In Principle

10 Things Authorised Firms Need To Know For 2019

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Introduction

In the 2018 edition of this publication, we ended the introduction with the line, "We can only hope that we will enter 2019 with greater certainty than 2018 as to how the regulatory landscape will look." Unfortunately, certainty still remains in rather short supply. With Brexit now (at least in theory) a matter of weeks away, it remains unclear what will happen: the government's original proposed Withdrawal Agreement has been decisively rejected, but Parliament has indicated that it would support that agreement if the "Irish Backstop" provisions are renegotiated. The Prime Minister has therefore been mandated to return to negotiations on this point, in the face of statements by European Union leaders that there is no prospect of such negotiations going ahead. At the same time, Parliament has signalled that it "rejects" a no-deal Brexit, but not agreed to a proposal which would have made this rejection binding. Further Parliamentary proceedings are now planned for the middle of February. Whether there is a hard, soft or no Brexit, there remain a number of issues beyond Brexit that authorised firms will have to consider in the year ahead. Including Brexit, here are 10 things that authorised firms need to know for 2019.

Executive Summary

1. Brexit

In the absence of a decision of what will happen come the 29 March 2019 (or indeed, come some future date if "exit day" is postponed"), firms have been left in a state of uncertainty. Whilst this makes planning for what will happen even more difficult, it is possible to plot out how certain more likely scenarios would play out. We consider what asset managers would face if the original Withdrawal Agreement is largely accepted (notwithstanding a change to the Irish backstop), what would happen in the event of the UK leaving the EU without an agreement, and what effect the UK's remaining in a customs union with the EU would have on asset managers. We also consider what preparations the FCA has made for a no-deal scenario, in particular surrounding the "temporary permissions regime".

2. The Extension of the Senior Managers and Certification Regime

The Senior Managers and Certification Regime (SMCR), which is currently in force for all banks, building societies, credit unions, and dual regulated investment and insurance firms, will be extended to cover all FCA solo-authorised firms by 9 December 2019. While the Financial Conduct Authority (FCA) will continue to approve people who take on Senior Manager roles, the obligation to certify employees below Senior Manager level as fit and proper will devolve on the firms themselves. Firms will also be required to train staff on the Conduct Rules and implement new or update existing systems and controls, including a variety of policies and procedures. Although the implementation is almost a year away, firms would be well advised to have the new requirements at the forefront of their minds to ensure a smooth transition.

3. Market Abuse

Market abuse continues to be an area of very significant interest for the FCA and growing interest across the rest of the EU. With the FCA's insight that compliance with the Market Abuse Regulation (MAR) is "state of mind" rather than a matter of following procedures, firms will have to be particularly vigilant to ensure that they remain compliant.

4. The FCA's Recent Enforcement Trends

Until the end of 2018, the FCA had a comparatively quiet year, at least in terms of the number of investigations publicly brought to a conclusion and the consequent number of fines issued. The number of penalties was down, and the length of investigations was increasing substantially. We have looked at the number and distribution of investigations and decision notices to put together a picture of the FCA's current enforcement trends.

5. Cybersecurity and Data Protection

2018 was an important year for data protection law with the entry into force of the General Data Protection Regulation (GDPR) in May. We expect to see a trickle of enforcement cases in 2019 under the new regime as the courts and tribunals interpret the new law's provisions. Especially with the greatly increased size of the penalties available for breaches, firms should continue to carefully monitor compliance with data protection obligations. Further regulatory guidance on core provisions of the GDPR is expected during 2019.

6. EU Securities Financing Transaction Regulation

The Securities Financing Transaction Regulation (SFTR) is one of the major pieces of post-financial crisis legislative reforms and introduces a reporting and transparency regime applicable to firms that parallels the over-the-counter (OTC) derivatives reporting requirements under the European Market Infrastructure Regulation (EMIR). All counterparties are required to report details of any securities financing transactions that they have concluded, modified or terminated to a registered or recognised trade repository. Whilst the reporting obligation under the SFTR is not expected to take full effect until 2020 at the soonest, for firms that regularly deal with repos and buy-sellback transactions, this piece of legislation should be firmly on the radar, given the requirement to build operational infrastructure to support the new reporting requirement.

7. Amendments to the European Market Infrastructure Regulation

EMIR is subject to a significant reform proposal, the EMIR "refit," which includes a number of changes that are expected to become effective in 2019. These are, in some way or other, likely to impact all firms currently subject to EMIR. EMIR is proposed to be extended in scope by clarifying that all alternative investment funds (AIF) should be considered to be financial counterparties (FC), which has caused some confusion as to the proper classification of non-EU AIFs with non-EU managers. The refit seeks to alleviate some of the regulatory burden for smaller counterparties by introducing an FC+ and FC- concept to exclude the below-threshold FCs from the scope of the clearing obligation and by making NFC- reporting the responsibility of counterparty FCs. A number of the amendments that are likely to take effect in 2019 therefore seek to address issues raised by industry since before EMIR was published in 2012. Clearing and margin requirements established under the current EMIR regime will also continue to be phased in during 2019, thereby completing the phase-in requirements for all counterparty categories subject to clearing.

8. EU Benchmarks Regulation and LIBOR Cessation

We are now in the "transitional period" of the Benchmarks Regulation (BMR), whereby EU-based existing "users" of benchmarks may continue to use non-EU-administered benchmarks in financial instruments until 1 January 2020, notwithstanding that such benchmarks are not listed on the European Securities and Market Authority's (ESMA)s register of "approved benchmarks." Post-1 January 2020 treatment of non-EU benchmarks is unclear, given the lack of available "routes" into the EU for non-EU-administered benchmarks under the BMR: No jurisdiction has, for example, been declared "equivalent" to the EU such that benchmarks administered in that jurisdiction may continue to be used. An additional wrinkle to 2019 compliance is that LIBOR is expected to cease to exist from the end of 2021. The FCA has stated that, from that time, it no longer expects panel banks to contribute to LIBOR; thus, it is expected to disappear. The impact of this is that, to the extent that users of benchmarks currently reference LIBOR in financial instruments and wish to continue to do so, the fact of LIBOR's possible cessation will need to be addressed in "robust written plans," which users of benchmarks are expected to prepare and, on request, make available to the FCA. As explained in the following, the FCA has also indicated that benchmark supervision is an important supervisory priority for this year.

9. EU Action Plan on Sustainability and Asset Management

In November 2018, the EU Commission issued a consultation on whether, and how, asset managers should be required to take principles of sustainability into account when making decisions. This proposal signals a key shift in using financial regulation to address environmental and social concerns, whether or not it is the case in practice that such matters are currently addressed by asset managers. While there is currently no clear indication of the shape of the rules affecting managers, the industry will be keeping a keen eye on these initiatives.

10. Individuals on the Enforcement Agenda: 2018 Key Cases and Enforcement Round-Up

In keeping with investigations that take longer, it is perhaps no surprise that the amount of case law that was generated in 2018 is somewhat smaller than in previous years. This notwithstanding, both the Upper Tribunal (which hears references from the FCA's Regulatory Decisions Committee (RDC)) and the courts have provided several relevant judgments. With the wider rollout of the SMCR, it seems likely that the regulator will continue, and perhaps sharpen, its focus on individuals this year.

1. Brexit

As anyone following the unfolding of the political process of Britain withdrawing from the EU can attest to, the only thing that is certain is the uncertainty.

The inconclusive process has meant that a number of options continue to be discussed and, while within the asset management industry a broadly shared view is that a hard Brexit is unlikely, a number of the options leave the treatment of financial services at best inconclusive. Asset managers have good reason to be vigilant to the political tides: even in the smoothest transition to a soft Brexit, responses will need to be prepared on a relatively quick timetable.

The key concern for asset managers will be the continuing access to EU markets. This means the ability to continue to provide services to existing and future fund and segregated account clients as well as EU investment managers, and the ability to market financial products and services to prospective clients and investors.

The specific mechanism that would allow for continuing and unrestricted access to the EU markets is still unclear: While some EU laws allow for an equivalency assessment, this is not the case in all relevant legislation, and it is likely that in some cases the price of market access will be a substantially higher regulatory burden that UK managers would have to bear. In the short term the patchwork of access provisions for third country entities under the existing laws is likely to result in unsatisfactory arrangements and a higher level of regulatory risk across the industry.

