BDO FS ADVISORY - MANAGED COMPLIANCE SERVICES

REGULATORY UPDATE

NOVEMBER 2023

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BDO MANAGED COMPLIANCE SERVICES CONTACT POINTS

BDO's Managed Compliance Services Regulatory Update summarises the key regulatory developments.

Our FS Advisory Services team support hundreds of clients with various regulatory and non-regulatory matters. Our breadth and depth of expertise gives us a broad perspective on the issues facing the financial services sector. We have aggregated insights from our in-house research, client base, the Regulators and professional bodies to support your regulatory considerations and activities.

We hope this pack provides value to you and your colleagues; please do share with us any feedback you may have for our future editions.

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CONSUMER DUTY UPDATE

CONSUMER DUTY UPDATE

The FCA's Consumer Duty implementation date on 31 July 2023 (for existing products and services) has passed and we are now into a period of embedding and review by the FCA. This article sets out some of the hot topics, risk areas and questions the regulator is posing, plus highlights the next milestones for implementation and review.

Just to recap, the FCA's Consumer Duty is extensive and wide-ranging consumer regulation that seeks to improve outcomes for retail consumers and SMEs. We have previously summarised the new regulatory requirements and links to previous articles published on our website can be found here.

As set out in the FCA's Business Plan, published in April, it is now focusing on the successful embedding of the Consumer Duty into firms' systems and controls. The regulator has a budget of £5m and we are starting to see some of the outcomes from the FCA's supervisory work:

- supervisory teams are carrying out a range of thematic and firm-specific reviews;
- we are seeing some very detailed information requests seeking analysis at a product or customer journey level
- FCA teams are requesting detail regarding gaps or harm identified and action plans in place to address these areas.

It is a learning process and there are no definitive responses for all cases. Over the next 12 months, we expect to see a greater level of consensus about what 'Good' looks like.

HOT TOPICS FROM OUR MARKET EXPERIENCE

Price and value

There has been specific focus across sectors on fees and charges and fair value for consumers. As a reminder, one of the four consumer outcomes is headed Price and Value.

We want all consumers to receive fair value. Value is about more than just price, and we want firms to assess their products and services in the round to ensure there is a reasonable relationship between the price paid for a product or service and the overall benefit a consumer receives from it. (FCA Policy Statement 22/9, 7.1.)

Given the cost-of-living pressures for consumers and small businesses, the FCA is focused on fair value, and we are seeing plenty of press coverage on topics, such as interest rates and commission charges to leaseholders. There should be a reasonable relationship between price, value and work done. Assessments of fair value need to be detailed and at a customer cohort level to identify customer groups where fees and charges may not show a reasonable link to price or value. It is an analytical process and a judgement on what is reasonable. The FCA expects action to reduce fees, change charging structures or disclosures where needed. The hardest discussions within a firm's senior management will be about reducing fees and charges.

CONSUMER DUTY UPDATE

Consumer Journeys and foreseeable harm

We are seeing requests for information about the granularity of consumer journey mapping, harm identified, and actions being taken. As a reminder, the consumer understanding and support outcomes, require firms to take a close look at processes that act as a barrier to consumers achieving their financial goals. A thorough evidenced rationale for customer journey mapping, issue identification and action plans and action tracking should be in place.

Added to this is the ability for firms to think about foreseeable harm. The Consumer Duty rules expect firms to identify what is reasonably foreseeable and act accordingly. For example, the rise in interest rates should have prompted a new risk assessment to identify issues ranging from operational capacity to deal with consumer calls to how interest rises are passed onto consumers.

Vulnerable Customers

Areas of focus also include identification and treatment of vulnerable consumers through customer journeys. Vulnerability is sometimes a difficult concept to operationalise for firms. Identification and assessment processes may not be well advanced, and we have seen FCA challenging the quality of MI in place to assess outcomes for vulnerable consumers.

