluded that Avacade had arranged deals without having the required FCA permission to do so, which is an offence under the Financial Services and Markets Act 2000.

Avacade advised more than 2,000 consumers to transfer £91.8 million from their pensions into self-invested pension schemes that invested in asset classes including life insurance policies, bonds financing real property transactions and ethical forestry. Many of the investments subsequently failed, including a tree plantation in Costa Rica that was severely damaged by a hurricane.

Avacade passed clients on an independent financial adviser, prior to the transaction being finalised. Avacade argued that they performed an 'introductory' role at the commencement of the transaction process Furthermore, they argued that 'making arrangements with a view to transactions in investments' should be construed narrowly, and as such Avacade was not conducting this activity.

The Court of Appeal disagreed, and instead held that:

- The entire process from sourcing the investors to concluding the transactions was part of one set of arrangements that was indivisible and seamless. When viewed holistically this had the effect of making arrangements with a view to transactions in investments, and Avacade performed an integral role in this process, and
- A 'causation' test does not need to apply to the activity of 'making arrangements with a view to transactions in investments'. 'With a view to' indicates that the purpose of the arrangements, as opposed to the actual outcome, is key. As one of the judges quipped: 'You cannot make the proverbial horse drink, but taking it to water involves making arrangements with a view to it drinking'.
-

Perils of being unregulated

This case demonstrates that the scope of 'Arranging' is potentially very wide. It might be the case that a firm is conducting regulated activities whilst unregulated since it is unaware of the parameters of 'Arranging'. This includes non-UK firms that have a UK presence in order to conduct 'investor relations'/'marketing'-type activities'. Whilst Avacade is a high-profile case, in particular due to the intimations of mis-selling pension products to consumers, it demonstrates that conducting regulated activities whilst unregulated can carry significant compliance and business risk.

Options

Firms performing the 'Arranging' activities have two options. The first is to become directly authorised by the FCA. This will involve the firm meeting a number of requirements including: the '4-eyes rule' (having at least two senior managers), having a registered compliance officer and money laundering reporting officer, and compliance with the FCA's prudential requirements including regulatory capital requirements. The second is to become an Appointed Representative of a FCA regulated firm. Effectively, the FCA regulated firm takes regulatory responsibility for the AR, including meeting the aforementioned requirements. It is a viable solution for smaller firms that are looking for an efficient way of conducting regulated activities.

RQC Group can assist with both of these options. We can both project manage your FCA application, and act as a 'principal firm' to firms seeking to perform the 'Arranging' activities (as well as other regulated activities such as advising on investments, managing investments and managing an AIF).

Honesty, integrity and SMCR – lessons from recent FCA sanctions

Under the FCA's Senior Managers and Certification Regime, the concept of 'integrity' is relevant to almost everyone that works in the UK financial services industry. 'You must act with integrity' is one of the Conduct Rules, which set minimum standards of behaviour for industry participants. In addition, individuals that are Senior Managers or perform a certification function are subject to the 'honesty and integrity' component of the 'fit and proper' test.

There are significant consequences where an individual has been found to have failed the 'integrity' test. This includes both FCA sanctions and action that the individual's employer (and potentially future prospective employers) must take under SMCR.

This is demonstrated in two recent FCA enforcement cases.

- **Jon Frensham**

In March 2017, Mr Frensham – an independent financial adviser - was convicted of attempting to meet a child following sexual grooming, an offence committed whilst he was an approved person. The FCA found that Mr Frensham failed in his obligation to be open and transparent with the FCA in failing to inform the FCA about his arrest, being remanded in custody in respect of the offence which led to his conviction, and his failure to inform the FCA of the decision by the Chartered Insurance Institute (CII) not to renew his Statement of Professional Standing and to expel him from membership.

© Robert Quinn Consulting Limited t/a RQC Group

The FCA has stated that although this offence was not connected to financial dishonesty, it considers the seriousness of the offence and all the circumstances enough to conclude that Mr Frensham is not a fit and proper person to perform any regulated function. Mr Frensham had referred the initial Decision Notice and the Upper Tribunal unanimously dismissed Mr Frensham's rebuttal.

- **David King**

Mr King was a FCA Approved Person, performing the 'customer function'. Mr King subsequently pleaded guilty to three counts of theft, one count of fraud by false representation and one count of acquiring, using and possessing criminal property. This related to Mr King defrauding family members by taking their share of his grandparents' estate which they had inherited, and instead of putting the inheritance into investments, he lied to the beneficiaries and used it to fund his own lifestyle.

This took place whilst Mr. King was acting as an Approved Person.

The FCA concluded that Mr. King lacks honesty and integrity and that he is not a fit and proper person to perform any function in relation to any regulated activity.

Whilst the facts of these two cases are different, it demonstrates the potential wide remit of instances where the FCA – or a financial services firm – might conclude that individual lacks integrity. The Frensham case relates to a serious crime where the individual was not honest and open with the FCA. This can perhaps be compared to two earlier cases.

In 2018, the FCA banned Paul Flowers, the former Chair of Co-operative Bank PLC, from the financial services industry. Mr Flowers engaged in behaviour considered to be unethical, including calling inappropriate chat lines whilst at work and using his work email account to send and receive sexually explicit messages, and to discuss illegal drugs. Whilst this activity per se was not illegal (albeit Mr Flowers was subsequently convicted for possession of illegal drugs) is was considered to be conduct unbecoming of someone in a high-profile position.

In 2014, the FCA banned Jonathan Burrows for persistent fare evasion. Whilst Mr Burrows was more up front than Mr Frensham once he was caught (he notified his employer) the FCA nonetheless concluded that Mr Burrows' behaviour was not fit and proper, since he knew that he was committing a criminal offence.

Whilst it is clear that there are certain circumstances where an individual can be sanctioned over actions unrelated to their actual financial services activity, the aforementioned cases demonstrate that in determining whether an individual lacks integrity as a consequence is contingent upon a number of factors including whether the activity involves fraud or another financial crime, the severity of the activity and the profile of the individual within the financial services industry. There are clearly 'grey areas' – Frensham's crime is labelled a 'serious crime', however where is the parameter between a 'serious crime' and a 'non-serious crime'? Or, with reference to the Flowers case, 'ethical' versus 'non-ethical' behaviour? As intimated above, this is not solely an issue for the FCA. Firms will need to consider this in the context of their SMCR procedures, which is part of a wider framework of culture and governance.