The now-partially rejected withdrawal agreement contemplates a transition period from 29 March 2019 until (at least) the end of 2020. While the final form of any agreement is still subject to active negotiations, a substantial transition period is now likely, not least because Parliament has expressed its disapproval to a no-deal Brexit which would serve to create significant instability in the markets and to have an adverse impact on consumer outcomes not only in the UK but across the EU. During such a transition period, for all relevant intents and purposes, EU law would continue to apply in the UK, and asset managers would not be required to make substantial changes in response to "exit day" in the short term.

While some jurisdictions and regulators have ensured that bilateral arrangements to ensure ongoing mutual access and regulatory cooperation have been concluded in advance of the 29 March withdrawal date, such bilateral arrangements are unlikely to be comprehensive, and are subject to revision depending on the ultimate outcome of negotiations with the EU and on ESMA's views on the appropriate regulatory approach and solutions.

No Deal

What happens if the UK "crashes out" with no deal? The EU and the UK would still be able to investigate and make equivalency determinations, though as it would likely take months, if not years, for these determinations to be made, in the short term there could be substantial difficulties for UK and EU entities to ensure that they were compliant. Without a transition agreement, therefore, equivalence determinations could only provide a medium-term solution for those in the financial services sector and, given the limitations to relying on equivalence, a somewhat limited one at that.

Customs Union

The Labour Party is currently the largest opposition party in the UK Parliament, and whilst there remain uncertain contours over its Brexit policy, it has declared that it would like the UK to be part of a "permanent custom union".

Whilst a customs union would go some way to permitting the free movement of goods, critically for asset managers, a customs union without an explicit extension to include services would preclude free movement of services of the kind that asset managers currently rely upon. In particular, under

MiFID II and the AIFMD, and absent any specific further legislative solution, a customs union will likely preclude firms being able to use passporting rights as they would now. While both above directives contain mechanisms for a third country passport, the regulatory framework for this does not currently exist, and the attendant conditions for the same would be onerous, and subject to material uncertainty. By contrast, membership of the single market would likely bring with it some form of passporting rights – if not in exactly the same way as they currently benefit the industry.

Temporary Permissions Regime

In preparation for a no-deal Brexit, the Treasury and the FCA have shown willing. Regulations have been proposed to implement a "temporary permissions regime", under which non-UK EEA firms currently operating in the UK would continue to be able to act as if they were authorised for a period of time. Ultimately, firms relying on a temporary permission will have to make a transition to full authorisation. The FCA has actively encouraged incoming EEA firms currently using passports to prepare applications for a temporary permission to avoid overcrowding at the last moment before the curtain falls.

Increasingly, a shared commonsense that a no-deal Brexit should be avoided at all, or nearly all, costs has seeped into the political discourse, and valiant efforts have been made by manufacturing and services industry lobbies to steer clear of a cliff-edge departure on 29 March. As the past years have shown, however, one does well to expect the unexpected, and the haphazard contingency plans that have been drawn up to this end could be put to test yet. The contingency plans of individual firms who, without any clear guidance are left eagerly poised for action, meanwhile, often have a significant component of hoping for the best.

2. The Extension of the Senior Managers and Certification Regime

On 4 July 2018, the FCA published near-final rules setting out how it intends to implement the extension of the SMCR to all FCA-authorised, nonbanking firms.[1] The FCA has proposed for this new regime to become effective on 9 December 2019, albeit with a transitional period to give firms time to implement it fully.

As had been previously proposed by the FCA, the SMCR will be implemented in tiers. Most firms will fall within the "Core Regime"; however, a small number of firms categorised as "enhanced regime" firms will be subject to additional requirements, and there will be fewer rules for "limited scope" firms.

The proposed new rules require firms to obtain prior FCA approval for "Senior Managers." An individual who is designated a Senior Manager may be personally liable for breaches of FCA requirements that take place within his or her area of responsibility. In addition, firms will be required to certify the fitness and propriety of individuals who are not Senior Managers, but who may cause significant harm to the firm or to its customers due to the nature of their role. A new set of Conduct Rules will apply to virtually all individuals within a firm.

The first enforcement case under the SMCR, regarding the CEO of Barclays, was decided in 2018: We discuss it in more detail under "Recent Case Law and Key Enforcement Cases" below.

To Whom Does This Apply?

The SMCR will apply to all UK nonbank firms authorised by the FCA. This will include UK group entities of non-UK firms, including US and Asian investment managers with a UK sub-advisor or a UK execution-only presence. The rules will also affect some non-UK staff of UK firms, including directors or material risk takers based outside the UK.

The Core Regime

The Core Regime consists of three main elements: the Senior Managers Regime, the Certification Regime and the Conduct Rules.

(i) Senior Managers Regime

An FCA-authorised firm will need to obtain prior approval by the FCA for the most senior staff members whose roles include the performance of "Senior Management Functions." As has been the case under the current system, the Senior Managers will need to demonstrate to the FCA that they are fit and proper to undertake their roles. As part of this, firms will need to obtain criminal records checks for all proposed Senior Managers. Approval to hold a Senior Management Function may be granted outright by the FCA for a limited time period or subject to conditions.

The Senior Management Functions include the Chairman function (SMF9), the Chief Executive function (SMF1), the Executive Director function (SMF3), the Compliance Oversight function (SMF16) and the Money Laundering Reporting Officer (SMF17). Anyone who performs these functions in a firm covered by the SMCR, whether present in the UK or not, will need to seek this authorisation.

Under the current Approved Person/Controlled Function regime, a corporate entity was permitted to hold a Controlled Function. Under the Senior Managers Regime, however, only individuals can hold a Senior Management Function, and it cannot be held by a corporate entity. In firms where a corporate entity currently performs a Controlled Function, it will be necessary to consider which individual will hold the Senior Management Function. Whilst the FCA has not made explicit how this will work, firms should consider who is directing the corporate entity that is performing the controlled function. It is likely that a director of that corporate entity will be the most suitable person to hold that Senior Manager position.

1 https://www.fca.org.uk/publication/policy/ps18-14.pdf.

Statement of Responsibilities

Firms must prepare a Statement of Responsibilities (SoR) with respect to each Senior Manager. Firms will need to provide the SoR to the FCA when a Senior Manager applies to be approved, and then whenever there is a significant change to his or her responsibilities. If a Senior Manager holds more than one Senior Management Function within one firm, he or she will be required to have only a single SoR describing all of his or her responsibilities. However, if a Senior Manager holds Senior Management Functions in two or more firms, he or she will need a separate document for each firm.

The FCA has published guidance on the contents of an SoR: An SoR must be a self-contained document, which does not incorporate any other document by reference. It must show clearly how the responsibilities performed by a Senior Manager fit in with the firm's overall governance and management arrangements, and this must be consistent with a firm's management responsibilities map. Ultimately, the firm's set of SoRs should demonstrate, when put together, that there are no gaps in the allocation of responsibilities among the Senior Managers.

Duty of Responsibility

Each Senior Manager will owe a duty of responsibility. This means that, if a firm is in breach of its obligations under the FCA's rules or principles, the Senior Manager responsible for the area in which the breach took place could be held personally accountable. In order to hold someone individually accountable, the FCA would have to show that the Senior Manager did not take the steps that a person in his or her position could reasonably be expected to take to avoid the breach occurring. This duty is included to improve accountability, not just of the junior decision-makers, but to the highest echelons of the business.

Prescribed Responsibilities

The FCA has proposed a number of "Prescribed Responsibilities." Firms will be obliged to ensure that, at all times, a Senior Manager has responsibility for each of the Prescribed Responsibilities. Some examples of Prescribed Responsibilities include the performance by the firm of its obligations under the Senior Managers Regime (including its implementation and oversight), the performance by the firm of its obligations under the Certification Regime (discussed below), the performance by the firm of its obligations in respect of notifications and training in relation to the Conduct Rules, and the responsibility for the firm's policies and procedures for countering the risk that the firm might be used to further financial crime.

(ii) Certification Regime

The Certification Regime will apply to employees who are not Senior Managers, but whose role means that it is possible for them to have a significant impact on customers, the firm or market integrity. These roles are called "Certification Functions." For each employee undertaking a Certification Function, the firm must assess whether they are fit and proper to do their job, and the firm must provide each such employee with a certificate to that effect. This certificate must circumscribe the areas of the business with which that employee will be involved. For each employee, certification must be undertaken at least once a year. In deciding whether someone is fit and proper under the Certification Regime, the firm will have to take into account several different factors, including whether that person has obtained relevant qualifications, whether he or she has undertaken certain training programmes, whether he or she possesses the requisite level of competence and whether he or she has the appropriate personal characteristics for the role.