Root Cause Analysis

There should be a range of metrics in place to measure outcomes. What will be important is the root cause analysis of identified issues and actions to address. This might be at a process, control or competency level, or a more strategic understanding of how a business model is operating. Our observation is that the FCA is challenging the quality of root cause analysis and extent to which strategic as well as process issues are identified.

The Annual Review

The responsibility of Boards this year will be to review and assess how they are meeting the Consumer Duty. The FCA's Final Guidance (FG 22/5) states that:

"A firm's governing body should review and approve the firm's assessment of whether it is delivering good outcomes for its customers which are consistent with the Duty and agree any action required, at least annually".

The FCA is specifically asking about the role of second and third lines in the review and reporting process and challenge to first line or support to the Board in its review role. Boards should be looking for assurance from second and third lines that metrics, reports and actions have sufficient breadth and depth of coverage and effective root cause analysis.

We have published a specific article about the annual review process here.

It would be reasonable to assume that any annual reports to, and reviews by, the Board will be subject to FCA scrutiny and, therefore, a good quality evidence-based discussion is important to demonstrate rationales for decisions, actions taken and progress towards embedded consumer culture.

Closed Books - 2024

As a postscript, we must not forget that for closed products, those no longer sold or renewed, the deadline for implementation of the Consumer Duty is 31 July 2024. The requirements are slightly different. Plans should be in place and well advanced. Some actions could be complex and should be highlighted as a risk area. For example, some potential issue areas could be missing product terms and conditions, exit charges, reduced levels of customer service and support in comparison to existing products and services on sale. Internal Audit teams should have specific focus on the risks for closed book Consumer Duty implementation projects and the costs of any potential actions.

WHAT SHOULD COMPLIANCE TEAMS THINK ABOUT?

- This is still an evolving regulatory initiative with emergent themes and Hot Topics. The industry, as much as the regulator, is learning as the regulatory process unfolds;
- Second and third lines should be providing meaningful and well documented challenge to support embedding of the new Duty and ensure that the annual review process is taking place;
- 2024 sees the first Annual review by the Board and deadline for implementation for closed book. Compliance teams should update the annual audit plan to incorporate appropriate assurance activity at key milestones for this process.

CONSUMER DUTY UPDATE

ARE YOU READY TO REPORT ON CONSUMER OUTCOMES?

Reporting on consumer outcomes is a central feature of The Consumer Duty. Firms are now expected to continually monitor and assess customer outcomes at all stages of the consumer/firm life cycle. Good governance is also expected with the Board reviewing how the firm is assuring good customer outcomes.

From the FCA's perspective, a firm's ability to evidence an effective approach will be a positive sign that they are successfully embedding the new rules.

As firms start to prepare for their annual Board review, we look at some of the key points to consider.

What should I include in my firms' consumer outcomes report?

For most firms, outcome testing frameworks will already be in place. Analysis of outcomes data should be showing what actions are being taken to improve, or where more investigation is needed. Focus will now be fine-tuning; calibrating tolerances or introducing additional measures as new data or technology becomes available.

The bedrock of an annual report to the Board should be the results of outcomes testing and assurance around its effectiveness. In considering the effectiveness of their outcomes testing firm's may reflect on the following:

- Does testing cover all in scope retail and SME customers, business lines and distribution channels?
- Are outcomes assessed across the whole customer journey?
- Is there sufficient capacity to complete the volume of testing required?
- Are internal and external sources of data being maximised?
- Have FCA communications about the consumer duty been incorporated into testing approaches?
- Are the metrics used the most useful ones, and are they outcomes focused?
- Is testing being done to the right quality?
- How are the results interpreted and judgements calibrated, and what is the right level of tolerance?
- What are the metrics telling you, and what actions should be taken?
- And how are judgements, root cause analysis and actions recorded, monitored, and reported?
- Is there sufficient internal challenge and review to the measures and results?

How should I prepare the board to review consumer outcomes?

