

EFFECTA'S ESSENTIAL INSIGHTS: A REGULATORY UPDATE

UK, February 2023

Welcome to EFFECTA's Essential Insights, a quarterly newsletter aimed at providing its readers with succinct overviews of some of the key regulatory issues currently faced by Firms.

2022 was a busy year for the Regulator, who issued the largest number of fines in any one year and published a huge amount of literature. New Regimes have been created, a new Principle introduced, and some key decisions and proposals have been made by the HMT on areas such as Brexit and MiFID II.

Our clients from all areas of financial services are having to grapple with understanding and implementing new rules, many of which become effective in 2023.

Whilst we hope this newsletter gives our readers the nuts and bolts of many of the regulatory matters currently being reviewed, it is by no means exhaustive. Therefore, should you have a question on any matter even if it

is not contained within this Newsletter, please do reach out. Our consultants are diverse in background and knowledge base, each one holding their own area of expertise, so whatever your question, we will have someone who will be able to help.

More information about our individual consultants can be found on our [website](#), but if you would like to discuss any of the topics covered in this newsletter and what implications they may have to your business, please do reach out to us on info@effectacompliance.com.

To review Effecta Middle East's Newsletter, [please click here](#).

In this newsletter EFFECTA UK covers the following topics:

1. Appointed Representatives: New Regime

The new Appointed Representative Regime rules became effective on 8th December 2022.

In addition, as part of the new enhanced reporting requirements, the FCA sent all Principal Firms a Section 165 request. The request asked Principals to provide information about each of their Appointed Representatives. Firms have until 28th February 2023 to respond.

To find out more on the new rules and the Section 165 request, [click here](#).

2. Dear CEO Letter: Wholesale Brokers

The FCA issued a Dear CEO letter to Wholesale Brokers on 11th January 2023. The letter detailed those risks the FCA considers most important for this sector of the industry to consider, and to which the Regulator would be looking to place its supervisory focus over the next 2 years.

To understand more, please [click here](#).

3. Market Watch 71: Insider Lists

In December 2022 the FCA issued Market Watch 71 with a key focus on Insider Lists and in particular the importance of:

- including personal information;
- maintaining accurate and up to date information; and
- reducing access to inside information to employees in order to prevent market abuse.

To find out more, please [click here](#).

4. Financial Promotions:

In December 2022 and February 2023, the FCA's new rules on Financial Promotions (issued in PS22/10 in August last year) came into effect. These rules outlined the stricter approach the Regulator is taking towards Firms which distribute Financial Promotions related to High-Risk products.

To find out more on the new rules, please [click here](#).

5. Remote Working: FCA's expectations for Firms

It is almost a year since the FCA warned Firms 'Covid was over', highlighting the Regulator would no longer consider the pandemic to be a legitimate reason for Firm's not being able to meet their regulatory responsibilities.

Firms must have their new working arrangements in place, and be able to evidence the risk assessments which have been completed to ensure such arrangements are in compliance with the Firms regulatory responsibilities. To understand more about what the Regulators expectations are with regards to remote working, please [click here](#).

6. Actions from the Regulator

The Regulator issued more fines in 2022 than any other year. Most noticeably, the Regulator moved its focus from the large Investment Banks to the smaller or medium sized firms and showed a tenacity to take action against Senior Managers where inadequacies were identified.

To learn more about some of the fines and regulatory actions taken in 2022, please [click here](#).



1. Appointed Representatives: New Regime

Background

In August 2022, the Financial Conduct Authority (FCA) published a **Policy Statement** setting out new rules to improve its Appointed Representative (AR) regime. The new rules became applicable to all existing and future firms operating as either a Principal or Authorised Representative from 8th December 2022.

What are the new rules?

1. Enhanced Reporting Requirements

The FCA now requires Principals to provide significantly more information on their Appointed Representatives ("ARs"). The types of information required to be provided by Principals are:

- **Information on the ARs entire business activity, not just the regulated activity to which the Appointed Representative relationship relates.** This means Principals need to continually monitor the financial soundness of their AR's and must disclose to the FCA the revenue the AR generates from it regulated, non-regulated and non-financial services activity.
- **Information regarding the nature of the financial arrangement between the Principal and the AR.**
- **Details of any individuals employed by both the Principal and the AR**
- **Notification of significant changes** to any of the above.