We offer a comprehensive suite of CPD-certified SMCR online training courses covering Senior Managers, Certified Staff and Conduct Rules training.

Insider dealing, temptation, addiction and Covid – a cautionary tale

A German fund manager who committed large-scale insider trading has been sentenced to 3 ½ years in jail and ordered to repay €45 million, representing the aggregated trading volume of the individual's illegal transactions.

The individual, a senior investment professional at Union Investment – a large German asset manager – admitted to 55 cases of insider trading between April and September 2020. He used an undisclosed brokerage account to front-run buy and sell orders of blue-chip stocks executed on behalf of his employer.

The individual told the court that he commenced insider trading after feeling 'offended' by a smaller-than-expected pay rise, following a 'deeply frustrating' salary in 2019 of €440,000. He decided to find a 'different way of rewarding himself', according to his psychiatrist.

The proceeds from the insider trading were left untouched, indicating that the individual was – initially - motivated by a feeling of validation as opposed to financial reward. The activity then became an 'addiction'.

The personal account dealing was executed at the individual's desk at his employer's office premises. "As everyone else was working from home, [due to Covid] it was only me and one junior colleague in the office", he told the court.

He was eventually caught after his personal broker flagged the suspicious trades to BaFin, the German regulator. He also passed on the inside information to a friend, who also engaged in insider dealing. The friend was arrested after police found chat messages between the two men.

In the UK, insider dealing is both a criminal and a civil offence. Furthermore, financial institutions are required to have in place appropriate systems and controls to tackle market abuse risk, including with respect to personal account dealing.

© Robert Quinn Consulting Limited t/a RQC Group

This case demonstrates that:

- Financial gain might not necessarily be the primary motivation for committing a market abuse offence
- Firms should have in place personal account trading rules and training plans, to deter individuals from committing market abuse
- Changes to work patterns, for example individuals increasing the time that they spend working remotely or in a more 'unsupervised' environment, might impact upon a firm's market abuse risk profile
- Where market abuse is suspected, the authorities must be informed – in the UK this is via the submission of suspicious transactions and order reports to the FCA. (Note that in the aforementioned case, the broker was criticised by BaFin for not flagging the suspicious trades sooner.)

Our CPD-certified Market Abuse online training course covers how to avoid these and similar pitfalls and the consequences of transgression.

© Robert Quinn Consulting Limited t/a RQC Group

RQC GROUP

UK/EU - Regulatory News

Firms reminded about potential financial crime risks linked to Afghanistan

31 August 2021

Recent developments in Afghanistan have prompted the FCA to highlight the continuing need for robust systems and controls that respond to changing financial crime risks.

The FCA expects firms to be aware of the possible impact these events may have on patterns of financial activity when they assess risks related to particular customers and flows of funds.

Firms must also comply with their legal obligations under the Proceeds of Crime Act 2002 and the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017. This includes the provisions related to firm risk assessments, customer due diligence, enhanced due diligence and transaction monitoring.

While Afghanistan is not currently listed as a 'high-risk jurisdiction', firms are required to apply risk sensitive enhanced due diligence measures where there is a high risk of money laundering or terrorist financing.

The FCA expect firms to consider the impact of these developments on their anti-money laundering policies and procedures in a risk-based manner, and to take the steps necessary to ensure they continue to meet their legal and regulatory anti-money laundering and reporting obligations. Specifically, firms should:

- Ensure that they appropriately monitor and assess transactions to Afghanistan to mitigate the risks if their firm being exploited to launder money or finance terrorism
- Continue to ensure that suspicious activity is reported to the UK Financial Intelligence Unit (UKFIU) at the National Crime Agency (NCA) and that they meet their obligations under Money Laundering Regulations and terrorist financing legislation

Sanctions are in place in respect of Afghanistan. Firms should continue to screen against the UK Sanctions List and in particular the regime specific list for Afghanistan.

Our CPD-certified Anti-Money Laundering online training course provides a sound knowledge and awareness of money laundering and terrorist financing.

FCA publishes final rules to strengthen investor protections in SPACs

10 August 2021

The FCA is changing the Listing Rules to reflect what applies to special purpose acquisition companies (SPACs). These are companies formed for the sole purpose of identifying and acquiring suitable business opportunities. At the IPO stage they are effectively 'shell companies' pending the acquisition(s).

There has been a presumption that a SPAC's listing is when it announces a potential acquisition target, or if details of the proposed acquisition have leaked. This is to protect investors from disorderly markets. The changes, which took effect on 10 August 2021, remove the presumption of suspension for SPACs that meet certain criteria intended to strengthen the protections for investors. These include:

- A 'redemption' option allowing investors to exit a SPAC prior to any acquisition being completed
- Ensuring money raised from public shareholders is ring-fenced
- Requiring shareholder approval for any proposed acquisition
- A time limit on a SPAC's operating period if no acquisition is completed

The USA leads the way in SPACs, with $87 billion raised in the first 3 months of 2021 alone (compared to $83 billion for the whole of 2020). The UK lags behind, but it is hoped that these more relaxed rules will make London a more competitive venue for SPAC listings.

© Robert Quinn Consulting Limited t/a RQC Group

FCA proposing changes to streamline decision-making

29 July 2021

The FCA is consulting on moving some decision-making from its Regulatory Decisions Committee ("RDC") to its Authorisations, Supervision and Enforcement Divisions. This will give greater responsibility for decisions to senior members of FCA staff close to the matters.

As part of the FCA's transformation, the FCA is making changes to ensure that it will continue to be more innovative, assertive and adaptive. The changes proposed today will involve streamlining the FCA decision-making and governance so it can move more quickly to stop and prevent harm faster.