The FCA's Final Guidance states that "A firm's governing body should review and approve the firm's assessment of whether it is delivering good outcomes for its customers which are consistent with the Duty and agree any action required, at least annually".

The FCA expects the annual review to focus on:

- The results of the monitoring that the firm has undertaken to assess whether products and services are delivering expected outcomes in line with the Duty;
- Any evidence of poor outcomes, including whether any group of customers is receiving worse outcomes compared to another group, and an evaluation of the impact and the root cause;
- An overview of the actions taken to address any risks or issues;
- How the firm's future business strategy is consistent with acting to deliver good outcomes under the Duty.

The Consumer Duty Final Guidance FG22/5 sections 6.80, 7.51 and 10.15 provide helpful questions to guide board reviews. The questions consider purpose, culture, and governance as well as delivery of outcomes and actions taken. The structure of a report to the Board should reflect these questions and enable a structured discussion.

Each Board is different, therefore thought should be given on how best to engage. This includes the right timing in the board cycle, the right reporting format, and an optimal level of detail. Ultimately the report should enable the Board to assess the judgements made about the quality of outcomes and understand actions taken or due.

The Consumer Duty Board Champion should be engaged early to consider which areas might need more in-depth challenge, possibly at an appropriate sub-committee. This may impact the time required for review and the structure of the report to the Board, with a synopsis of related meetings, and progress against actions.

Compliance, Risk and Internal Audit should scrutinise reporting, the quality of metrics, judgements made, and actions taken. This should demonstrate that testing is fully operational and effective, and act as a measure of how well consumer duty principles are embedding across the organisation.

Finally, firms should allow enough time. An early 'dry run' might help flush out any unanticipated challenges, and the Board might appreciate a first review with further review once feedback has been addressed.

02

ECONOMIC CRIME UPDATE

ECONOMIC CRIME UPDATE

FCA FINES INVESTMENT FIRM FOR SERIOUS FINANCIAL CRIME CONTROL FAILINGS

On 2 October 2023, the FCA fined ADM Investor Services International ('ADMISI') Limited £6,470,600 for serious financial crime control failings.

The firm's engagement with the FCA commenced in 2014 when the FCA had concerns about its AML systems, including the absence of a formal Customer Risk Assessment ("CRA") approach. The FCA subsequently visited the firm in 2016 and noted that there was:

- Limited sophistication of ADMISI's CRA and its ability to use this to undertake a comprehensive assessment of a customer's financial crime risk;
- A lack of a Business-Wide Risk Assessment ("BWRA");
- Limited evidence of ongoing customer monitoring via periodic reviews undertaken following a risk-based approach; and
- A lack of regular review (and refresh) of the firm's anti- financial crime policies and procedures.

Following the FCA's 2016 visit, the firm was placed under restrictions by the FCA and instructed to not to take on any new business from high-risk customers to reduce its risk exposure. By October 2016, the firm had introduced or enhanced its policies and procedures to address the FCA's concerns and, after further remedial action, the FCA lifted its restrictions in 2018.

Notwithstanding the progress made between 2016-18, the FCA opted to exercise its right to penalise the firm for historically failing to have appropriate controls in place to mitigate and manage the elevated money laundering risks presented by its inherently higher risk business model when it should have done.

WHAT SHOULD COMPLIANCE/FINANCIAL CRIME TEAMS THINK ABOUT?

While firms cannot turn back the clock to remedy historic gaps/deficiencies in their anti-financial crime systems and controls, they can ensure that compliance is a key priority in the present. Compliance teams should there take note of the ADMISI decision and ensure that their assurance work considers how the firm:

- Takes steps (via a BWRA) to understand the inherent risks to which the business is exposed based on the business model, customer demographic, geographical connections, products and services offered, and delivery channels used;
- Assesses the strength of its mitigating controls to determine whether residual risk remains within risk appetite and, if not, take steps accordingly (such as de-risking or implementing control enhancements);
- Ensures that anti-financial crime policies and procedures are up-to-date to capture the latest regulatory developments and sectoral guidance, and gain formal approval from Senior Management;
- Develops and deploys a Customer Risk Assessment (CRA) approach which is aligned to regulatory requirements and expectations, but also appropriate to the firm's size and sophistication to enable senior management to undertake a comprehensive assessment customers' financial crime risk;
- Monitors customer relationships on an ongoing basis, both periodically following a risk-based approach and being alive to trigger events, to continue to evaluate the risks posed and adjust the nature and level of controls accordingly.
- Considers the specifics of the ADMISI fine and seeks to apply lessons learnt. This may include engaging external support to gain proactive assurance with respect to the design and operating effectiveness of the financial crime framework.

ECONOMIC CRIME UPDATE

SANCTIONS COURT CASE PROVIDES INTERESTING OUTCOMES

On 6 October, the UK Court of Appeal ('CoA') issued its judgment in a case brought by Boris Mints & others v PJSC National Bank Trust & PJSC Bank Okritie. The case centred around the extent to which a sanctioned party (designated person) could be considered to 'control' an entity and thus the sanctions applicable to the designated person also extend to the entity. In this instance, the case related to sanctions against Russian President, Vladimir Putin.

The outcome was that a designated person would be considered to 'control' an entity where the entity is not a personal asset of the designated person, but the designated person is able to exert influence over it by virtue of the political office that the designated person holds. Further, the judge stated that "in a very real sense,…..Mr Putin could be deemed to control everything in Russia".

The case brought significant interest given the grey areas in interpretation of the ownership and control clauses cited in applicable sanctions regulation.

On 16 October, the UK Foreign, Commonwealth & Development Office ('FCDO') issued a statement which noted that the UK Government is "carefully considering the impact" of the outcomes of the case. Importantly, it clarified that *"There is no presumption on the part of the Government that a private entity based in or incorporated in Russia or any jurisdiction in which a public official is designated is in itself sufficient evidence to demonstrate that the relevant official exercises control over that entity"* but is committed to exploring options to further enhance clarity in this area going forwards.

WHAT SHOULD COMPLIANCE/FINANCIAL CRIME TEAMS THINK ABOUT?

This further exemplifies continued need for focus on the sanctions compliance agenda. In addition to the FCA-driven focus areas, firms should consider:

- Gaining familiarity with the Boris Mints & others v PJSC National Bank Trust & PJSC Bank Okritie case and analyse how similar situations may occur in their own firm;
- Horizon scan and monitor for UK Government and/or OFSI updates or guidance because of the outcomes of this case; and
- In the interim, revisit internal definitions and guidance relating to beneficial ownership and control to ensure that their frameworks provide sufficient clarity and guidance relating to the instances in which entities may be subject to sanctions by virtue of their direct or indirect ownership or control by a designated person, and that staff are aware of items which may need escalation as well as instances which are deemed outside of risk appetite.

03

DATA PROTECTION UPDATE

SUBJECT ACCESS REQUESTS

DATA PROTECTION UPDATE
Subject Access Requests

Following a number of recent high-profile subject access requests over the summer, firms within the financial services sector are reviewing their processes to ensure that they do not make the headlines for non-compliance in this area.

WHAT IS A SUBJECT ACCESS REQUEST?

The UK General Data Protection Regulation (UK GDPR), which is enshrined in domestic legislation as the Data Protection Act (2018), affords individuals several rights in relation to their personal data, including the right to access, which is commonly known as a 'subject access request'. Individuals have the right to access and receive a copy of their personal data and other supplementary information, and firms are required to provide this information, although it should be noted that such a request can also be refused if it is deemed to be manifestly unfounded or excessive.

Individuals can make a subject access request verbally or in writing, including via social media.

Firms are required to process subject access requests within one calendar month, which can be extended by a further two months if the request is overly complex or onerous, and in the most circumstances, firms cannot charge a fee to deal with the request.