2. Enhanced Oversight Requirements

Principals will be required to complete annual self-assessments on the fitness and propriety of their AR's as well as the adequacy of their control framework and oversight of the ARs activities; with these assessments being formally documented and available for review at the request of the FCA.

In addition, Principals will be required to:

- Assess the fitness and propriety of the ARs senior management and the financial soundness of the Firm
- Implement wind down plans and create robust compliance monitoring plans to ensure their ARs do not operate outside of the scope of their permissions
- Ensure they have systems and controls in place which provide a comparable level of oversight of an AR to those directly employed by the Firm

What should Firms be doing now?

As part of the FCA's enhanced monitoring, Principals must submit their Section 165 information request to the Regulator no later than 28th February 2023. To complete the Form, Principal Firms must ensure they understand all activities undertaken by their AR and are provided, on a regular basis, with financials which correctly detail the revenue associated with each of those activities.

As detailed above, the new Regime became effective on 8th December 2022. Principal Firms must have updated their control monitoring plans, demonstrating enhanced oversight of their ARs, and have submitted to the Board a paper which explains the new requirements, the risks associated with any AR arrangements and which requests any required additional resources.

How can Effecta help?

Effecta is currently working with clients to analyse their control frameworks against the new rules, identifying the steps which need to be taken to ensure they are compliant.

If you would like Effecta to conduct a review or to advise you on whether your existing governance and oversight arrangements satisfy the new rules, please do reach out.



2. Dear CEO Letter: Wholesale Broker Firms

Background

The purpose of the Dear CEO letter was two-fold.

Firstly, it provided an update on the FCA's view of the key risks arising from wholesale brokers and what the FCA believes the drivers of these risks to be.

Secondly, the Letter sought to highlight to the wholesale markets which areas the FCA supervision team would be focusing on over the next 2 years.

What do the FCA believe to be the most important risks arising from wholesale brokers?

Conduct Risk has long been at the forefront of the FCA's agenda, with the Regulator publishing literature on an ongoing basis, which links failures in controls or the cause of market harm to be directly attributable to poor conduct and culture within Firms.

Therefore, it is of no surprise this Letter is framed by conduct risk concerns. What is perhaps surprising is the FCA's statement that it believes brokerage firms are behind other areas of the financial services sector in this regard, citing poorly resourced control functions, weak financial crime processes and inadequate fit and proper assessments of brokers as the main indicators.

What are the FCA's supervisory priorities?

The FCA was clear in highlighting the following four key areas of focus as its supervisory priorities for 2023/2024:

1. **Financial Resilience:** The FCA believes there is a lack of expertise within Firms with regards to liquidity risk management. Thus resulting in Firms underestimating their exposure to intraday liquidity risks and, consequently, failing to hold sufficient liquidity to survive periods of extended market volatility and stress. Considering the current economic market, it is no surprise the FCA is reminding firms to ensure the level of liquidity they hold under the new Investment Firm Prudential Regime is sufficient and their risk assessment accurately reflects the risks faced by the Firm.

2. **Remuneration Structures:** The FCA states the balance between fixed and variable remuneration remains skewed, with brokers receiving a high percentage of their remuneration through discretionary cash bonuses. The FCA believes this incentivises brokers to put through trades by "whatever means" and puts Firms under pressure to identify poor conduct within tight deadlines before bonuses are paid.
3. **Governance and Culture:** The FCA heavily references the importance of Firms implementing the SMCR effectively, ensuring recruitment processes are robust and only those individuals who hold the correct skills and expertise hold Senior Management Functions. The FCA believes the wholesale sector is weak in this area, highlighting it had seen too many Firms hiring individuals who had been disciplined elsewhere.
4. **Control Functions:** The FCA is clear in its expectations, that control functions must be adequately resourced and have influence at Board level. The FCA highlighted Financial Crime and Market Abuse as the two areas they commonly find brokers to have weak systems and controls.

What are Firms expected to do in response to this letter?

By the end of February 2023, all CEOs must have discussed the letter with their fellow Directors and/or Board and have agreed actions and next steps. This discussion of the letter must be formally documented, with minutes recording the details of the discussion and a clear paper audit of the required next steps.

Firms must check their risk assessments, policies and control monitoring plans to ensure these are an accurate reflection of the risks faced by a Firm and the controls that have been implemented.

The Dear CEO Letter does not contain any new requirements, it discusses topics and concerns the FCA has been highlighting to the wholesale broking sector for years. The difference is the letter is clear the FCA will now start to act against Firms. To quote its statement with regards to liquidity risk:

"We will be carrying out targeted work in

this space and, where we identify material weaknesses or firms underestimating their liquidity needs, we will take action, which may include business restrictions and Board effectiveness reviews”.