The Certification Functions include what was CF29 under the Approved Persons regime, which was (unfortunately) called the "significant management function." Care should be taken that no confusion arises: To be clear, holders of the significant management function under the Approved Persons regime in all likelihood will be subject to the Certification Regime and not the Senior Managers Regime.

The restriction of the Certification Regime to "employees" is somewhat deceptive: Not only does it encompass "employees" in the ordinary sense of the word, but it also includes anyone who provides, or is under an obligation to provide, services to the firm and who is subject to the supervision, direction or control by the firm as to the manner in which those services are provided. Third-party contractors and other agents may fall within this definition. The Certification Regime applies to all UK-based employees, any non-UK-based employees who have contact with UK clients and any material risk takers, regardless of where they are located.

Whilst perhaps uncommon, it is possible that someone performing a Senior Management Function will also be performing a Certification Function. In this case, it is necessary for both procedures to be followed, that is, the FCA will have to authorise that person to hold a Senior Management Function, and the firm will have to certify them as fit and proper to perform their role.

Directory

As the SMCR replaces the Approved Persons regime, the number of people approved individually by the FCA will decrease dramatically, since the vast majority of employees will not be Senior Managers, but will fall within the Certification Regime. Consequently, the Financial Services Register currently maintained by the FCA will become much less useful, since only those people approved by the FCA (Senior Managers) would likely continue to appear on it.

In light of this, the FCA published a consultation paper in July 2018 proposing the introduction of a new Directory. This Directory would contain information not only on Senior Managers, but also on all people who have been certified by their organisation. Populating this Directory will require the co-operation of authorised firms, since they will be the ones with the information on their certifications. The provision of this information to the FCA for the Directory may well be a nontrivial matter for firms.

The FCA's consultation closed on 5 October 2018, and we expect the FCA to issue a policy statement in Q1 of this year. At that point, we will hopefully know much more about what is proposed and what burdens might be placed on individual firms.

(iii) Conduct Rules

The Conduct Rules will be enforceable by the FCA against individuals. The individual Conduct Rules will apply to all staff (barring certain ancillary staff, such as receptionists, cleaners and catering staff). The FCA will apply the Conduct Rules to a firm's regulated and unregulated financial services activities. It should be noted that this is a narrower scope than how the Conduct Rules apply within the SMCR as applied to banks, where the Conduct Rules apply across the board to all activities.

The Conduct Rules are divided into two tiers, the first tier being applicable to all staff, and the second tier being applicable to Senior Managers only. The Conduct Rules are high-level guidance and largely replicate the principles currently applicable to Approved Persons. They are informed by the Principles for Businesses, which remain unchanged. Firms will be obliged to train all staff on how the Conduct Rules apply to their activities within the firm.

The Enhanced Regime

The largest and most complex firms will be subject to certain additional requirements under the enhanced regime. Enhanced regime firms will include "significant investment (IFPRU) firms" and firms with assets under management of £50 billion or more.

Enhanced firms will need to comply with the Core Regime requirements and certain additional requirements. Such requirements include additional Senior Management Functions and Prescribed Responsibilities, as well as an overall responsibility for every business activity and management function of the firm. In addition, an enhanced regime firm will have to compile a responsibilities map that sets out the firm's management and governance arrangements.

Regulatory References

For incoming employees who are either going to be performing Senior Management Functions or who will be covered by the Certification Regime, a firm will have to request a reference from their previous employers covering the preceding six years. This reference will be known as a "Regulatory Reference." This reference must include information of any disciplinary action following breaches of the Conduct Rules, as well as any information relevant to whether the employee was fit and proper. This information will need to be shared in a standard template, and, for each employee, the Regulatory Reference must be updated appropriately if and when any new relevant information comes to light.

Since Regulatory References will be mandatory to provide, it is important that firms do not attempt to enter into agreements that conflict with their obligation to provide such references (for example, NDAs).

Non-Executive Directors

Non-Executive Directors (NED) will need to be approved by the FCA if they are to perform the SMF9 Chair Function or the SMF14 Senior Independent Director Function. NEDs who do not need to be approved may still be subject to the Conduct Rules and the Certification Regime. In addition to the generally applicable Conduct Rules, NEDs will also need to comply with Rule SC4 (the requirement to disclose appropriately any information of which the regulator would reasonably expect notice), which otherwise applies to only those holding Senior Management Functions.

Next Steps

The FCA has announced various conversion mechanisms that should ease the transition from the current Approved Persons regime to the SMCR. For example, Approved Persons at "core" firms will have their Controlled Function approval mapped to the relevant Senior Management Function where possible (e.g., a director holding CF1 will become (if appropriate) an executive director holding SMF3). Other Approved Persons holding just CF30 (Customer), for example, may not need to hold a Senior Management Function at all and will simply be covered by the Certification Regime. Whilst this will ease the transition somewhat, this automatic mapping will not be possible for all Approved Persons (e.g., an Approved Person holding CF4 (Partner) may have to hold SMF3 (Executive Director), as well as SMF27 (Partner). It will be necessary, therefore, for some care to be taken to ensure that the conversions to the new regime are all correctly completed.

The FCA has also announced transition provisions with respect to the Certification Regime. For example, firms will have one year from the commencement date of 9 December 2019 to provide a certificate to employees as required. However, firms will have to have identified who will need to be certified under the Certification Regime on day 1.

Whilst the commencement date is still some time away, firms would be well advised to have started to think about what they will need to do in good time so as to ensure a seamless transition when this is required.

FCA

"Complying with [MAR] is more than adhering to a set of prescriptive requirements"; it is a "state of mind," so says the FCA.[2] In reiterating its understanding of MAR, the FCA once again has provided firms with a high bar to meet in the detection and avoidance of market abuse, but at the same time providing comparatively little direction on how to comply.

Market abuse remains a high priority for the FCA. In 2017/2018, the FCA received 4,829 insider dealing reports and 666 market manipulation reports, and consequently opened 87 abuse cases. The regulator's continued interest makes it all the more important to glean as much as possible from the FCA's publications to try to discern how best to satisfy the requirements placed on firms as the "first line of defence" against market abuse.[3] A few themes from the FCA's recent publications are worth highlighting.

First, in relation to systems surrounding internal alerts and warnings of potential market abuse, the FCA has warned against relying on "out of the box" or "industry standard" software. Whilst the FCA has appreciated that generic software can be helpful to a firm, the FCA thinks that this is too blunt an instrument for a firm to rely on. There is a danger that people who are intent on market abuse will not be caught if they deviate at all from the most common forms of market abuse that such software is designed to detect. The remedy, from the FCA's point of view, is that each firm must assess what warnings and alerts are appropriate for the business that firm conducts, taking into account the scale, size and nature of the firm's activity. Whilst this may be informed by "industry standards," the firm must exercise its own independent judgment in determining what will be sufficient.

Second, the FCA has reported that it thinks that there is a level of underreporting of suspicious trades and orders (Suspicious Trades and Order Reporting, or STOR). In particular, the FCA thinks that firms are sometimes taking too narrow a view of the market, and thereby missing suspicious behaviour; the example used by the FCA is in relation to fixed income products, where firms may analyse the trades of one particular product and not consider trades in other related products that, when analysed together, would require a STOR submission.[4]

Third, the FCA has scrutinised firms' use of insider lists. Under MAR, firms are required to maintain insider lists, and there are templates that must be used setting out what information should be contained within an insider list. When requested, these lists must be provided to the FCA. The FCA notes that it has "observed varying quality in the insider lists we have received to date."[5] A particular concern that the FCA has is the overuse of permanent insider lists as a way of trying to avoid keeping temporary insider lists up to date. The advice to firms given by the FCA is to anticipate likely sources of insider information and set up systems that can ensure that insider lists for individual deals or events are naturally created whenever a market participant gains inside information. Removing a dependence on permanent insider lists is, it appears, designed to encourage this behaviour.

The European Securities and Markets Authority

2018 saw ESMA issue its first annual report under MAR, providing a summary of actions under MAR across the EU in 2017.[6] In summary, the results are as follows:

2 FCA, Market Watch, December 2018, Issue 58, https://www.fca.org.uk/publication/newsletters/market-watch-58.pdf.
3 FCA, Market Watch, December 2018, Issue 58, https://www.fca.org.uk/publication/newsletters/market-watch-58.pdf.
4 FCA, Market Watch, September 2018, Issue 56, https://www.fca.org.uk/publication/newsletters/market-watch-56.pdf
5 FCA, Market Watch, December 2018, Issue 58, https://www.fca.org.uk/publication/newsletters/market-watch-58.pdf.
6 https://www.esma.europa.eu/sites/default/files/library/esma70-145-1081_mar_article_33_report_sanctions.pdf.