The RDC is a committee of the FCA Board. At present it takes certain decisions on behalf of the FCA. The consultation is proposing that certain decisions will now be made by FCA staff including:

- imposing a requirement on a firm or varying its permissions by limiting or removing certain types of business
- making a final decision in relation to a firm's application for authorisation or an individual's approval that has been challenged
- making a final decision to cancel a firm's permissions because a firm does not meet the FCA's regulatory requirements
- the decision to start civil and/or criminal proceedings

The RDC will continue to make decisions in relation to contentious enforcement cases, where the FCA is proposing a disciplinary sanction or seeking to impose a prohibition order.

Following this consultation, the FCA aims to publish a Policy Statement in or around November 2021.

Financial promotions quarterly data 2021 Q2

21 July 2021

The FCA has published its most recent quarterly data on the number of financial promotions that have been amended or withdrawn due to non-compliance with FCA rules.

Pursuant to reviewing firms' financial promotions, if the FCA concludes that an advert is in breach of their rules, the FCA will ask the firm which has communicated or approved it to withdraw the advert, or change it so that it complies with their requirements. The FCA may also ask firms to consider whether any customers may have acted on the basis of non-compliant promotions and to take appropriate action to remedy any harm which consumers may have suffered as a result.

In Q2 of 2021 the FCA reviewed 439 financial promotions, which includes promotions identified through both complaints received and the proactive work the FCA perform to ensure promotions meet their requirements, including that they are fair, clear and not misleading.

48% of reports received from consumers
28% of reports received from internal areas of FCA
13% of reports received from UK Regulators
6% of reports related to FCA's proactive monitoring
3% of reports received from firms
2% of reports received from other sources

34 cases resulted in 84 promotions being amended or withdrawn through their interaction with authorised firms. A majority of these relate to retail investments or retail lending. 88% of the amend/withdraw outcomes related to either website or social media promotions.

FCA consults on post-Brexit divergence for PRIIPS regulation

20 July 2021

The FCA has set out proposals to change disclosure documents provided to retail investors under the Packaged Retail and Insurance-based Investment Products ('PRIIPs') regulation.

The FCA view is that some products in the Key Information Document ('KID') has potential to contain misleading information as a result of the methodologies used in producing performance scenarios and summary risk indicators.

A key element in the FCA's recent Consultation on the New Consumer Duty was to ensure that firms provide information which is understandable and helps consumers to make properly informed decisions. The FCAs proposed rule changes for PRIIPS aims to give firms greater flexibility to ensure that their communications meet this test.

© Robert Quinn Consulting Limited t/a RQC Group

Sheldon Mills, Executive Director, Consumers and Competition said:

'Exiting the EU has provided us an opportunity to quickly amend technical standards surrounding key information documents as we know that they are not fully achieving the intended aims. We want to ensure that consumers have what they need through transparent information and furthermore through the reduction of potentially misleading information being displayed.'

Following the UK's exit from the EU, the Financial Services Act 2021 allows the FCA to specify whether a product can be classified as a PRIIP under the PRIIPs Regulation as well as allowing the FCA to define what is meant by 'performance information'. The FCA has a range of options on how PRIIPs manufacturers can produce and present performance information most effectively in the KID in order to reduce the risk to consumers.

The FCA is consulting on the most serious concerns over PRIIPs and proposes to:

- Clarify the scope of the PRIIPs regulation making it clearer that certain common features of these instruments do not make them into PRIIPS and guidance on the meaning of PRIIPs being 'made available' to retail investors
- Amend the PRIIPs Regulatory Technical Standards ('RTS') to: require written explanation on performance in the KID; combat the potential for PRIIPs being assigned an inappropriately low summary risk indicator in the KID and; address concerns over applications of the slippage methodology when calculating transaction costs

Subject to the outcome of this consultation, the FCA plans to amend the PRIIPs RTS by the end of 2021, with any changes made coming into effect on the 1st January 2022.

Guiding principles on design, delivery and disclosure of ESG and sustainable investment funds

19 July 2021

The FCA has published a letter to the chairs of authorised fund managers setting out their expectations on the design, delivery and disclosure of environmental, social and governance (ESG) and sustainable investment funds. The FCA has received a high volume of applications for authorisation of funds with a sustainable focus. However, the FCA has found that many of these applications are poor-quality and fall below their expectations. The FCA expects clear and accurate ongoing disclosures to consumers where funds make ESG-related claims. Examples that have fallen below their expectations:

- A proposed passive fund had an ESG-related name that they found misleading as it was looking to track an index that did not hold itself out to be ESG-focused. It also had very limited exclusions from the index, based on high-level ESG criteria
- A fund application claimed to have a strategy to invest in companies contributing to 'positive environmental impact'. The fund intended to invest predominantly in companies that, while reporting low carbon emissions, would not obviously contribute to the net-zero transition. We had expected to see a measurable non-financial objective alongside the financial objective or strategy with information on how that impact would be measured and monitored
- Instances where it was challenging to reconcile the fund's proposed holdings with statements made, setting expectations for consumers. One example was a sustainable investment fund containing two 'high-carbon emissions' energy companies in its top-10 holdings, without providing obvious context or rationale behind it (e.g., a stewardship approach that supports companies moving towards an orderly transition to net zero)

The FCA has developed a set of guiding principles, informed by broad stakeholder liaison and consumer research, to help firms apply our existing rules. The guiding principles are there to ensure that any ESG-related claims are clear and not misleading, both at the time of application and on an ongoing basis, so that consumers can make informed choices.

The guiding principles are relevant where an FCA authorised investment fund pursues a responsible or sustainable investment strategy and claims to pursue sustainability characteristics, themes or outcomes. These principles are targeted at funds that make specific ESG-related claims, not those that integrate ESG considerations into mainstream investment processes.

ESG continues to be an evolving topic. In setting out FCA expectations the letter is helpful to market participants aside from authorised fund managers.

© Robert Quinn Consulting Limited t/a RQC Group

FCA Published Business Plan, 2021/22 and Annual Report and Accounts

15 July 2021

On 15 July 2021, the FCA published its Business Plan for the coming year.

In his foreword to the Business Plan, CEO Nikhil Rathi states that the FCA must become a "forward looking, proactive regulator", in order to meet the challenges of the changing landscape of the UK financial services. This will be done through "innovation, assertiveness and adaptability".