Whilst the intention of the right of access is to increase transparency, and to enable individuals to determine whether their personal data is being used in accordance with data protection laws, in practice, subject access requests are often used by ex-employees or disgruntled customers who are looking for specific information, or want to cause disruption (this especially in the case of a long-standing employee, where the number of documents containing personal data can run into the thousands).

Either way, in view of the enforcement powers of the Information Commissioner's Office ('ICO') (and associated reputational damage), financial services firms should be fully cognisant of the risks associated with getting this wrong and Internal Audit team should appropriately plan for data protection reviews.

DATA PROTECTION UPDATE
Subject Access Requests

WHAT SHOULD DATA PROTECTION OFFICERS THINK ABOUT?

People

- Are employees aware of the process in the event of a data subject rights request, where strict time limits apply? Employee awareness is a key control to ensure that prescribed time limits are adhered to. Organisations should, therefore, be considering whether employees receive sufficient training to identify, (and for specific teams) manage subject access requests.
- Have sufficient resources been allocated to managing subject access requests in line with prescribed timescales? If an organisation has seen an increase in the number of subject access requests received, have sufficient resources been allocated to meet the demand in line with the regulatory timescales?

Process

- Have processes for managing subject access requests been defined? Subject access requests can be tricky and lengthy to navigate, especially when it comes to verifying the identity of the requestor, applying an extension, managing exceptions or instances in which a request can be refused, finding and retrieving the data, redacting/removing personal data pertaining to other individuals and providing the data to the requestor within the prescribed timeline. All these considerations highlight the importance of formally documenting processes for managing subject access requests.
- Does management have oversight of compliance with key timescales? Depending on the volume of subject access requests received, exceeding the one calendar month deadline for managing a request, or regularly applying an extension for basic requests, can be indicative of wider issues, such as a lack of dedicated resource to manage subject access requests.

Technology

- Are processes for extracting and redacting personal data automated or manual? Depending on the volume of subject access requests an organisation receives, an overreliance on manual processes for extracting and redacting personal data can lead to inefficiencies and increase the risk that prescribed deadlines could be missed.

ICO REGULATORY FOCUS

As highlighted above, the ICO has a range of enforcement powers at its disposal, including monetary penalties, enforcement notices, undertakings, reprimands and, in some cases, individual prosecutions. However, if the press coverage of recent high-profile cases is anything to go by, internal audit teams should be mindful of any associated reputational damage arising from enforcement action taken, which is published via the ICO website on an ongoing basis.

Further to this, it's worth noting that an organisation has recently received a reprimand from the ICO, for failing to process 35% of subject access requests within the statutory deadlines of one and three months, so the ICO is focusing on this.

Following a number of headlines over the summer, the topic of subject access requests remains a key area of focus within the sector, and our specialist team is available to provide support.

04

ESG UPDATE

FOUR PRACTICAL ACTIONS FOR DRIVING CLIMATE CHANGE RISK MATURITY THROUGH TCFD REPORTING

ESG UPDATE

The Task Force on Climate-related Financial Disclosures (TCFD) recommendations published in June 2017 were the first of their kind, designed to provide a framework for firms to disclose critical climate-related financial information.

The recommendations provide a framework for financial institutions to develop more effective disclosures through existing and new reporting processes.

For some firms, reporting is mandatory. The Companies (Strategic Report), Climate-related Financial Disclosure Regulations 2022 and the Limited Liability Partnerships, Climate-related Financial Disclosure Regulations 2022, cover large corporates (firms with more than 500 employees and more than £500m operating income).

The FCA ESG sourcebook, on the other hand, initially covered just listed entities, but was extended to larger regulated financial institutions, including asset managers with assets under management of more than £50bn for financial years beginning 1 January 2022, and extended to asset managers with more than £5bn for financial years beginning 1 January 2023, to be reported by 30 June the following year.

