

EFFECTA'S ESSENTIAL INSIGHTS: A REGULATORY UPDATE

UK, October 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 in the UK and UAE.

The summer has not slowed the regulator down in relation to policy guidance through Dear CEO letters and Dear MLRO letters. There have been changes to regulation and enforcement actions taken, with some significant regulatory action being taken in relation to AML failings, Senior Management Conduct and Cybercrime, three key areas of focus for all regulators it would seem in 2023.

In addition, the FCA are now moving with much more purpose in relation to Diversity & Inclusion, setting out what the Regulator expects of firms and the impact these expectations are likely to have over the next couple of years.

The DFSA has issued its sectorial review of Representative Offices and the FSRA has released new rules around client classification.

As always, our newsletter reflects our consultants, diverse in background and knowledge base. We all enjoy assisting firms with their regulatory questions, but also hold very different areas of expertise, enabling us to cover a wide client base and bring more than one perspective to the table.

More information about our individual consultants can be found on our website, but rest assured whoever you speak with will always try and bring a pragmatic solution. 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 go straight to EFFECTA Dubai's Newsletter, [please click here](#).

In this newsletter EFFECTA UK covers the following topics:

1. FCA publishes 'Dear CEO' Letter on supervision strategy for Corporate Finance Firms.

On 28 September 2023, the Financial Conduct Authority ("FCA") published a 'Dear CEO' letter addressed to the CEOs of Corporate Finance Firms ("CFF's"). The letter outlines the role of CFFs in the UK economy and the potential risks of harm that such firms pose. The letter also explains the FCA's strategy to address these harms and its expectations of CFFs and sets out the FCA's supervisory priorities.

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

2. Financial Promotions

A Financial Promotion is "an invitation or inducement to engage in investment activity in the course of business" and it is a criminal offence for an unauthorised Firm to issue a Financial Promotion within the UK unless an exemption applies. A number of unauthorised Firms rely on the fact that an FCA authorised Firm approves their financial promotion, but the FCA is concerned this exemption is exposing consumers to possible harm.

As such the FCA will be imposing the new 'Financial Promotion Requirement' ("FPR") on all existing and newly authorised firms.

In practice, any Firm which wishes to approve the Financial Promotions of an unauthorised firm will be required to apply to the FCA for the 'gateway permission'.

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

3. Diversity & Inclusion and-Non Financial Misconduct

In 2021, the FCA published DP21/2: Diversity and inclusion ("D&I") in the financial sector, followed by a survey to see how firms designed and embedded D&I strategies in their institutions. On 25 September 2023 the FCA and PRA published proposals to introduce a new regulatory framework on D&I; FCA CP23/20 and PRA CP18/23.

These CP's aim to integrate non-financial misconduct ("NFM") considerations into staff fitness and propriety assessments, Conduct Rules and Threshold Conditions.

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

4. Recent Enforcement Action

Some recent FCA enforcement action includes:

- ADM Investor Services Fined £6.5 Million for AML Failings
- Former Barclays CEO personally Fined and Banned by the FCA
- Equifax Ltd fined £11 Million for significant Cybersecurity Breach

[To read more about these actions, please click here.](#)



1. FCA publishes 'Dear CEO' Letter on supervision strategy for Corporate Finance Firms.

Background

On 28 September 2023, the Financial Conduct Authority ("FCA") published a 'Dear CEO' letter addressed to the CEOs of Corporate Finance Firms ("CFF's"). The letter outlines the role of CFFs in the UK economy and the potential risks of harm that such firms pose. The letter also explains the FCA's strategy to address these harms and its expectations of CFFs and sets out the FCA's supervisory priorities.

The FCA's CFF portfolio consists of approx. 500 firms and includes firms that predominantly advise corporate clients seeking to raise funds or execute strategic transactions. It also includes firms that offer ancillary services such as corporate broking and investment research. CFF's typically raise funds from institutional investors and treat the corporate issuer as their client and any investors as a corporate finance contact.

The role of CFF's in the UK

CFF's play a critical role in the UK economy as they source capital for businesses, fuelling the creation of jobs and wider economic growth. They support small and medium sized enterprises in raising capital, price formation and maintaining secondary market liquidity. As such, CFFs are a vital part of the financial ecosystem and have an important role to play in maintaining the integrity, transparency and competitiveness of UK capital markets.

Market context

The CFF sector has faced challenging market conditions since the Russian invasion of Ukraine. Lower IPO and M&A activity has impacted most CFFs and there has been cost rationalisation and consolidation in the sector in response to the downturn.