For the retail markets, the FCA intends to focus on:

- Enabling effective consumer investment decisions; ensuring strengthening financial promotions rules around high risk investments and around approval of financial promotions
- Ensuring consumer credit markets work well with access to affordable credit while trying to avoid consumers being overcome by debt, including supervision of "buy now pay later" firms
- Making payments safe and accessible, supervising payment and e-money services
- Delivering fair value in a digital age
- Proposal of a new Consumer Duty, which is under consultation, to raise standards and ensure better treatment of consumers

In the wholesale markets:

- Review of the rules in primary and secondary markets, following the freedom from leaving the EU, to increase the effectiveness of UK wholesale markets. This includes listing and prospectus rules as well as a **review of MiFID rules**, LIBOR transition and liquidity mismatches in open-ended money market funds and property funds
- Non-bank finance: **Supervision of ESG attributes of asset managers**, making sure these are fair, clear and not misleading (no greenwashing). Also working with the Treasury and Bank of England on the Long Term Asset Funds (LTAFs)
- Tighter supervision of Appointed Representatives and Principal Firms. The FCA will carry out targeted supervision and plan to consult on changes to strengthen the AR regime

The FCA also lists a number of priorities across all markets:

- Tackling **frauds and scams**; including stopping regulated firms facilitating fraud, detecting and pursuing improperly authorised fraudsters, and detecting and pursuing FCA-supervised fraudsters
- **Financial resilience** and resolution: In the long term, the FCA wants firms that fail, to do so in an orderly manner. For this to be the case, appropriate capital and reserves are necessary. Firms with financial resources appropriate to their potential to do harm should, over time, reduce the level of FSCS payouts in the FCA's opinion. The Introduction of the **Investment Firms Prudential Regulation** is part of this goal.
- Operational resilience: Firms should be **operationally resilient** across multiple form of disruption to minimise harm. In March 2021, the FCA published a policy statement (PS 21/3) noting changes that will affect, among others: banks, building societies, designated investment firms, enhanced scope senior managers' and certification regime (SMCR) firms and entities authorised or registered under the Electronic Money Regulations 2011. Measures include impact tolerances, i.e. the maximum tolerable disruption
- Diversity and Inclusion: In part ensuring their own working environment is inclusive and representative of the society we live in, the FCA also wants to see regulated firms and listed companies have more **diverse representation**, foster **inclusive cultures** and design and deliver products that reflect the diverse needs of consumers while offering fair value
- ESG: Supporting the Government's aim of net-zero emissions by 2050, working with the Government and international partners to promote **standardisation and setting out disclosure rules**, based on the work of the Task Force on Climate-related Financial Disclosures ('TCFD'). The FCA will monitor institutional investor stewardship, as well as looking at ESG rating providers to see how these support firms in disclosures and benchmarking.

- International cooperation will remain a priority in spite of Brexit.
- Market access, equivalence and trade negotiations: working with the Government to develop mechanisms for cross-border market access and future trade relationships

In its Annual Report and Accounts, the FCA highlights its response to Covid-19, and its quick response to the pandemic in order to support consumers and small firms through various means. For regulated firms, the regulator obviously brought some reporting relief through extended deadlines. It also stepped up monitoring of firms' solvency though surveys.

On the international side, the FCA worked with the Government and Treasury on a range of items, such as the MoUs, Temporary Permissions Regime and onshoring of EU legislation, among others.
Internal restructuring has also been ongoing. The FCA has seen the merging of certain functions in order to be able to better focus on its statutory objectives and enable the regulator to be more responsive and act quickly to changing situations.
The regulator also highlights work on ESG and climate related disclosures in a backward look but which ties in with the business plan and its future endeavours.

© Robert Quinn Consulting Limited t/a RQC Group

FCA Publishes Annual Reports on Data Items – Enforcement, Investment Management, Data Transparency and Market Liquidity

15 July 2021

Part of the regulator's annual report, the Enforcement Data Annual Report sets out the enforcement action taken during 2020/2021. During this time, the FCA issued 134 Final Notices, secured 147 outcomes using their enforcement powers and imposed 10 financial penalties totalling £189.8 million.

The total value of fines has decreased by 15% from 2019/20, from £224.4mn to £189.8mn. The largest value fine in 2020/21 was for £64 million against Lloyds Bank plc, Bank of Scotland plc and The Mortgage Business plc. In 2019/20 the largest was for £102.2 million against Standard Chartered Bank. The number of penalties also dropped, from 15 in 2019/20 to 10 in 202/21. Of these 10, 8 were against firms and 2 against individuals.

The FCA opened 33 cases for insider dealing during the year, and closed 48. Market manipulation cases opened total only 3, but 29 cases were open at the fiscal year start and 15 were closed during the year.

By far, the majority of outcomes of enforcement, publicised during the year, were variation, cancellation or withdrawal of approval/permissions (72.8%, or 107 of a total of 147 outcomes).

Interestingly, in their report, the FCA does not only show financial misconduct data, but also sets out a case study pertaining to non-financial misconduct, namely the prohibition of Mark Horsey. Mr Horsey was one of three cases whose conduct outside of their regulated roles led to prohibitions, because the individuals failed to meet the Fit and Proper criteria.

The FCA also published:

Trade transparency and market liquidity data - tracking proportions of trades carried out on venues with varying levels of trade disclosure, including liquidity and turnover in UK equities and bonds.

Investment management data – based on survey of UK based asset managers, assessing profitability and ongoing fees.

FCA Market Cleanliness statistics 2020/21

15 July 2021

Defined as "the proportion of corporate takeover events for which the FCA observed a significant abnormal movement in share price before the takeover announcement", each year the regulator publishes a Market Cleanliness (MC) Statistic for takeover announcements in the UK equity markets.

Looking at parameters such as abnormal trading volume and potentially anomalous trading ratio, the FCA looks for indications of market abuse and insider dealing. While the regulator acknowledges that the market volatility following the Covid-19 shock in March 2020 could have a material impact on the results, it nevertheless shows small increases on all parameters from the previous year.