- The only criminal proceedings brought were by the German authorities. Criminal fines were imposed on seven individuals for market manipulation, although the total amount of the fines was very limited at only EUR 12,450.
- Two Article 14 MAR proceedings were brought – one each by the Slovenian and Lithuanian authorities – in relation to the infringement of the insider dealing requirements. These did not result in financial penalties.
- Thirty-five pecuniary sanctions were issued across the EU relating to the infringement of Article 15 MAR on market manipulation. With the exception of a EUR 40,000 sanction imposed by the French authorities, these were all comparatively small fines.
- For "other infringements" of MAR, 107 pecuniary sanctions and 111 nonmonetary sanctions were imposed. Notably, this included a penalty of £70,000 issued by the FCA against Tejoori Limited for failing to inform the market of inside information as required by Article 17(1) MAR.

4. The FCA's Recent Enforcement Trends

The Statistics

The FCA's enforcement figures do not make for comfortable reading for financial institutions. Year on year, the number of investigations opened by the FCA is increasing. This zeal for opening investigations, however, is not matched by an equivalent growth in the number of cases reaching a conclusion. In real terms, this means not only that, statistically speaking, you are more likely to be the subject of an investigation, but that this investigation is likely to take a significant time to conclude.

In the minutes of the meeting of the FCA board in September 2018, it is noted that the FCA planned to "clea[r] all legacy cases by Q1 of 2019."[7] Our review of the notices that the FCA has produced since then would suggest that this was perhaps optimistic.

Accuracy of the Data

We note that the accuracy of the FCA's reports on the number of open investigations has been placed under some scrutiny recently. At the end of last year, the results from several freedom-of-information requests made to the FCA within a matter of weeks of each other were published.[8] Each of these requests ostensibly asked for the same information, how many open investigations there are, yet the FCA gave three different, incompatible answers.

Whilst we have no reason to doubt the figures provided by the FCA, which we review here, it is evident that the presentation of the data is not intended to be neutral and that further contextualisation is required.

Number of Cases

The latest full figures on the number of cases that we have are for the 2017/2018 year.[9] On 1 April 2017, there were 410 investigations open. In the following 12 months, 208 cases closed, and another 302 investigations started. Ultimately, by 31 March 2018, there were 94 more open investigations than the previous year.

The most striking increase in this period relates

7 https://www.fca.org.uk/publication/minutes/fca-board-26-and-27-september-2018.pdf, point 11.2.

8 See L. Rogerson and R. Wolcott, "*UK FCA published inconsistent, double counted enforcement statistics in freedom of information responses*" (Thomson Reuters, 14 December 2018).

9 Unless otherwise stated, figures in this section are taken from: https://www.fca.org.uk/publication/corporate/annual-report-2017-18-enforcement-performance.pdf (last accessed 14 December 2018).

to investigations into culture and governance. The number of cases in this category increased by more than 300%, from 15 to 61 cases. Financial crime cases also showed a substantial increase of more than 50%, from 55 to 86 open investigations, and market abuse investigations were up by nearly 30%, from 22 to 28 open cases. The only type of investigation showing a substantial decrease in this period was wholesale conduct investigations, which declined by just more than 30% from 38 to 26 cases.

Whilst these statistics must be understood within the context of a comparatively small data set, these figures do tally with the FCA's stated priorities, particularly with the ever-increasing focus on individual accountability and acting against criminal conduct threatening the integrity of the market.

Case Length

The average length of civil and regulatory cases brought by the FCA, including cases that settle or where the FCA decides to take no further action, has increased by about a month and a half, from 17.6 to 19.1 months.

This figure, on its own, however, is somewhat misleading: This modest increase in the overall average covers some more concerning changes in particular categories. For example, in a case that eventually settles, the length of time from commencement of the investigation up to settlement has increased by nine months to 32.3 months. Of even greater concern, the average length of a concluded case that was referred to the RDC has nearly doubled since the previous year to 59.4 months (almost five years). Since this is an average, it is quite possible that some cases have taken substantially longer than this.

In contrast to these figures, however, the average duration of a concluded case that is eventually referred to the Upper Tribunal has decreased by approximately nine months to 52.4 months.

Final Notices and Financial Penalties

In 2017/2018, the FCA issued 269 final notices, with penalties imposed of almost £70 million. By contrast, in the first six months of 2018/2019, the FCA issued only 77 final notices, and penalties of only just under £2.4 million. While the FCA was more active in the second half of last year – notably, in October, it fined Tesco Personal Finance plc £16.4 million, and, in December, it fined Santander UK plc £32.8 million – the £60.4 million total fines for 2018 remains the second lowest since the regulator's inception by both volume and number of fines.

Criminal Cases

The FCA noted in its 2017/2018 Enforcement Annual Report that "[c]riminal cases can take significantly longer to resolve than regulatory cases" and reports that the average length of all criminal cases is 58.2 months[10]. Whilst substantially longer than the "average" civil or regulatory case – that is, including investigations that are not pursued or that settle – we note that this is eminently comparable to the average duration of cases involving an RDC or Upper Tribunal reference.

One recent criminal case is of particular note. The FCA brought a prosecution against a former UBS compliance officer and a UBS trader over allegations of insider dealing.[11] The two defendants had their first hearing before the City of London Magistrates in June 2017. Only in October 2018 did the eight-week trial start. Then, in December 2018, after five days of deliberations, a jury was unable to reach a verdict and was discharged. This was despite the judge permitting the jury to come to only a majority verdict. The FCA has notified the court that it intends to seek a retrial against these defendants.[12]

10 https://www.fca.org.uk/publication/corporate/annual-report-2017-18-enforcement-performance.pdf, page 9.
11 https://www.fca.org.uk/news/press-releases/two-charged-insider-dealing.
12 https://www.ft.com/content/9b00c710-fe17-11e8-ac00-57a2a826423e.

5. Cybersecurity and Data Protection

Financial regulation is now inexorably intertwined with data protection rules. It is also striking that these rules often have very broad application beyond the EU. As explained below, recent enforcement cases indicate that the nexus does not have to be extremely obvious or clearly direct.

(i) The GDPR

The data protection framework set out in the GDPR continues to become further entrenched in the financial regulatory framework relevant to financial market participants, including asset managers. This is reflected, for example, in the FCA's focus on cybersecurity in its 2018/2019 Business Plan, which sets out the FCA's objectives for the period,[13] joint FCA and UK Information Commissioner's Office (ICO) statements,[14] and co-ordinated investigations and enforcement actions of the FCA acting with the ICO.[15]

It is worth looking back to two enforcement actions of 2018 to be reminded of the direction in which GDPR enforcement is going, which accords with the expectations of many of aggressive enforcement and (a concern for non-EU-based asset managers) the relatively narrow connection to the EU that is being considered sufficient by the ICO to bring an enforcement action.

13 https://www.fca.org.uk/publication/business-plans/business-plan-2018-19.pdf.
14 https://www.fca.org.uk/news/statements/fca-and-ico-publish-joint-update-gdpr.
15 https://ico.org.uk/about-the-ico/news-and-events/news-and-blogs/2018/09/credit-reference-agency-equifax-fined-for-security-breach/.

(ii) AggregateIQ Data Services Ltd – Enforcement over an Entity with no Presence in the EU

In October 2018, AggregateIQ Data Services Ltd (AIQ) was the first target of a formal enforcement notice by the ICO under the GDPR.[16] AIQ, which is a Canadian business, was required to "cease processing any personal data of UK or EU citizens obtained from UK political organisations or otherwise." AIQ breached the GDPR because it "processed personal data in a way that data subjects were not aware of, for purposes which they would not have expected, and without a lawful basis for processing". The case is significant for non-EU businesses in particular because the enforcement notice was served on an entity established outside of the UK that had no presence at all in the EU. The ICO took the view that AIQ's processing of personal data related to the monitoring of data subjects' behaviour in the EU and that it was therefore within the scope of its enforcement powers.