How can Effecta help?

Effecta has extensive experience in all of the areas noted within the Letter, with an in house expert in IFPR and a Senior Consultant who spent 15 years working in-house in the brokerage sector.

We can help Firms with their infrastructure, providing updated risk assessments, policies and registers as well as creating tailored control monitoring plans. We also work with clients to complete deep dives into certain areas, producing Board reports with our findings where required.

Event

Please note, Effecta are holding a round-table on the Dear CEO Letter. The purpose of the event is to run through each of the topics in the letter and to provide practical advice on what steps Brokerage Firms can take. If you would like to attend the event, please contact us directly on cbowyer@effectacompliance.com.



3. Market Watch 71: Insider Lists

Insider Lists: What must they include?

The FCA noted that a large proportion of insider lists provided in response to regulatory requests did not contain personal information as required under the Market Abuse Regulation (MAR) including telephone numbers, dates of birth, and national identification numbers. The FCA reminded firms that this information was important as the FCA uses this data to cross reference with MiFIR (Markets in Financial Instruments Regulation) transaction reports, MAR suspicious transaction and order reports as well as other information sources. Without accurate and complete information, the FCA's ability to identify potentially suspicious trading is greatly reduced.

Insider lists must be maintained in the right format and must include the information set out in the UK version of [Implementing Regulation \(EU\) 2016/347](#). The FCA specifically reminded firms that these technical standards are legally binding. There are two templates firms need to maintain which are deal specific/event based and permanent insiders. If you are unsure of the format it is set out in the technical standards of the FCA handbook under MAR.

Insider Lists: FAQs on Personal Information

The FCA used Market Watch 71 as an opportunity to clarify a couple of FAQ's:

- national identifiers, for UK nationals, should be the national insurance number, and UK nationals passport numbers when reporting in the EU.
- personal telephone numbers must be included not just main switchboard numbers
- contractors must be included and assurances obtained that personal information for insiders will be provided.
- Where individuals identify local data protection laws which prevent them from disclosing personal information firms must consider how they can meet the MAR requirements or if they have to withdraw access to the information in that jurisdiction.

In addition, the FCA confirmed that insider lists and personal data may be kept separately but must be capable of being provided to the FCA within 2 days

Reducing access to Inside Information

Since Market Watch 60 the FCA have noticed that firms have made considerable steps in reducing the number of permanent insiders. Some of the methods used for reducing this list include:

- Introducing permanent insider registers for specific products or events.
- Periodic reviews of the roles of all permanent insiders.
- Comparing records of electronic access to files containing inside information with insider lists. Those who did not access the information could then potentially be removed.
- Identify where individuals perhaps only require anonymised high-level information.
- Consideration of the necessity of non-deal team employees in particular functions, as well as multiple jurisdictions, having access to inside information.

Market Watch 71 is quite specific about the need to reduce the number of insiders and therefore reduce the opportunity for unlawful disclosure. It is also clear that the FCA expect firms to capture personal information on the insider lists correctly, this was also raised in Market Watch 70 in relation to transaction reporting. Much of the information required under MAR should be captured during the onboarding stage and the FCA have drawn specific attention to firms who offer services to retail clients electronically, as being particularly weak in this area.

You have been warned!

How can Effecta help?

Effecta has conducted several deep dives into the implementation of MAR within Firms, working with Firms to identify any areas requiring enhancement.

In light of the recent FCA actions against Firms which have failed to implement MAR correctly, this is an area of focus for our clients and one within which our Consultants have significant experience.

If you would like Effecta to conduct a review of your approach to insider lists, or market abuse in general, please do contact us.



4. Financial Promotions

Background

In August 2022, the FCA issued the Policy Statement PS22/10 "Strengthening our financial promotion rules for high-risk investments and firms approving financial promotions" which outlined the stricter approach the regulator is taking to high-risk products, placing consumer awareness and protection in their spotlight.

Why are these rules coming through now?

The FCA are concerned that given the current economic climate, notably inflation rates being as high as they are, consumers will be more likely to invest in high-risk investments, due to the potential returns they can generate. At a time when people are dealing with a cost-of-living crisis, there is concern consumers may look to engage with investments outside of their risk tolerance.