FCA reviews the Derivatives Trading Obligation

14 July 2021

The FCA has published a consultation paper on the Derivatives Trading Obligation ('DTO') and the interest rate benchmark reform. The DTO requires that financial and certain non-financial counterparties conclude transactions in standardised and liquid over-the- counter ('OTC') derivatives only on regulated trading venues. Due to the transition from LIBOR, and the discontinuation of certain OTC derivatives, the list of derivatives subject to the DTO needs updating. The FCA reviews DTO in light of the interest rate benchmark reform and the recent Bank of England consultation to modify the derivatives clearing obligation in line with Article 5 of UK EMIR.

© Robert Quinn Consulting Limited t/a RQC Group

FCA and Bank of England publish review of open-ended investment funds

13 July 2021

The FCA and the Bank of England has undertaken a review of what they see as the liquidity mismatch in open-ended investment funds and consequently risks posed to investors.

The review is part of a larger assessment of resilience and vulnerabilities in market-based finance. The Financial Policy Committee ('FPC') has looked at resilience in the market-based sector for a number of years. This report looks at non-bank financial institutions, now accounting for approximately 50% of the UK financial sector. Part of the failing of the sector included the "dash for cash" or liquidity shock in March 2020 borne out of the Covid crisis.

The review on open-ended investment funds, launched in 2019, concluded that there is a mismatch between redemption and liquidity of open-ended funds' assets and in part linking to the 'dash-for-cash' mentality. The vast majority of open-ended funds domiciled in the UK offer daily redemptions to investors, accounting for over 96% of UK open-ended funds' assets.

At the same time, funds' holdings of assets that take longer to liquidate in an orderly way, especially during a period of market stress, are increasing. By offering daily redemptions while investing in less liquid assets, funds can create incentives for investors to redeem ahead of others, particularly in a stressed market. This in turn can potentially incentivise investors to try to be the first to sell, creating a run dynamic, which in turn creates price moves, hindering markets functioning well.

The review sets out three key principles for fund design that could deliver greater consistency between funds' redemption terms and their underlying assets.

The review also puts forward a possible framework for how an effective liquidity classification framework for funds could be designed, including suggesting an effective liquidity classification framework to capture liquid and illiquid assets; using the framework to design and determine redemption terms for a fund; enhancing internal risk management and stress testing; and possibly using liquidity classification for regulatory reporting purposes.

Diversity and inclusion in the financial sector

07 July 2021

Together with the Prudential Regulation Authority and Bank of England, the FCA has released a Discussion Paper to drive forward diversity and inclusion within the financial services sector. Whilst some initiatives have been launched to promote change such as The Women in Finance Charter, Parker Review and Stonewall Workplace Equality Index, it is acknowledged within the paper that progress to date has been slow and that much more needs to be done to create truly diverse and inclusive organisations.

Authorised fund managers' assessments of their funds' value

06 July 2021

The FCA has set out its findings following its review of assessments of value ('AoV') processes for funds operated by Authorised Fund Managers ('AFMs'). During the review it was found that a number of AFMs had not implemented the AoV process as required, and practices fell short of FCA expectations and the requirements within the Collective Investment Schemes sourcebook. AFMs should review the FCA's findings and assess the quality of analysis and decision making within their own processes and the judgements reached by AFM Boards and consider if action should be taken to address value concerns.

Primary Markets Effectiveness Review CP21/21

05 July 2021

Within its Consultation Paper on Primary Market Effectiveness, the regulator states that the number of listed companies in the UK has fallen by about 40% from a recent peak in 2008. Between 2015 and 2020, the UK accounted for only 5% of IPOs globally.

In the face of such statistics, within the Consultation Paper the regulator highlights the importance of the primary, public markets in growing the UK economy, and asks for input on the functioning of the listing regime as well as exploring changes to the existing regime to remove barriers to listing.

© Robert Quinn Consulting Limited t/a RQC Group

UK/EU - Enforcement

Dolfin Financial

25 August 2021

The FCA have published its First Supervisory Notice ('FSN') regarding Dolfin Financial ('Dolfin'), redacted to avoid identifying third parties who have not had an opportunity to make representations.

On 12 March 2021 the FCA imposed a number of restrictions on Dolfin, an investment firm. Dolfin is no longer able to carry on regulated activities due to concerns about the way it conducts its business. Among the failings, the regulator found that a Tier 1 investor visa was unlawfully obtained; incomplete and misleading information was provided including relating to a HNWI whose association would lead to reputational damage; inadequate financial control framework combined with high-risk clients.

Because of the above, the FCA exercised its power under section 55L(3)(a) of the Financial Services and Markets Act 2000 to impose the requirements on Dolfin.

The FSN was served on Dolfin on 12 March 2021, but the full FSN was not published then to allow for representations to be made by Dolfin. The firm has made clear that it does not accept the findings in the FSN.

Dolfin entered Special Administration on 1 July 2021.

FCA published Decision Notice against Geoffrey Armin for lack of skill, care and diligence

09 August 2021

The FCA has issued a financial penalty of over £1.2 million against Geoffrey Armin, as well as banned him from holding Senior Management Functions and providing advice on pensions transfers.

Mr Armin has been found by the FCA as "seriously incompetent" in regard to his advising on defined benefit pension transfers. In addition, Mr Armin has been found to have failed to take reasonable steps to ensure that his firm, Retirement and Pension Planning Services Limited, complied with relevant regulatory requirements and standards. The FCA has found that Mr Armin failed to obtain the necessary information required to assess the suitability of pension transfers for customers, disregarded information including customers' financial situation, income needs throughout retirement, and how their existing pension benefits compared to the proposed alternative.

Mr Armin has referred this Decision Notice to the Upper Tribunal.

FCA publishes Decision Notice against Markos Markou for lack of oversight

28 July 2021

The FCA has published a Decision Notice in respect of Markos Markou, the Director and Chief Executive of a mortgage broker firm, Financial Solutions (Euro) Limited ('FSE'). Mr Markou has referred the Decision Notice to the Tribunal.

The FCA considers that Mr Markou is not a fit and proper person and has withdrawn his approval to perform his current senior management functions, made an order prohibiting him from performing any functions in relation to any regulated activity and imposed a penalty of £25,000.