(iii) Equifax Ltd. – Non-EU Cyber-Attack Did Not Preclude Application of EU Rules; and Significant Fine

In September 2018, the ICO issued Equifax Ltd, a UK-based credit reference agency, with a £500,000 fine for failing to protect the personal information of approximately 15 million UK citizens whose data was breached during a cyber-attack against Equifax that took place in 2017.[17] The fine was the maximum permitted to be levied under the pre-GDPR legislative framework. Since the failings occurred before the date of entry into force of the GDPR (25 May 2018), the investigation was carried out under the previous UK regime. The case is significant for non-EU businesses in particular because the location of the cyber-attack in the US did not preclude strict application of the UK's data protection rules. Although the information systems of Equifax in the US were compromised, Equifax in the UK was identified as responsible for the data of its UK customers: The ICO took the view that the UK arm of Equifax failed to take appropriate steps to ensure that its US parent, which was processing the data on its behalf, was protecting the information. Although too soon to tell, compliance challenges may arise post-Brexit if it is the case that,

16 https://ico.org.uk/media/action-weve-taken/enforcement-notices/2260123/aggregate-iq-en-20181024.pdf.
17 https://ico.org.uk/media/action-weve-taken/mpns/2259808/equifax-ltd-mpn-20180919.pdf.

over time, the substance of key requirements under the GDPR diverge from the form of the GDPR that is adopted by the UK as a legally separate regime on "exit day": There may eventually, in effect, be two fairly distinct versions of the GDPR.

Regulatory guidance is expected to be forthcoming in 2019 concerning, among other aspects of the GDPR, its high-level principles, including lawfulness, fairness, transparency of data processing and storage requirements.

The EU e-Privacy Regulation

The e-Privacy Regulation (the EPR) impacting, among other matters, "direct marketing" in the EU, is in the process of being finalised, and it is expected to come into effect in late 2019 or early 2020 once the legislative process has concluded.

Although the rules replace and tighten existing "direct marketing" requirements under the existing e-Privacy Directive from 2002,[18] direct marketing will, as explained below, now be subject to EU-wide rules that are uniform across the EU rather than, as currently, implemented differently by member state. Further, the stricter concept of "consent" from the GDPR will now be applied. Consent must therefore be freely given, obvious and evidenced by a positive action of the recipient: A pre-checked consent box, for example, is unlikely to suffice. The EPR presents the possibility of significant fines along the lines of the GDPR.

The territorial scope of the EPR is wide-reaching: In addition to compliance being required by legal and natural persons within the EU, legal and natural persons located outside of the EU will also be required to comply with the EPR where they provide electronic services to users located in the EU. Whilst enforcement against non-EU persons may be difficult, for anyone with any connection to the EU, these rules will be important to follow as well.

Direct marketing is defined broadly as "any form of advertising, whether written or oral, sent to one or more identified or identifiable end-users of electronic communications services, including the placing of voice to voice calls, the use of automated calling and communication systems with or without human interaction, electronic message, etc." Those engaging in direct marketing will need to display their phone number or, alternatively, use a special identifiable pre-fixed number that makes clear that the call relates to marketing.

One of the most significant rules that is expected to be contained in the EPR and so will be in force across the EU provides for a "soft opt-in" in particular circumstances. The soft opt-in provides that direct marketing will be permitted to be directed towards a person who has already received goods or services from the business, provided that (a) the direct marketing relates to similar goods or services, and (b) that, in each communication, the subscriber is given the opportunity to "opt-out." This rule is similar to the one already in force in the UK under the Privacy and Electronic Communications (EC Directive) Regulation 2003 (PECR);[19] however, it will be necessary to wait and see whether the concept is given the same meaning by the EU courts as it has been understood domestically.

Cybersecurity

In October 2018, the FCA fined Tesco Personal Finance plc £16.4 million for its systems and controls-related failings following a cyber-attack that the FCA considered "largely avoidable".[20] The FCA said in its final notice that Tesco Personal Finance plc failed to take appropriate action to prevent the foreseeable risk of fraud. In doing so, it breached Principle 2 of the FCA's Principles for Businesses to conduct their business with due care, skill and diligence.

18 Directive 2002/58/EC of the European Parliament and of the Council of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sector.

19 The Privacy and Electronic Communications (EC Directive) Regulations 2003 SI 2003 No.2426.

20 We discuss this case further in the "Recent Case Law and Key Enforcement Cases" section below.

6. EU Securities Financing Transaction Regulation[21]

2019 will see the final legislative steps being taken to finalise core provisions of the EU SFTR relating to reporting of securities financing transactions (SFT) – essentially covering repos and buy-sellback transactions.

Investment firms and credit institutions will not be required to comply with reporting provisions until 12 months from the date of the European Commission adopting the relevant regulatory and implementing technical standards, and for UCITS and AIFs, until 18 months has elapsed from the date of their adoption. The SFT reporting rules have not yet been finalised following extended disagreement between the Commission and ESMA.[22] Although compliance will not be required until early/mid-2020, many financial market participants will need this time to put in place relevant IT and operational systems for collateral management and the reporting of SFTs. It is possible, however, that much of the work required may already have been done where systems have been introduced for EMIR, given similarities with regard to a number of the reporting provisions.[23]

Notwithstanding the final form or timing of Brexit, the UK is likely to adopt any rules that enter into force in the EU after "exit day" in substantively similar form to that in which they are published, given that the rules originate from globally agreed G20 standards.

21 Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012.

22 The Commission announced its intention in July 2018 to endorse the RTS and the ITS, with some amendments compared to the draft submitted by ESMA to the Commission. ESMA has issued a statement that it does not agree with one of the amendments relating to the Commission's proposal to drop ESMA's provision that makes it mandatory for reports to include Legal Entity Identifiers for branches and Unique Transaction Identifiers once these have been developed and "endorsed by ESMA" – the Commission takes the view that this amounts to a delegation of power to ESMA to make changes to the reporting requirements that does not accord with the scope of their legal powers.

23 For example, if both entities that are subject to an SFT are located in the EU, they will both be required to report the trade to an authorised trade repository on a T+1 basis.

7. Amendments to the European Market Infrastructure Regulation

EMIR has caused some difficulties since its promulgation in 2012, which a large EMIR reform project, expected to be finalised in a number of respects in 2019, is intended to address. As explained below, this so-called EMIR "refit" proposal will affect a large number of the requirements under EMIR, impacting all types of participants subject to the rules. There are also requirements under the current EMIR package that are scheduled for phase-in during 2019 relating to clearing and margin, for which participants should be preparing to the extent applicable to them. Finally, an intragroup exemption from clearing is expected to be extended following its expiry at the end of 2018.

(i) The EMIR Refit Proposal

Although the EMIR refit is still in the midst of the European legislative process and certain requirements may therefore find themselves altered by the time of its conclusion, the following sets out a number of key areas of the reform package as they currently stand in the process:

- **Proposal that all AIFs become "financial counterparties":** One of the key changes in the EMIR refit is the proposal that the definition of FC be amended to capture **all** AIFs, and not only AIFs that have an authorised or registered Alternative Investment Fund Manager (AIFM).[24]
- **Introduction of a "small financial counterparty":** A definition of "small financial counterparty" (SFC) is proposed to be introduced for entities that trade infrequently and do not pose a systemic risk; these entities would be exempt from the clearing obligation under EMIR.[25]
- **Amendment of the time reference for the clearing threshold determination:** The proposal is for a once-yearly determination based on the aggregate month-end average total notional amount for March, April and May, replacing the current 30-day rolling average determination.
- **Proposal to remove the requirement that clearing for one asset triggers clearing requirement for all asset classes:** The EMIR refit is expected to remove the requirement that, where the clearing obligation is triggered by an NFC for one asset class subject to the clearing obligation, it is then subject to the clearing obligation for all asset classes subject to the clearing obligation. Instead, it is proposed that the NFC would be in scope for only the clearing obligation requirements for the class of derivative that has fallen over the relevant clearing obligation threshold; this change would significantly reduce the clearing burden for many entities that trade clearable products only relatively infrequently.
- **Proposed amendment of reporting requirement for NFC entities:** It has been proposed that the reporting requirement be amended so that, where an FC has entered into a derivative transaction with an NFC falling below the clearing threshold, the FC would be responsible for reporting on behalf of both parties.
- **Proposed extension of the clearing exemption for pension schemes, which expired on 16 August 2018**.

24 Original drafts of the legislation had suggested that non-EU AIFs with a non-EU AIFM would be reclassified as FCs, which would have represented a significant expansion of the scope of EMIR to non-EU AIFMs. More recently, the definition of FC has been narrowed so that it captures EU AIFs (regardless of the location of the AIFM), as well as, per existing rules, AIFs (wherever located) with an authorised or registered AIFM.

25 The determination for whether an entity is an FC or an SFC would, in current proposals, be made by applying the same clearing only once yearly, based on the aggregate month-end average total notional amount for March, April and May. Risk mitigation rules would however continue to apply to the SFC.