The FCA hopes that the implementation of these new rules will help to ensure firms are:

- Communicating clearly with consumers about the risks associated with high-risk investments.
- Providing customers, with clear information needed to make informed decisions about available investment opportunities.
- Approving financial promotions to a high standard.

Who will these effect and when will they be introduced?

Although these rules are aimed at High-Risk Investments it is expected that these rules will be transferred to other products and promotions in time.

For High-Risk Investments, changes to the main risk warning and risk summary requirements came into effect on 1st December 2022. The remainder of requirements came into effect on 1st February 2023.

What should Firms be doing?

Firms that promote high-risk investments need to familiarise themselves with the FCA's final rules and carry out the following:

- Identify/classify high-risk investments they promote (RMMI/NMMI)

- Update and change risk warnings as per the guidelines (the guidelines provide prescribed wording which must be used)
- Train staff on the new rules

Firms that approve financial promotions need to:

- Ensure that their name and date of approval are included on all future promotions
- Carry out self-assessments as to whether they have the necessary competence and experience to approve financial promotions
- If an S21 approver, obtain necessary attestations that there are no material changes to previously approved promotions

How can Effecta Help?

We can:

- Conduct a health check of your firm's 'Consumer Journeys' or Onboarding Procedures to ensure they are compliant with the new rules.
- Carry out an Independent Review of your Financial Promotions and provide feedback to the relevant teams internally.
- Procedure Evaluation: For firms who already have a Financial Promotion sign off procedure in place, Effecta can review whether it continues to be fit for purpose.
- Training: Effecta can deliver training to Marketing or Compliance teams alike on what the rules mean for their work and what they should be looking out for when preparing Financial Promotions.
- Templates: Effecta are also able to provide useful templates for your sign off process including a Financial Promotion 'Cheat Sheet', process 'Decision Tree' and a Sign Off form.

5. Remote Working

Background

During Covid, Firms had to alter their working arrangement almost instantly, transitioning their working model from being entirely office based to entirely remote almost overnight.

Whilst the FCA did not provide Firms with any form of temporary relief from meeting the threshold conditions or complying with FCA regulations, there was an element of understanding the pandemic was unprecedented and Firms were understandably not prepared for the situation.

What are the FCA's expectations now?

In February 2022, the FCA very clearly stated 'Covid was over', warning Firms they could no longer indicate their working arrangements were ad hoc or undefined due to the pandemic.

The Regulator accepts a Firm's working arrangements may have changed but has clarified the FCA's expectations have not. Therefore, whilst the FCA has offered no direct opinion on the use of remote working, it has stated that if a Firm permits remote working, it must ensure it continues to meet its regulatory requirements and threshold conditions.

The FCA expects Firms:

- To have agreed at Board Level the type of working arrangement which can be permitted
- To have updated their risk assessments and compliance monitoring plans to reflect any new working arrangements
- To have implemented any additional controls to ensure continued oversight of any activity conducted outside of the office
- To notify the FCA of any material changes to its working arrangements such as a new permanent place of business (such as a residential address)

What should Firms be considering when deciding whether to permit remote working?

Firms should only permit remote working if they are satisfied it will not affect:

- The Firms location in the UK or its ability to meet its threshold conditions;

- The FCA obtaining information (noting the Regulator must be permitted to access any venues where regulated activity takes place for the Firm including private residences);
- The Firms ability to oversee its functions (recognising there are often 'no eyes' on the actions of employees when they are at home)
- The culture of the Firm
- The risk appetite of the Firm. Risk Assessments specifically on remote working must be delivered to the Board and additional resources implemented to mitigate the identified risks.
- Legal risk of operating in a jurisdiction the firm does not have a license or loss of control over confidential information in an unsecure environment.

What should Firms be doing?

All Firms must have completed the following actions:

- Updated their Risk Register and Risk Assessment to reflect the risks associated with any changes to their working model;
- Reviewed their Compliance Monitoring Plans to ensure they have sufficient controls and resources to mitigate any risks identified as a result of remote working;
- Provided Management Information to the Board on any changes to the Firm's working model, obtaining approval for additional resources where required;
- Completed Formal Board Reports on any changes to the Working Model which can be provided to the FCA on request;
- Notified the FCA and/or the Exchanges of any changes to Principal places of business;
- Updated policies to reflect any changes as a result of the new working arrangement.
- Review if staff should be back in the office and if so should this be full time or hybrid.
- Ensure any working from home arrangements are backed up with formal training so that staff understand the continuing and additional obligations imposed in allowing for this arrangement.