The FCA found that, between 2015 and 2017, Mr Markou did not have appropriate oversight of FSE's mortgage business. Mr Markou also failed to take sufficient steps to prevent FSE from transacting mortgage business between July 2017 and October 2017, during which period he was aware that FSE did not have valid professional indemnity insurance.

Following interventions by the FCA between 2011 and 2015, Mr Markou was fully aware of the serious risks that this conduct created. By ignoring the risks, the FCA believes that Mr Markou acted recklessly and demonstrated a lack of integrity. Mr Markou's conduct placed FSE at risk of being used as a vehicle for financial crime and did not appropriately protect the interests of consumers.

Mr Markou has referred the Decision Notice to the Upper Tribunal (the Tribunal) where he and the FCA will each present their cases. The Tribunal will then determine what, if any, is the appropriate action for the FCA to take, and will remit the matter to the FCA with such direction as the Tribunal considers appropriate for giving effect to its determination. The Tribunal's decision will be made public on its website.

Accordingly, the action outlined in the Decision Notice is provisional and will have no effect pending the determination of the case by the Tribunal. At this stage, the facts and matters stated in the Decision Notice therefore reflect the FCA's belief as to what occurred and how Mr Markou's behaviour is to be characterised.

Ian Hudson sentenced to 4 years imprisonment for fraudulent trading and carrying on regulated activities without authorisation.

26 July 2021

On 26 July 2021, at Southwark Crown Court, His Honour Judge Tomlinson sentenced Ian James Hudson to 4 years' imprisonment for one count of fraudulent trading, with two additional terms of 14 months, each reflecting a breach of s19 FMSA, to run concurrently following his earlier guilty plea. This followed charges laid by the FCA concerning carrying on a business, Richmond Associates, for a fraudulent purpose and carrying on regulated activities when not authorised or exempt.

Mark Steward, Executive Director of Enforcement and Market

© Robert Quinn Consulting Limited t/a RQC Group

Oversight at the FCA, said:

'Mr Hudson's defrauding was calculated and persistent over a number of years, preying on victims who believed he was a financial adviser and trusted friend when he was neither of these things. We remind investors to check the FCA's register of authorised persons to ensure any financial adviser is authorised to provide financial advice by the FCA.'

Between 1 January 2008 and 31 July 2019, Mr Hudson advised on regulated mortgages, pensions and other investments and purported to invest significant deposits received by him from clients on their behalf. At no point during this time was he authorised by the FCA to undertake these, or any financial services, as is required by law.

In addition, while Mr Hudson told clients that the money they deposited with his business, Richmond Associates, would be invested in various financial vehicles or otherwise put to specific uses, this was not always the case. Instead, he used those deposits to re-pay existing clients, to make payments to other individuals, or to fund his own lifestyle. In total, approximately £2m was deposited by Mr. Hudson's clients.

Confiscation proceedings are being pursued by the FCA. Any sums recovered from Mr Hudson will be used to compensate victims.

FCA publishes final notice and bans fraudster from regulated activities

14 July 2021

In its final notice, the FCA set out the case banning Mr Matthew Creed from performing any regulated activity. This decision follows an FCA investigation that found Mr Creed failed to inform the FCA about his bankruptcy and a disqualification as a company director. The FCA found that he lacks honesty and integrity in his dealings with them.

Mr Creed was approved to carry out FCA regulated functions at AAA Management Limited between January 2005 and December 2019. He was also the director of a company not regulated by the FCA, PEL, between January 2002 and April 2013. Between February and August 2012, Mr Creed dishonestly executed eight transfers which removed £166,000 from PEL's accounts.

Mr Creed provided an undertaking which disqualified him from holding office as a company director in March 2016. In June 2016, he became aware he was the subject of a criminal investigation for executing fraudulent transactions. As an approved person Mr Creed was required to report the fact of his disqualification and the fact that he was under criminal investigation to the FCA and failed to do so.

Mr Creed was also convicted of dishonesty offences under the Insolvency Act 1986.

© Robert Quinn Consulting Limited t/a RQC Group

USA - Ongoing Developments

SEC releases observations regarding fixed income principal and cross trades by investment advisers

In September 2019 the SEC's Division of Enforcement (the 'Division') published a Risk Alert highlighting the most common compliance issues observed by the staff related to principal and agency cross trades. Subsequently the Division has published a follow up in which it supplements the staff's observations made in the 2019 Risk Alert by providing greater detail on certain compliance issues. The supplemental observations are derived from an examination initiative that focused on SEC-registered investment advisers that had engaged in cross trades, principal trades, or both, involving fixed income securities ('FIX Initiative'). Division staff conducted over 20 examinations as part of the FIX Initiative, and the examined advisers collectively managed approximately $2 trillion in assets for over two million client accounts, including more than one million retail clients, nearly 3,000 pension and profit-sharing plans, and over 150 mutual funds.

During the FIX Initiative, Division staff reviewed the examined advisers' practices for principal and cross trades by focusing on the following areas:

- Conflicts of interest, such as whether these trades appeared to be made in the clients' best interests, rather than to further the interests of the advisers
- Compliance programs, such as whether the advisers' adopted written policies and procedures pursuant to the "Compliance Rule" effectively addressed these trades.
- Disclosures, such as whether the conflicts of interest related to these trades were fully and fairly disclosed to clients.

Approximately two-thirds of the examined advisers received deficiency letters, which addressed the staff's observations regarding a variety of topics. However, the vast majority of deficiencies the staff observed were related to compliance program issues, conflicts of interest, and disclosures.

1. Compliance programs

Most of the deficiencies the staff observed were related to issues with the examined advisers' compliance policies and procedures, e.g.:

- Policies and procedures inconsistent with the examined advisers' actual practices, disclosures, and/or regulatory requirements
- Policies and procedures lacked certain considerations or guidance, such that the examined advisers' personnel did not have the full scope of information that may be necessary to achieve compliance
- The implemented policies and procedures were not effectively tested

2. Conflicts of interest

Reviews of examined advisers' practices often identified conflicts of interest associated with cross trades that were not identified by the advisers and mitigated, disclosed, or otherwise addressed by their compliance programs e.g.