(ii) Phase-In of Requirements Relating to Clearing and Margin

The clearing obligation under EMIR will continue to be phased in during 2019 for Category 3 and Category 4 counterparties.[26] Phase-in of the initial margin requirements under EMIR will also continue in 2019, with the threshold for mandatory initial margin falling to an aggregate average notional amount of uncleared derivatives on a groupwide basis above EUR 750 billion from 1 September 2019.

Entities subject to the clearing and margin rules will need to consider, among other matters, whether their clearing/CCP relationships are adequate and, for initial margin purposes, which custodian they will use, and the required steps to implement custodial relationships.

(iii) Extension of the Intragroup Exemption from the Clearing Obligation

On 27 September 2018, ESMA submitted proposed amendments to the European Commission relating to the secondary legislation under EMIR concerning intragroup transactions with a third-country entity.[27] These changes, once passed (which we fully expect to happen), will extend the expiry date for the exemption from clearing for interest rate derivative classes denominated in the G4 currencies to 21 December 2020.[28]

Many industry participants have not prepared for expiry of the exemption, partly because it was expected that the exemption would be extended until third-country equivalence decisions are in place. These are currently absent. ESMA therefore issued a statement[29] on 31 October 2018 in which it emphasised that national regulators should apply a "risk-based approach" to enforcement of noncompliance with the clearing obligation by entities utilising the intragroup exemption from clearing.

26 For (i) Category 3 counterparties (i.e., FCs whose group's aggregate month-end average of outstanding notional amount of OTC derivatives is below 8 billion EUR, assessed over January/February/March, and AIFs that are NFCs below the threshold) from 21 June 2019 for CDS; and (ii) for Category 4 counterparties (those that are NFCs not falling within any other category), from 9 May 2019.

27 https://www.esma.europa.eu/sites/default/files/library/esma70-151-1768_final_report_no.6_on_the_clearing_obligation_intragroup.pdf.

28 The exemption expired on 21 December 2018, for interest rate derivative classes denominated in G4 currencies subject to the clearing obligation and will expire on later dates for CDS and certain other interest rate derivatives.

29 https://www.esma.europa.eu/sites/default/files/library/esma70-151-1773_public_statement_on_co_and_to_for_intragroup_as_well_as_cat_4.pdf.

8. EU Benchmarks Regulation and LIBOR Cessation

The BMR[30] entered into force on 1 January 2018, regulating the "use," "contribution to" and "administration" of benchmarks. The BMR continues to raise issues into 2019, in particular, for "users" of benchmarks, which will include asset managers.

(i) Challenges for Users of Benchmarks

In 2019, users of benchmarks are finding themselves with the difficult question of whether they are able to continue to use non-EU administered benchmarks from the end of the year.

The "use" restrictions in the BMR prevent EU-based entities from referencing a non-EU administered and non-ESMA authorised "index" used as a benchmark in financial instruments from 1 January 2020, unless, in broad terms:

i. The jurisdiction of the administrator of the index has been declared "**equivalent**" to the EU for the purposes of the BMR by the European Commission.

ii. An administrator located outside of the EU has been **recognised** by an EU member state under the BMR. or

iii. An EU located administrator **endorses** a non-EU benchmark and takes responsibility for its supervision.

30 Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016, on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014.

Although we are currently in the middle of a "transitional period" under the BMR (which permits entities located in the EU to use existing indices/benchmarks until 1 January 2020, even where none of these circumstances are met, provided that they "used" the benchmark when the BMR entered into force), there is the problem that, to date, no jurisdiction has yet been declared "equivalent" to the EU for the purposes of the BMR. Recognition and endorsement of benchmarks have also not proved popular. It is not clear therefore how non-EU benchmarks may be used after the transitional period.

Given this concern, a number of financial industry groups collaborated in November 2018 to formally request by letter to ESMA and the Commission that the transition period be extended.[31] We expect that it is very likely that regulatory guidance will be published during the course of 2019 to assist with these issues.

(ii) Users' Updates to "Robust Written Plans" and the Impact of the Future Cessation of LIBOR

In 2019, updates to benchmark plans may be needed in light of LIBOR ceasing to exist.

Under the BMR, users of benchmarks are required to have in place a "robust written plan" to address fallbacks for any benchmarks used in case they cease to be available or if they change such that they can no longer be used.[32] These plans are required to be made available to the FCA at their request.

Written plans for benchmarks should be looked at carefully in 2019, particularly where any plans reference LIBOR. As is now well known, the LIBOR benchmark rate is expected to cease to exist from the end of 2021 following the FCA's statement in July 2017 that panel bank contributors to LIBOR will no longer be encouraged by the FCA to provide quotes to set LIBOR. Monitoring preparations for LIBOR's cessation also appears to be an FCA supervisory priority for 2019.[33]

31 https://www.isda.org/2018/11/21/briefing-on-the-need-to-extend-the-transition-period-of-the-benchmark-regulation/.

32 Article 28(2).

33 In September last year, the FCA sent a "Dear CEO" to large UK banks and insurance companies in which the FCA asked for details of recipients' preparations and the actions being taken to manage transition from LIBOR to alternative interest rate benchmarks. Although the audience consisted of large banking and insurance institutions, it is difficult to preclude the FCA looking at these issues more generally for entities under their supervision, including asset managers.

(iii) Brexit and the BMR

On 23 November 2018, the UK government published an explanatory stating how the BMR will be "on-shored" in the event of a "no-deal" Brexit.[34] According to the memo, the UK plans to introduce a "UK version" of the BMR that would effectively be a copyout of the EU version of the BMR as in force on exit day. Benchmarks on the ESMA register are proposed to be grandfathered for use in the UK for 24 months from the date of the UK's exit from the EU. The extent to which the "UK BMR" would reflect updates to the "EU BMR" post-Brexit is not clearly addressed; however, it is not inconceivable that the two regimes could diverge over time in significant respects.

34 https://www.gov.uk/government/publications/draft-benchmarks-amendment-and-transitional-provision-eu-exit-regulations-2019/the-benchmarks-amendment-eu-exit-regulations-2018-explanatory-information.

9. EU Action Plan on Sustainability and Asset Management

In November 2018, the European Commission published a consultation[35] for input from stakeholders regarding the extent to which institutional investors and asset managers should be subject to duties of "sustainability," and reflect these in their decision-making relating to investments. The consultation follows publication of an interim report by the EU High Level Expert Group on sustainable finance in July 2017, which recommended that the Commission clarify the fiduciary duties of institutional investors and asset managers concerning environmental, social and governance factors, and long-term sustainability.

The striking aspect of the consultation is the planned shift to using financial regulation as a tool to encourage the sustainability of investments. No laws or regulations have been proposed at this stage.

Although respondents who have published their replies publically have generally agreed that sustainability should be more directly addressed in the legal framework applicable to investment decision-making, some have resisted the assumptions that asset managers have hitherto ignored sustainability as an integral part of their investment process.

35 https://ec.europa.eu/info/sites/info/files/2017-investors-duties-sustainability-consultation-document_en.pdf.

Questions that have been asked include the following:

- "Do you think relevant investment entities should consider sustainability factors in their investment decision-making?"
- "What are the sustainability factors that the relevant investment entities should consider?" (Choices include climate factors, social factors, governance factors and other environmental factors.)
- "Which of the following entities should consider sustainability factors in their investment decision-making?" (Choices include collective investment funds (AIFs, UCITS, etc.), insurance providers, and individual portfolio managers.)
- "Within the portfolio's asset allocation, should relevant investment entities consider sustainability factors even if the consideration of these factors would lead to lower returns to beneficiaries/clients in the medium/short term?"

10. Individuals on the Enforcement Agenda: 2018 Key Cases and Enforcement Round-Up

As discussed more fully in the previous section, there were comparatively few enforcement cases in 2018, and correspondingly few final notices or decisions from the Upper Tribunal. Of the few cases that were decided, however, we note the following:

Jes Staley[36]

On 11 May 2018, the FCA and the PRA fined Barclays' CEO, Jes Staley, a total of £642,430 for allegedly failing to act with due skill, care and diligence in the way that he conducted himself in response to an anonymous letter received by Barclays in June 2016. Barclays is also now subject to special requirements by which it must report annually to the regulators detailing how it handles whistleblowing, with personal attestations required from Senior Managers responsible for the relevant systems and controls.