Overall, the CFFs sector has been resilient during this period of lower transaction activity and market integrity has been upheld. However, the FCA is understandably concerned that in periods of market downturn, CFFs may look to take on higher-risk business or to perhaps fail to

implement the same level of robust controls and diligence on potential clients. It appears this is the main driver for the FCA releasing the Dear CEO Letter to CFFs in September 2023.

What did the Dear CEO Letter say?

The FCA focused on the following 4 areas and potential risks:

1. Client Categorisation:

The FCA is concerned Firms are incorrectly categorising Retail Clients as either Corporate Finance Contacts or Elective Professional Clients.

The FCA will be undertaking a targeted review of CFFs' client categorisation processes over the next 12 months and will request Firms to provide evidence of compliance with the relevant categorisation rules. The FCA makes clear in the letter that firms should expect the FCA to take robust action, including the application of business restrictions, where it finds abuse of the corporate finance contacts regime or financial promotion exemptions.

2. Consumer Duty:

The FCA is concerned Firms which do not directly deal with retail customers, have failed to consider the wider impact and applicability of the Duty. The FCA reminds Firms to ensure they have considered the impact of the Duty, reiterating that the Duty could apply to firms which issue or approve financial promotions to retail clients in the UK. Further, the FCA states CFFs should be mindful of the Duty during client categorisation. Encouraging clients to opt up to professional client classification to circumvent the protections afforded to retail clients, or financial promotions restrictions, would breach the Duty.

The FCA will be collecting data about firms' approaches to the Duty in due course and will expect firms to be able to explain how the Duty applies to them.

3. Dealing with Problem Firms:

The FCA expects CFFs to use their regulatory permissions to advance a legitimate business purpose and to construct and maintain their permission profile in a way that accurately reflects this. However, it notes that it continues to see firms that appear to hold permissions for no



clear business purpose or in order to favourably influence public perceptions of their unregulated business. The FCA will contact firms that do not appear to be using their regulatory permissions to understand why they need them and, where necessary, request firms to vary or cancel their permissions. The FCA also emphasises the importance of being transparent and maintaining channels for communication; firms should keep their contact details up to date on the FCA Connect Portal and be responsive to requests from the regulator.

4. Market Abuse:

The FCA reminds firms of the requirement to ensure that market abuse controls are tailored to their individual business models. The FCA focuses on conflicts of interest and insider, specifically personal account dealing and the use of 'Inside Information'.

What steps should be taken by CFF's?

The FCA Expects Firms to:

- Discuss the Dear CEO Letter Board Level. All Firm's must ensure Board Minutes are available which evidence the discussion of the letter and its applicability to the Firm.
- Identify any possible gaps or areas which need enhancement to ensure compliance with the FCA's rules. Such actions must be documented within a project plan.
- Action any identified remediation actions without delay, with escalation on progress of actions feeding directly into the Board.

If a Firm has not already completed the above steps, they should ensure they do so as a matter of priority.

How can Effecta Help?

Effecta has a number of CFF clients and therefore has the expertise to support clients in this area with the interpretation and remediation of the issues identified within the Dear CEO letter. If you require any help, either in understanding how the letter applies to your Firm, or in remediating any identified gaps, please reach out to Effecta directly.



2. Financial Promotions

Background

A Financial Promotion is "an invitation or inducement to engage in investment activity in the course of business".

It is a criminal offence for a Firm to issue a Financial Promotion within the UK unless:

- ii. the Firm is authorised by the FCA; or
- iii. the Financial Promotion is approved by an FCA authorised Firm.
- iv. An exemption applies.

A number of unauthorised Firms rely on this second exemption. However, the FCA is concerned this exemption i is exposing consumers to possible harm.

This concern from the Regulator derives from the monthly spot checks it completes on Financial Promotions. The FCA publishes its high-level findings on the FCA Register and has continuously noted there are too many Financial Promotions being approved which do not comply with the FCA's rules on Financial Promotions (in Q4 2022, 69% of Financial Promotions communicated or approved by authorised firms were amended or withdrawn following the FCA's involvement).

One of the main failings identified by the FCA are that a large number of Financial Promotions do not contain adequate risk disclosures and thus consumers are not aware of the potential risks and consequences associated with an investment.

The FCA believes one of the main reasons Financial Promotions do not contain adequate risk disclosures is because some authorised firms are approving Financial Promotions for products which are unrelated to their expertise of business activity. Similar to the FCA's views on the Appointed Representative Regime, Firms should only be overseeing or approving activities to which it has expertise.

What action is the FCA looking to take?

The FCA will be imposing the new 'Financial Promotion Requirement' ("FPR") on all existing and newly authorised firms.