- Contrary to the advisers' policies and procedures, cross trades were not executed at independent market prices for the securities and did not use best price and best execution efforts, which resulted in at least one of the participating clients receiving an unfair price for the securities.
- Cross trades were subject to mark-ups or other fees that were not fully disclosed.

3. Written disclosures

The staff observed that over a third of the cross trade-related deficiencies addressed disclosure issues, e.g.

- Omission of certain relevant information concerning cross trading activities in their Form ADVs
- No disclosures regarding the conflicts of interest associated with executing such trades in their Form ADV Part 2As
- Lack of disclosures in their Form ADV Part 2As, advisory agreements, and separate written communications to clients regarding the conflicts of interest created by advisers that were providing guidance to their clients on both sides of the trades or acting as a broker for both sides of the transactions

The Division encourages advisers to review their written policies and procedures regarding principal and cross trades, including the implementation of those policies and procedures, to ensure that they are consistent with the Advisers Act and the rules thereunder.

SEC releases observations from examinations of investment advisers managing client accounts that participate in wrap fee programs

The SEC's Division of Enforcement (the "Division") has of late prioritized examinations of advisers associated with wrap fee programs due to the growth of investor assets participating in such programs. The Division has conducted over 100 examinations of advisers associated with wrap fee programs and has now issued a Risk Alert discussing the most frequently cited deficiencies and observations.

Examinations generally focussed on whether they fulfilled their fiduciary duty obligations, the adequacy of disclosures and the overall effectiveness of the compliance program. The most frequently cited deficiencies were related to compliance and oversight (including policies and procedures regarding the tracking and monitoring of the wrap fee programs) and disclosures (including disclosures regarding conflicts, fees, and expenses).

1. Fiduciary duty and recommendations not made in clients' best interests

The staff observed issues with recommendations made to clients to participate in wrap fee programs, specifically related to both the advisers' trading practices and their assessments that the wrap fee programs were initially, and on an on-going basis, in the best interests of their clients.

© Robert Quinn Consulting Limited t/a RQC Group

The most common duty of care issues were not monitoring the trading activity in clients' accounts (or the monitoring activities were considered ineffective), and advisers not having a reasonable basis to believe that the wrap fee programs were in a clients' best interests.

2. Potentially misleading or omitted disclosures

Many of the examined advisers had omitted or provided inadequate disclosures, particularly disclosures regarding conflicts of interest, fees, and expenses. The staff also observed instances of inconsistent disclosures regarding the same topic in various documents, e.g. advisory agreements indicating that clients will pay brokerage commissions, but the wrap fee program brochures expressly stating that clients will not pay such fees.

3. Compliance programs

The staff frequently observed that advisers had weak or ineffective compliance policies and procedures relating to their wrap fee programs and, in some instances, advisers did not comply with their own policies and procedures.

While acknowledging that there is no "one-size fits all" approach, the staff has provided some of the observed policies and practices which may assist advisers with compliance in these areas.

1. Fiduciary duty and recommendations not made in clients' best interests

- Conducting reviews of wrap fee programs, initially and periodically thereafter, to assess whether the programs are in the best interests of clients, using information obtained directly from clients (e.g., through interviews, discussions, and/or questionnaires)
- Periodically reminding clients to report any changes to their personal situations, or financial standing or needs, and investment objectives that might impact the clients' risk tolerances, investment allocations, and/or recommended investment
- Communication to prepare and educate clients when recommending to convert their accounts from non-wrap fee accounts to participating in wrap fee programs

2. Fiduciary duty and recommendations not made in clients' best interests

- Providing clients with disclosures regarding the advisers' conflicts of interest related to transactions executed within the wrap fee programs
- Providing clear disclosures about whether certain services or expenses are not included in the wrap fee e.g. additional charges for particular types of trades, wire and electronic fund transfer fees, etc.

3. Compliance programs

- Written compliance policies and procedures include factors to be used when assessing whether investment recommendations made to clients participating in wrap fee programs are in the clients' best interests
- Compliance programs monitor and validate that the advisers sought best execution for clients' transactions
- Policies and procedures define what the adviser considers to be "infrequently" traded accounts and compliance programs review such accounts to determine whether the wrap fee programs remain in the clients' best interests

The Division encourages advisers recommending wrap fee programs to consider and adopt policies and procedures to address any identified risks, conflicts, and challenges related to such programs.

© Robert Quinn Consulting Limited t/a RQC Group

USA - Regulatory News

NFA proposes amendment to the Branch Office definition

23 August 2021

Recognizing the ongoing impact of COVID-19 on remote and hybrid working environments, the NFA has submitted to the CFTC a proposal to amend the definition of a Branch Office.

The proposal amends the definition of a branch office to specifically exclude any remote working location or flexible shared workspace where one or more associated persons ('APs') of a commodity pool operator or commodity trading advisor from the same household work or rent/lease such location, provided that:

- the location is not held out to the public as an office of the CPO or CTA
- the AP(s) do not meet with customers or physically handle customer funds at the location
- any CFTC or NFA required records created at the location are accessible at the CPO or CTA firm's main or applicable listed branch office

The amended definition is designed to capture both work from home arrangements as well as flexible shared workspace arrangements. Accordingly, firms may delist locations that are currently identified as branch offices if those locations fall outside the amended definition.

© Robert Quinn Consulting Limited t/a RQC Group

USA - Enforcement

SEC settles fraud charges with two former executives of TCA Fund Management Group Corp.

24 September 2021

The SEC has settled administrative actions against Michael Vernon, the former COO of registered investment advisory firm TCA Fund Management Group Corp. ('TCA'), and Steven Rosen, its former CFO, for their roles in the firm's fraudulent inflation of net asset values and performance results of several funds it managed.

According to the order, both Vernon and Rosen played a role in the scheme by assisting in the recording of false data on the funds' books and records which resulted in inflated performance figures. TCA distributed promotional materials to the funds' current and prospective investors that included inflated asset values and false performance.