This is slightly different to the Companies Act requirement which mandates the TCFD report to be included within a firm's annual report. PRA regulated firms, not in the scope of these requirements, are also expected to engage with the TCFD framework, as indicated in the PRA's Supervisory Statement (SS3/19).

Adherence, either on a voluntary or mandatory basis, has helped improve risk management practices, transparency, and investment decision-making.

The Challenges

According to research published by the TCFD in October 2023, insurance companies and banks have had the highest levels of reporting on risk management recommendations, which may be attributed to the financial regulators' general emphasis on risk management processes.

Asset managers and asset owners have reported facing more challenges with their climate-related reporting due to receiving insufficient information from investee companies. Asset managers highlighted insufficient information from public companies as the biggest challenge (62%), followed by private investments (49%), while asset owners identified information on private investments (84%) as the most difficult to report on.

Through our experience providing climate change risk management and reporting support to financial services firms, we have accumulated experience on four key actions that firms can undertake to improve their TCFD reporting and risk management of climate-related risks:

Carry out a gap analysis against TCFD

Firms that wish to improve their climate change disclosures can carry out a gap analysis to evaluate their current disclosures with the 2021 TCFD recommendation, the 2021 sector guidance, the FCA's and the Financial Reporting Council (FRC) thematic reviews and the TCFD status annual reports. This can help determine whether there are gaps or errors in the latest or planned disclosure, ensuring the disclosures can be made more relevant and comprehensive.

An end-to-end gap and governance analysis provides senior management and the board with comfort that the process is fit for purpose and provides a strong platform for improving the maturity of the disclosures.

Ensure your climate change risk management framework is fit-for-purpose

Industry practices have evolved since the first requirements were introduced in 2019, with new data and tools now available. Likewise, PRA and FCA expectations for regulated in-scope firms have evolved and firms should take a step forward after spending the last three years developing their frameworks. Key areas where firms must take steps to remove barriers are governance and oversight, engagement and data management.

ESG UPDATE

At this point, ensuring climate risk management controls are aligned with the regulatory framework and the PRA's feedback is crucial. Those falling behind need to develop a robust implementation and a roadmap to integration, and this should be readily available to demonstrate to the PRA that they are appropriately managing both the internal and systemic risks associated with climate change, should they require it.

Assessing whether the risk assessment, risk appetite statement and metrics are aligned can help to improve TCFD disclosures, as not only do these controls need to be consistently explained in a number of the TCFD recommendations, but also the metrics form the basis of the targets recommended disclosures.

Obtain assurance over the TCFD disclosures

The increased global focus on climate-related financial disclosures has required that the second and third lines of defence, as well as independent assurers, play a fundamental role in ensuring disclosures have been prepared in accordance with appropriate methodologies reducing the risk of information being inaccurate, misleading or exaggerated.

The second line of defence, such as the risk, finance, and compliance function, has a role to play in supporting and overseeing the first line in their management of sustainability related risks and publication of TCFD disclosures.

The internal audit function, as the third line of defence, has also the capacity to review and contribute to the improvement of TCFD Disclosures. The reviews and conclusions made by internal auditors can provide assurance to the Board that the process, methodologies and controls involved in making TCFD disclosures are operating effectively. In doing this, they drive maturity of the controls and improve confidence in the disclosures made.