According to the regulatory notices, in June 2016, a member of Barclays' board received an anonymous letter from an individual outside the bank, purportedly a shareholder, citing concerns about a senior employee, Barclays' process for hiring him and Mr. Staley's role in dealing with those concerns at a previous employer. Later that month, Barclays received a second anonymous letter expressed as being from a Barclays employee. Mr. Staley became concerned that the letters were part of a campaign against the employee and targeted at undermining Mr. Staley's hiring strategy. Mr. Staley instructed the firm's security team to identify the author of the first letter. Mr. Staley was informed that the letter was being treated as a whistleblower, and so he should not attempt to uncover the author. Although Mr. Staley initially accepted this advice, he later resumed his search to identify the author after he mistakenly interpreted an update from compliance that the correspondence was no longer being treated as a whistleblower.

The final notices addressed to Mr. Staley from the FCA and the PRA found that the Barclays CEO was in breach of the requirement to act with due skill, care and diligence (individual conduct rule 2) because he should have identified that:

- He had a conflict of interest in relation to the letter and needed to take particular care to maintain an appropriate distance from Barclays' internal investigation.
- There was a risk that he would not be able to exercise impartial judgment in relation to how Barclays should respond.
- Once the complaint was in the hands of the Compliance team, it was important that Compliance retained control over its investigation process.

While the regulators said that Mr. Staley made serious errors of judgment, they did not find him to have acted with a lack of integrity. They did, however, point out that the standard of conduct expected from a CEO under individual conduct rule 2 was more exacting than for other employees and that CEOs must ensure that appropriate standards of governance are maintained. The final notices make no allegations regarding the Senior Manager Conduct Rules. Although the regulators acknowledged that Mr. Staley made no personal gain from the events, they viewed his misconduct as sufficiently serious for each to impose a penalty of 10% of his annual income (with a 30% reduction in the overall fine for agreeing to settle at an early stage in proceedings). Barclays has also announced that it reduced Mr. Staley's compensation for 2016 by £500,000.

In addition to the penalty imposed on Mr. Staley, Barclays agreed to enhanced reporting requirements under which it must inform the regulators on an annual basis how it handles whistleblowing, with personal attestations required from those Senior Managers responsible for the relevant systems and controls.

In related proceedings, New York State's financial

36 https://www.fca.org.uk/publication/final-notices/mr-james-edward-staley-2018.pdf.

regulator fined Barclays Bank Plc and its New York branch US$15 million based on the same conduct that underlies the enforcement in the UK.[37] The New York agency accused the bank of governance shortfalls and suggested that it had taken a "step back" after prior enforcement for other violations.

Alistair Rae Burns[38]

Mr. Burns' case was factually complicated. The Upper Tribunal's judgment is informative on some important questions of principle, however: To what extent is an approved person liable to ensure that a particular investment is suitable for a particular customer when it is known that that customer is receiving independent advice from a third party?

Mr. Burns was an approved person holding the CF1 (director) position at TailorMade Independent Limited (TMI). TMI itself was authorised by the FCA and acted as an independent financial advisor, particularly advising customers on the benefits of transferring their pensions into Self-Invested Personal Pension Schemes (SIPP). Mr. Burns also had interests in other companies that functioned under the "TailorMade" brand (e.g., TailorMade Alternative Investments Limited (TMAI)). TMAI was not authorised by the FCA, although its business was the promotion of comparatively illiquid and esoteric investments to customers. Many of these investments were inappropriate, and, eventually, TMI and TMAI had to stop trading, and TMI's authorisation was removed.

Amongst other allegations, the FCA alleged against Mr. Burns that he had failed to take reasonable steps to ensure that TMI, as a regulated entity, gave advice that was suitable for its customers. Further, the FCA alleged that TMI failed to obtain the necessary information from its clients to ensure that it had enough information so that it had a reasonable basis to believe that such investment advice given was suitable (e.g., information on the customer's financial situation, investment objectives, and knowledge and experience in relation to the relevant types of investment). These rules are laid out in the FCA handbook at COBS 9.2.

In defence, Mr. Burns pointed out that the investments in question were not "specified investments"; that is, they were not investments subject to regulation in all contexts. Second, Mr. Burns argued that all TMI did was arrange to set up a SIPP for a customer and that it did not give advice on the investments that went into the SIPP, and that it was TMAI that did this.

The Tribunal found that, in any circumstance where a firm gives advice to a customer on the merits of establishing a SIPP, any advice given on the merits of the underlying assets to be held within the SIPP must fall within the scope of the regulator's rules, whether or not they would, in another context, be considered specified investments. Mr. Burns' first argument was therefore unsuccessful: The investments in a SIPP are subject to regulation in this context.

Second, whilst the Tribunal accepted that, where a customer has "genuinely made a decision without advice from the IFA firm which arranges for the establishment of the SIPP to acquire investments to be held within the SIPP, then the obligations of the IFA firm … may be more limited."[39] The Tribunal accepted that a SIPP exists for the customer to make some of his or her own decisions about investments and that merely setting up a SIPP for a customer did not necessarily mean that TMI would have to scrutinise the investments as if it had offered to advise on them alone. The Tribunal thought, however, that any "limitation" on the COBS 9.2 principles on which TMI might try to avail itself was narrow. It was open to TMI to take into account the fact that the customer had already decided (possibly with advice) the type of investments that he or she wanted to hold in a SIPP when assessing the client's knowledge of the sector. It did not, however, mean that TMI or Mr. Burns was excused from advising on the underlying investments at all; it was still necessary for them to gather enough information about the customer to decide whether the proposed investments were suitable.

The Tribunal approved a lower-than-requested financial penalty against Mr. Burns of £60,000 and upheld the FCA's decision to impose a prohibition on Mr. Burns.

Investment advisers should be aware that the COBS 9.2 rules (to gather enough information about a customer to determine whether a particular investment is suitable) may apply to investments that might otherwise not be regulated if the client is being advised in relation to another, related action that is regulated. Further, advisers should beware that instructions from a customer cannot be followed without thought. If the customer has received advice from another firm, the adviser may take this into account, but still must decide whether the advice that the customer has received is suitable.

37 https://www.nytimes.com/2018/12/18/business/barclays-whistle-blower-fine.html.

38 https://www.bailii.org/uk/cases/UKUT/TCC/2018/246.pdf.

39 [2018] UKUT 246 (TCC), [268].

Angela Burns[40]

On 24 May 2013, the FCA published a decision notice against Angela Burns fining her £154,800 and issuing a prohibition order. Five and a half years later, after references to the Upper Tribunal and the Court of Appeal, and an attempted appeal to the Supreme Court, the FCA issued its final notice against Ms. Burns in December 2018.

Ms. Burns had been an NED at two mutual societies and acted as chair for their investment committees. Ms. Burns was engaged by the societies to provide investment advice, and she suggested a registered investment advisor.

Unbeknownst to the mutual societies, however, Ms. Burns, at the same time, was trying to elicit consultancy work for herself with the investment advisor. In her approach to the investment advisor, Ms. Burns explicitly referred to her NED positions in the mutual societies to make herself more attractive.

In falsely holding herself out as a neutral investment advisor for the mutual societies, and aggravating this by relying on her position in those societies for her own gain with the investment advisor, the FCA – and the Upper Tribunal and the Court of Appeal agreed – decided that Ms. Burns was in breach of Principle 1, to act with integrity in carrying out her accountable functions. The FCA determined that she should have declared her conflicts of interest.

Consequently, the FCA issued a prohibition order against Ms. Burns. The one success that Ms. Burns had before the Upper Tribunal, which was not disturbed on appeal to the Court of Appeal, was to have the proposed fine of £154,800 reduced to £20,000.

ENRC v. SFO[41]

Firms often bring in external law firms to conduct investigations and to provide reports on what has happened. Firms choose to instruct outside counsel for these investigations for a number of reasons, but one important reason is the hope that the final report will be protected by legal professional privilege and so will not have to be disclosed to a court or the regulator.

Last year, we drew attention to two cases where the court had taken a narrow view of privilege, and compelled the firms involved to disclose various notes and papers produced by external law firms during the investigation. One of those cases, *Eurasian Natural Resources Corporation Limited v. Serious Fraud Office*, has now been successfully appealed to the Court of Appeal.

The judgment given is helpful for firms, but it still does not mean that everything produced by a law firm during an investigation will be covered by privilege. In particular, timing will matter.

In December 2010, ENRC received an email from a whistleblower alleging criminal conduct in Kazakhstan and Africa. ENRC appointed external lawyers to investigate this. By March 2011, ENRC was aware that the SFO was interested in the situation, and ENRC's general counsel arranged for the firm's dawn-raid procedures to be reviewed and upgraded in response. ENRC's head of compliance predicted a dawn-raid before the end of summer 2011. In August, the SFO wrote to ENRC advising it to consider carefully the SFO's Self-Reporting Guidelines, and requested a meeting with its general counsel.