The SEC's orders find that Vernon and Rosen each violated antifraud provisions of the Securities Act of 1933, and Sections 206(2) and 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-8 thereunder. Without admitting or denying these findings, Vernon and Rosen each consented to a cease-and-desist order, a payment of a penalty of $35,000, and a broad limitation on activities within the financial services sector, with a right to apply to act in such capacity after three years.

SEC charges quant analyst in multimillion dollar front-running scheme

23 September 2021

The SEC announced charges against a quantitative analyst who worked at two prominent asset management firms for perpetrating a years-long front-running scheme that generated profits in excess of $8.5 million.

The SEC's complaint alleges that from at least January 2014 through October 2019, Sergei Polevikov had access to real-time, non-public information about the size and timing of his employers' trade orders and trades, and used that information to secretly trade on, and ahead of, his employers' trades. On nearly 3,000 occasions, Polevikov bought or sold a stock on the same side of the market as his employers before his employers executed the trades and would typically close his positions the same day, capitalizing on the price movement caused by his employers' large trades. The complaint alleges further that Polevikov concealed his fraudulent scheme by executing the trades in the account of his wife, Maryna Arystava, who uses a different last name.

The SEC's investigation originated from its Market Abuse Unit's Analysis and Detection Center, which uses detailed data analysis tools to detect suspicious patterns, such as improbably successful trading across different securities over time. In a separate action, the U.S. Attorney's Office for the Southern District of New York also announced related criminal charges against Polevikov.

The SEC's complaint charges Polevikov with violating the antifraud and reporting provisions of the federal securities laws and seeks disgorgement of ill-gotten gains plus interest, penalties, and injunctive relief. The complaint also names Arystava as a relief defendant.

SEC surpasses $1 billion in awards to whistleblowers

15 September 2021

The SEC has announced awards of approximately $110 million and $4 million to two whistleblowers, meaning its whistleblower program has now paid more than $1 billion in awards to 207 whistleblowers since 2012. Interestingly, payments have exceeded $500 million in fiscal year 2021 alone. Whistleblower payments are made out of an investor protection fund established by the US Congress that is financed entirely through monetary sanctions with no money taken or withheld from harmed investors. Whistleblowers may be eligible for an award when they voluntarily provide the SEC with original, timely, and credible information that leads to a successful enforcement action, and awards can range from 10-30% of the money collected when the monetary sanctions exceed $1 million.

SEC announces three actions charging deficient cybersecurity procedures

30 August 2021

The SEC has sanctioned eight firms in three actions for failures in their cybersecurity policies and procedures that resulted in email account takeovers exposing the personal information of thousands of customers and clients at each firm. All were SEC-registered as broker dealers, investment advisory firms, or both.

In SEC's first order, cloud-based personnel email accounts were taken over by unauthorized third parties, resulting in the exposure of personally identifying information ('PII') of at least 4,388 customers and clients. None of the accounts taken over were protected in a manner consistent with the advisor's policies. The SEC's order also found that breach notifications to the firms' clients included misleading language suggesting that the notifications were issued much sooner than they actually were after discovery of the incidents.

© Robert Quinn Consulting Limited t/a RQC Group

In the SEC's second order, cloud-based email accounts of over 121 firm representatives were taken over, resulting in the PII exposure of at least 2,177 customers and clients. The SEC's order finds that although the firm discovered the first email account takeover in January 2018, it failed to adopt and implement firm-wide enhanced security measures for cloud-based email accounts of its representatives until 2021, resulting in the exposure and potential exposure of additional customer and client records and information.

In the SEC's third order, cloud-based email accounts were taken over by unauthorized third parties, resulting in the PII exposure of approximately 4,900 customers and clients. The SEC's order found that while the breaches occurred between September 2018 and December 2019, the firm failed to adopt written policies and procedures requiring additional firm-wide security measures until May 2020 and did not fully implement those additional security measures firm-wide until August 2020, placing additional customer and client records and information at risk.

The SEC's orders against each firm found that they violated Rule 30(a) of Regulation S-P, also known as the Safeguards Rule, which is designed to protect confidential customer information. Two of the firms were also found to have violated Section 206(4) of the Advisers Act and Rule 206(4)-7 in connection with the breach notifications to clients.

Without admitting or denying the SEC's findings, each firm agreed to cease and desist from future violations of the charged provisions, to be censured and to pay penalties ranging from $200,000 to $300,000.

Our Cyber Security online training courses for U.S. Financial Institutions are tailored to a wide variety of needs, from understanding and mastering the basics of Cyber Security to an advanced deep-dive course including legal requirements, risks and liabilities.

SEC obtains emergency relief, charges investment adviser and principal with operating $110 million Ponzi scheme

25 August 2021

The SEC filed an emergency action to stop a fraudulent Ponzi scheme allegedly perpetrated by Marietta, Georgia resident John Woods and two entities controlled by him. The entities in question are registered investment adviser Livingston Group Asset Management Company, dba Southport Capital ('Southport'), and investment fund Horizon Private Equity, III LLC ('Horizon').

According to the complaint the defendants raised more than $110 million from more than 400 investors in 20 states by offering and selling interests in Horizon. Woods, Southport, and other Southport representatives allegedly told investors that their Horizon investments were safe, would be used for different investment activities, would pay a fixed rate of return, and that investors could redeem their principal without penalty after a short waiting period.

According to the complaint, however, these statements were false and misleading as Horizon did not earn any significant profits from legitimate investments, and a significant percentage of purported "returns" to earlier investors were paid from new investor money.

The SEC's complaint also alleged that Woods repeatedly lied to the SEC during regulatory examinations and charged the defendants with violating the antifraud provisions of federal securities laws.

© Robert Quinn Consulting Limited t/a RQC Group

RQC GROUP

Thank you for taking the time to read our quarterly regulatory newsletter. Please contact your consultant with any feedback or queries.

United Kingdom

Ariel House,
74A Charlotte Street,
London
W1T 4QJ
United Kingdom

+44 (0) 207 958 9127
contact-uk@rqcgroup.com

United States

401 Park Avenue S,
Suite 1014,
New York
NY
10016

+1 (646) 751 8726
contact-us@rqcgroup.com

© Robert Quinn Consulting Limited t/a RQC Group