In practice, any Firm which wishes to approve the Financial Promotions of an unauthorised firm will be required to apply to the FCA for the 'gateway

permission'. To flip this on its head, if you are an unauthorised Firm, you will only be able to distribute Financial Promotions in the UK if you obtain approval from a Firm which either holds a gateway permission or falls into one of the exemptions.

What are the exemptions?

On 6 September 2023, the exemptions from the FPR (ie the requirement to apply for a Gateway Permission) were published. We have summarised these exemptions below.

In the following instances, a Firm does not require a Gateway permission to approve a Financial Promotion to be distributed in the UK:

- a. Where the authorised Firm also prepared the content of the Financial Promotion.
- b. Where the unauthorised person who prepared the content is in the same group as the authorised firm approving the communication.
- c. The content of the Financial Promotion is prepared by an AR and the content of the Financial Promotion is related to the activity to which the Principal Firm has agreed to hold responsibility.

In addition, Firms should be aware, the existing exemption with regards to High Net Worth and Self-Certified Sophisticated Investors remain unchanged for now and can continue to be relied upon.

What are the timelines?

The FCA is running a 3-month transition period which starts on 6 November 2023.

During this period, affected Firms must submit their Gateway Permission application to the FCA. However, the FCA has stated that whilst a Firms application is being considered by the FCA, it will be permitted to continue to approve Financial Promotions.

After the transition period (ie from 7 February 2024), Firms will only be able to approve Financial Promotions if they hold the Gateway Permission.

How do Firms apply for a Gateway Permission?

Firms which are already authorised will be required to apply to the FCA by way of a Variation of Permission.

Firms seeking authorisation will request the permission as part of their application for authorisation.

Firms will not be able to request a 'blanket' permission but will instead have to detail the type of financial promotion it is seeking to approve.

In both instances, the FCA will consider the suitability and competence of the Firm and whether they have the expertise to approve Financial Promotions. For a Firm to demonstrate it holds the required level competence, it will need to demonstrate (amongst other things) it has sufficiently skilled staff, as well as adequate systems and controls to ensure all communications comply with the FCA rules on Financial Promotions.

Reporting Requirements

Firms which obtain the gateway permission, will be required to submit bi-annual reports to the FCA which detail:

- a. The number of approvals (broken down by type of product)
- b. The number of complaints received for approved Financial Promotions
- c. Revenue from approval activity; and
- d. Total revenue from regulated and unregulated activities.

How can Effecta help?

Effecta has significant experience preparing Variations of Permission and supporting Firms through the process. If you believe you will require the permission, Effecta can help you to prepare the application documents, to ensure a smooth process in obtaining the permission.

Should you require any advice or support in this area, please contact Effecta on cbowyer@effectacompliance.com



3 Diversity & Inclusion and Non-Financial Misconduct

Background

In 2021 the FCA published DP21/2: Diversity and inclusion ("D&I") in the financial sector, followed by a survey to see how firms designed and embedded D&I strategies in their institutions. On 25 September 2023 the FCA and PRA published proposals to introduce a new regulatory framework on D&I; FCA CP23/20 and PRA CP18/23. These CP's aim to integrate non-financial misconduct ("NFM") considerations into staff fitness and propriety assessments, Conduct Rules and Threshold Conditions.

These consultations are open for comment until 18 December 2023 with the expectation for any new regulations to take effect 12 months after the publication of the Final Rules in 2024.

What are the FCA's expectations for Firms?

Scope of the proposed new rules

Whilst the NFM requirements are likely to impact the majority of firms in some way, they will have a significant impact on those firms with more than 250 employees which already publish details on the gender pay gap. These larger firms will now be required to develop and implement D&I strategies, publish diversity targets, report and disclose certain D&I data, as well as recognise D&I deficiencies as a non-financial risk. All regulated firms, except the SMCR limited scope firms, will also be required to report average employee numbers on an annual basis.

Non-Financial Misconduct

NFM will form part of the fitness and propriety assessment as well as the Suitability Threshold Conditions in COND.

It is proposed that only serious misconduct, such as bullying, harassment or multiple instances that are collectively serious, would be considered a breach of the conduct rules and be required to be included in the annual fitness and propriety assessment. This is the first time the concept of non-financial misconduct will be incorporated in the FCA established rules. Firms will also be required to notify the FCA if they take disciplinary action for NFM that is considered a breach of conduct rules.