The relevant question in this case was whether documents created by the external law firm, including notes of interviews with employees, after this letter was received would be protected by privilege.

There are two branches of legal professional privilege, namely legal advice privilege and litigation privilege. ENRC argued that the documents in dispute should generally be protected under litigation privilege, and further that the notes of interviews with employees should also be protected under legal advice privilege. In broad terms, legal advice privilege protects professional communications between a lawyer and a client whenever these communications are made. Litigation privilege, on the other hand, protects communications that are made when legal proceedings are "reasonably contemplated" and when the communications are made for the "sole or dominant purpose" of those proceedings.

At first instance last year, Mrs. Justice Andrews decided that the notes of interviews with employees could not be protected by legal advice privilege.[42] There is Court of Appeal authority that legal advice privilege can arise between only lawyers and employees who have been specially authorised to seek and receive legal advice. These employees had

40 https://www.fca.org.uk/publication/final-notices/angela-burns-2018.pdf.

41 https://www.bailii.org/ew/cases/EWCA/Civ/2018/2006.html.

42 https://www.bailii.org/ew/cases/EWHC/QB/2017/1017.html.

not been specially designated, and so she decided that legal advice privilege would not apply.

Mrs. Justice Andrews further decided that, in the relevant period after the SFO's letter in August 2011, ENRC did not reasonably contemplate that proceedings would be brought. Consequently, she found that litigation privilege could also not apply to these documents.

The Court of Appeal rarely overrules its own precedents. Whilst it was overtly critical of the authority restricting legal advice privilege to communications between a lawyer and only some employees, the Court left it to the Supreme Court to decide the question. The SFO has said that it does not plan to appeal this decision; we may have to wait some time for another case to reach the Supreme Court.

In any event, overruling this decision would not have made a difference to the outcome of this case, since the Court of Appeal thought that litigation privilege should apply to the documents in this case, including notes made of interviews with employees. It held that, in all the circumstances of this case, and especially where (a) the SFO had gone beyond merely stating general principles from its guidelines and (b) lawyers had been appointed to conduct an investigation, there was "clear ground" to say that proceedings were reasonably in contemplation. Indeed, much of what ENRC was attempting to do was avoid the proceedings that it thought would be coming its way.

The message from this case is generally positive. Even though legal advice privilege remains somewhat unhelpful in terms of protecting investigation material, the courts should now look more favourably on litigation privilege claims.

Santander[43]

On 19 December 2018, the FCA fined Santander £32.8 million for failing to effectively process the accounts and investments of deceased customers. The FCA found that, between 1 January 2013 and 11 July 2016, the bank breached:

- Principle 3 of its Principles for Businesses (management and control) by failing to take reasonable care to organise and control its probate and bereavement process responsibly and effectively with adequate risk management systems.
- Principle 6 (customers' interests) by failing to ensure that its probate and bereavement process paid due regard to the interests of its customers and their representatives and treated them fairly.

The FCA said that the bank's probate and bereavement process contained weaknesses that reduced its ability to effectively identify all the funds that it held that formed part of a deceased customer's estate. This resulted in it being unable to effectively follow up with representatives of the deceased customer. Such weaknesses meant that the process would start, but would stall and remain incomplete, meaning that funds would not be transferred to those who were entitled to receive them.

Since 2015, Santander has carried out remediation exercises to transfer funds from affected accounts to the rightful beneficiaries. These exercises are almost complete, which means that most of the 40,000 affected customers have now received the funds, together with interest and compensation for any consequential loss.

The bank was also found to have breached Principle 11 (relations with regulators) for failing to promptly disclose information relating to the above-detailed issues to the FCA.

Mark Steward, the FCA's head of enforcement, cautioned that the FCA remains "on the lookout for firms with poor systems and controls and will take action to deter such failings to ensure customers are properly protected."[44]

Arif Hussein[45]

The FCA issued a decision notice prohibiting Arif Hussein from performing any function in relation to any regulated activity on the grounds that Mr. Hussein had knowingly or recklessly engaged in conduct that he believed was improper; that Mr. Hussein was knowingly or recklessly complicit in his employer, UBS's, manipulation of LIBOR; and that Mr. Hussein lacked honesty and integrity. In particular, the FCA alleged that Mr. Hussein had engaged in improper internal chats with a trader-submitter at UBS for the purpose of influencing UBS's LIBOR submissions. Mr. Hussein referred this notice to the Upper Tribunal.

43 https://fca.org.uk/publication/final-notices/santander-uk-plc-2018.pdf.

44 https://www.fca.org.uk/news/press-releases/santander-uk-plc-fined-serious-failings-its-probate-and-bereavement-process.

45 https://www.bailii.org/uk/cases/UKUT/TCC/2018/186.pdf.

Before the FCA's RDC, Mr. Hussein had contended that he had been involved in internal chats with trader-submitters to explore internal opportunities to hedge or "net" his trading positions (in short, he had engaged with trader-submitters in their capacities as short-end derivatives traders, rather than as LIBOR submitters). Before the Upper Tribunal, Mr. Hussein repeated this defence, but he also stated that he believed at that time that it was acceptable for trader-submitters to take into account trading positions when determining what a LIBOR submission would be. The FCA contended that Mr. Hussein had changed his defence between the interviews he had had at the FCA and the RDC hearing, and then at the Upper Tribunal hearing, and that this change indicated a lack of integrity.

The Upper Tribunal agreed with Mr. Hussein's position that he had thought his chats with the trader-submitters to be appropriate. The Upper Tribunal noted that, at the relevant time, there were no formal procedures within UBS regulating the LIBOR submission process, and Mr. Hussein did believe that his trading positions could be taken into account by the submitters. The Tribunal found that Mr. Hussein did not act dishonestly or recklessly and that his participation in the chats was not contrary to the standards required of him.

The Tribunal accepted, however, that Mr. Hussein had misled the FCA through his answers at interview and that he should have appreciated during the proceedings before the RDC that the chats had had a dual purpose: The chats had not simply been exploration into his hedging or netting options. The Tribunal found that Mr. Hussein should have told the RDC that he thought it permissible for his trading positions to be taken into account in the LIBOR submissions. The Tribunal therefore agreed with the FCA that Mr. Hussein had changed his position and that this meant that he must have misled the regulator and failed in his duty to be candid with the FCA. Somewhat reluctantly it appears, the FCA agreed that this failing by Mr. Hussein was sufficiently serious that it was reasonable for the FCA to impose a prohibition order on him. Notwithstanding that the Tribunal disagreed with the RDC and the FCA's submissions on many issues, therefore, the Tribunal dismissed Mr. Hussein's reference.

Interestingly, the Upper Tribunal expressed some concern that a comparatively junior trader should have received a prohibition order from the FCA whilst more senior managers had apparently escaped sanction. Whilst the Upper Tribunal has no power to do anything more than express its strong concerns about this to the FCA, this statement is somewhat unusual.

The most important message from this case is the obligation to reflect and be truthful about what happened from as early in the investigation as possible. Had Mr. Hussein's position remained consistent throughout the proceedings, it seems likely that the Tribunal would have found for him; as the Tribunal said, "we do not believe him to be a thoroughly bad person. He made a serious error of judgment." Unlike in court litigation, where parties are expected to develop their cases as the proceedings progress, the duty of candour to the FCA means that this approach is not open in these regulatory proceedings. Everything that an authorised or approved person does, whether before the investigation or during the investigation, is open to scrutiny, and litigation conduct must adapt accordingly.

Tesco Personal Finance plc[46]

In November 2016, Tesco Personal Finance plc (Tesco Bank) reported that it had suffered a serious cyber breach during which £2.26 million was stolen from 9,000 consumers' accounts. Tesco Bank quickly refunded any customers who had lost money in the attack.

In October 2018, the FCA announced that it would fine Tesco Bank £16.4 million for failing to exercise due skill, care and diligence in protecting its customers. The FCA noted that this sort of cyber-attack was a "foreseeable risk" from which Tesco Bank had failed to protect its customers. Further, the FCA determined that, once it became aware of the cyber breach, Tesco Bank had failed to act with "sufficient rigour, skill and urgency."

Even if the cyber breach had been too sophisticated for Tesco Bank reasonably to be expected to have been able to prevent – which was not the case here – the FCA was critical that Tesco Bank did not have in place a response plan that would permit a swift recovery. The FCA requires firms to have an effective plan in place setting out what to do if a damaging event occurs, whether that event should have been foreseen or not.

46 https://www.fca.org.uk/publication/final-notices/tesco-personal-finance-plc-2018.pdf.

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