How can Effecta Help?

Effecta has worked with a number of clients to ensure the above noted actions are completed, including engaging with a Firm's Board to ensure they understand the FCA's expectations in this area. In light of Effecta's expertise in this area, Effecta recently delivered a training session to Firms on remote working and the FCA's expectations.

If you would like Effecta to support your Firm in completing any of the noted work, or would simply like some advice on what steps other Firms are taking to mitigate the risks associated with remote working, please do reach out to us directly.



6. Actions Taken by the Regulator

BGC Brokers LP fined £4.8m by the FCA

In December 2022, the FCA fined BGC Brokers LP (BGC) £4.8m for failing to properly implement the Market Abuse Regulation (MAR) trade surveillance requirements. The FCA noted the manual, electronic and automated solutions in place at the Firm did not cover all the required asset classes under MAR.

As a consequence of these gaps in monitoring the FCA stated BGC *"were exposed to a risk that it may fail to identify suspicions of market abuse by market participants"*. It was the FCA's opinion the Firm knew of the inadequacies in its automated surveillance system but noted it failed to implement additional systems and controls to mitigate the systems limitations. As a result, the FCA's final notice clearly identifies failings in the senior management bodies of BGC, highlighting a lack of challenge and poor culture from the top.

The FCA has fined a number of Firms in the last 12 months with regards to failings in the implementation of MAR. The FCA has repeatedly reminded Firms of the requirement to be able to evidence the review and implementation of new pieces of legislation.

Therefore, if such steps were not taken by your Firm with regards to MAR, or you have concerns it has not been updated to reflect changes in your business activities, please do make this a priority.

Guaranty Trust Bank (UK) Limited fined £525,000 by the FCA

The FCA fined Guaranty Trust Bank (UK) Limited (GTB) for failings in its anti-money laundering controls for high-risk customers. The FCA highlighted the Firm failed to apply enhanced due diligence measures to those customers who should have been considered high risk. The Firm did not subject these customers to screening checks, regular ongoing monitoring checks or enhanced KYC procedures.

Al Rayan Bank PLC fined £4m by the FCA

In January 2023, the FCA fined Al Rayan Bank PLC just over £4m for failing to implement adequate anti-money laundering controls. The

FCA specifically highlighted the Firms failure to understand or ask questions about the source of wealth and source of funds of its customers, resulting in it being unable to identify whether the money it received from such customers was the result of financial crime.

The FCA has been clear weaknesses in AML controls will be treated seriously, with large fines being attached to findings of inadequate controls in this area. The recent political situation in Ukraine has only amplified the scrutiny in this area and Firms must ensure they have systems and controls in place which not only meet regulatory and legal requirements, but which are able to respond immediately to changes in sanctions.

FCA Imposes restrictions on Pello Capital Limited

On 15th November 2022 the UK Financial Conduct Authority ("FCA") imposed conditions on the activities of Pello Capital Limited ("Pello") with immediate effect as a result of concerns about the firms ability to meet its Threshold Conditions. Shortly after this Pello entered liquidation.

Pello was a IFPRU 50k Limited Licence Firm, with permissions including dealing as agent, arranging (bringing about) deals in investments and making arrangements but was not authorised to hold client money or assets, as such Pello had Model B arrangements with third party custodians.

The restrictions on its business were imposed by the FCA following the "severe" issues identified during the FCA's S166, which was finalised in summer 2022, and the perceived lack of progress in undertaking remedial action which FCA deemed to be insufficient. During the S166 review the FCA identified material and wide ranging issues relating to the Firm's risk management controls and governance arrangements which led to a significant number of recommendations which the Firm could not demonstrate they were adequately progressing remediation work on.

FCA were concerned that the lack of controls at the Firm were leading to risks of financial crime or poor market conduct and that the



remediation to mitigate these risks was not progressing within the Firms rather ambitious timeframes and hence found the need to impose restrictions on carrying out any regulated activities.

The Firm was then left in a situation where it was finding it difficult to raise capital, it owed money to the skilled person and failed to provide FCA with key information and even provided information FCA considered to be misleading. Ultimately this lead to Pello liquidating.

This case is a clear example of where investing in Compliance is worth every penny rather than risking the FCA identifying weaknesses, restricting a firms ability to continue to do business and ultimately failing to be able to meet its Threshold Conditions and having to liquidate.