Diversity & Inclusion

Firms in scope will be required to develop an evidence-based D&I strategy containing as a minimum:

- the firm's D&I objectives
- a plan for meeting them and measuring progress
- a summary of the arrangements in place to identify barriers to meeting the objectives; and
- ways to ensure staff have adequate knowledge of the D&I strategy.

The FCA has stressed flexibility in how firms should draft their plans noting that every firm is different (a slightly different approach has been taken by PRA). The overall responsibility for ensuring the firm complies with its plans rest with the Board and senior management. This responsibility will require the firm to conduct regular reviews to ensure its policies and procedures remains effective and appropriate. This will include setting internal targets to address any areas of under-representation at each level of the firm from the Board to the employee "population".

Once the rules are implemented, firms with over 250 employees will be required to gather data and identify any gaps on a "comply or explain" basis. This information will be required to be submitted in a regulatory return.

There are also annual reporting requirements on the firms progress against the targets it has set.

What do Firms need to do?

The first thing to do is review the CP and establish the impact it is likely to have on your Firm. The CP is open for comments until 18 December 2023 so Firms should make sure they have discussed (and can evidence they have discussed) the impact of the proposals with the Board and senior managers of the Firm.

Things to consider will include:

NFM:

Compliance will need to discuss the impact of NFM with HR, legal as well senior managers and relevant policies and procedures will need to be updated to reflect the changes.

Firms will also need to consider any impact on remuneration and bonus policies as well and recruitment procedures to ensure thorough background checks are undertaken to cover NFM.

Training will need to be provided for staff and managers which includes details on the consequences for breaches.

D&I:

Large firms (over 250 employees) will need to carry out an assessment of current policies such as appraisals, remuneration/bonuses and incentives, data collection, recruitment.

Large firms will need to identify who will be responsible for overseeing these changes and monitoring the firms progress against targets. The Board will need to be heavily engaged in this process with ultimate responsibility resting with them and reflected in the Prescribed Responsibilities.

Perhaps the biggest challenge is going to be collection of data especially data relating to such topics as Inclusion.

How can Effecta Help?

If you would like to understand how these proposed changes will impact your Firm, please reach out to our Effecta consultants. We will also ensure that we keep you updated as these proposed rules move from consultation to final FCA rules, including some of the challenges the industry will face and general feedback.



4 Recent Enforcement Action

FCA Fines ADM Investor Services £6.5 Million for AML Failings

In a recent action by the Financial Conduct Authority ("FCA") in September 2023, ADM Investor Services International Limited ("ADMISI") was fined £6,470,600 for failing to comply with anti-money laundering ("AML") requirements and regulatory standards.

ADMISI, a London-based brokerage company, exhibited deficiencies in its AML systems and controls, leading to breaches of Principle 3, which necessitates responsible and effective organisation of affairs with adequate risk management systems. These failures included inadequate risk assessments being completed on clients, weak internal policies around AML, lack of monitoring of ongoing activity of clients, and insufficient reporting. ADMISI's internal audit function also failed to identify AML and financial crime failings within the firm.

This penalty was subject to a 30% discount through the Authority's executive settlement procedures, reducing the potential fine from £9,243,738 to £6,470,600.

Former Barclays CEO Fined and Banned by FCA

The FCA has penalised former Barclays CEO James Staley, fining and barring him from senior financial industry roles for endorsing a misleading letter to the FCA. The misleading letter contained false statements about Staley's relationship with Jeffrey Epstein, which the FCA concluded revealed a lack of integrity on his part. The FCA emphasised the need for honesty and transparency in the financial sector in its action notice, highlighting that the letter submitted to the FCA by Mr Staley incorrectly asserted that Mr. Staley did not share a close relationship with Mr. Epstein when it was clear from email correspondence that he was in fact one of his "closest" and "most cherished" friends.

This case highlights the responsibility of top executives to set ethical examples. Staley's industry experience and prominent position make his ban from such roles especially significant, reminding industry leaders of the high standards expected of them under the SMF Conduct Rules.

FCA Fines Equifax Ltd £11 Million for Massive Cybersecurity Breach

On October 13, 2023, the Financial Conduct Authority ("FCA") issued an £11,164,400 fine to Equifax Ltd for its role in one of the largest cyber-security breaches in history. Equifax's failure to effectively manage and monitor the security of UK consumer data outsourced to its US-based parent company resulted in hackers gaining access to the personal information of millions of individuals. This breach exposed UK consumers to the risk of financial crime.

This case underscores the critical importance of compliance with FCA regulations in safeguarding consumer data. Firms, whether they outsource or not, are held accountable for maintaining the highest standards in data protection. Cybersecurity and data protection are of growing importance for the security and stability of financial services.