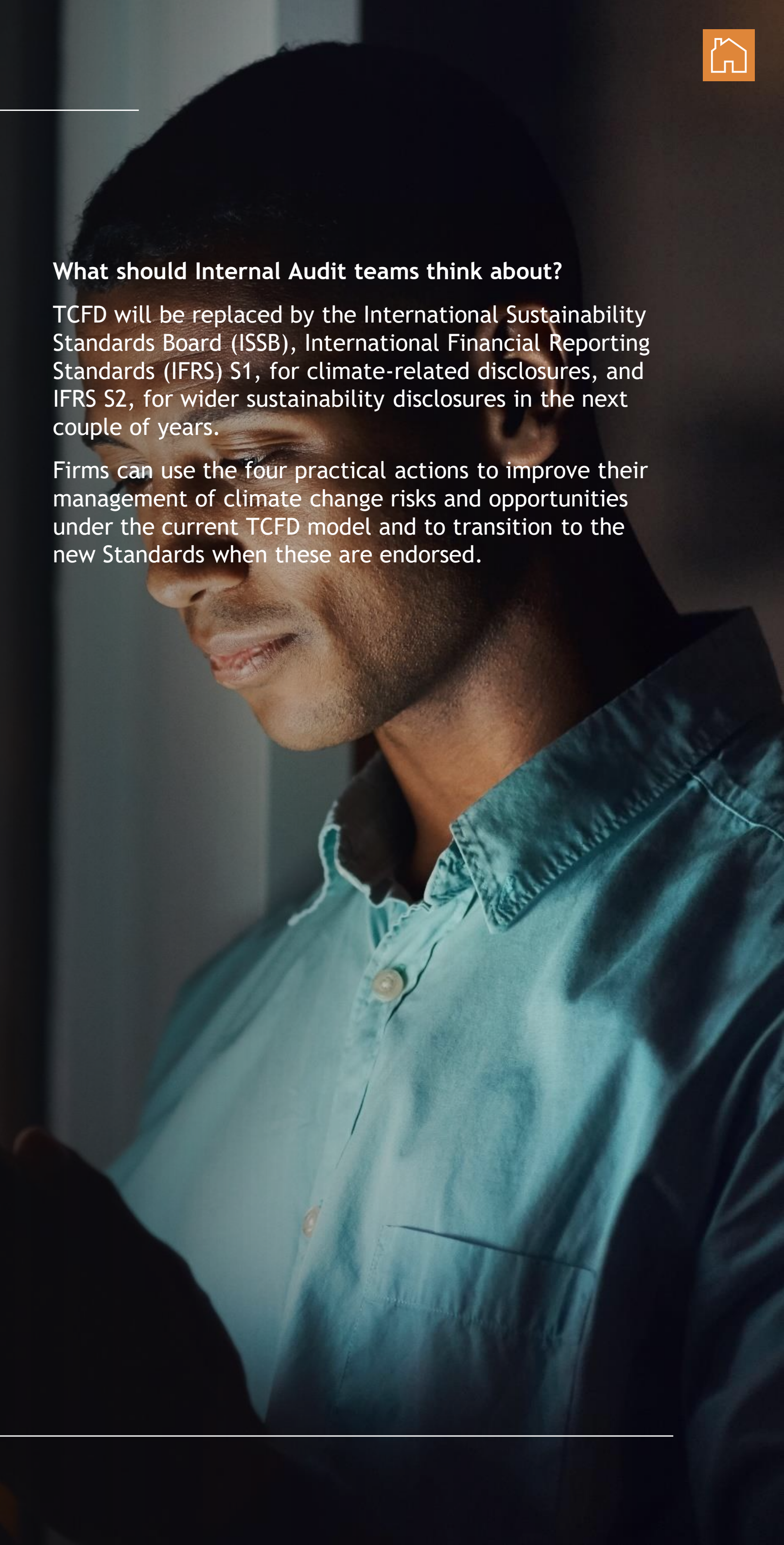
We have seen the benefit of adding an additional layer of oversight and transparency to the disclosures and reducing the risk of greenwashing.

Keep the climate change components of the ESG strategy up to date

Better climate change risk management improves business performance and leads firms to developing ESG and climate change strategic plans that align with broader business goals. Climate change, as well as other material ESG aspects, are normally part of any robust ESG strategy and framework.

We are seeing that whilst some firms have implemented an ESG strategy, it is uncertain whether the plan is being progressed and the objectives are achievable. In addition, whilst firms may have designed a climate change strategy, it may be unclear whether it is being implemented effectively.

TCFD disclosures are a mechanism in which firms can communicate to their stakeholders their climate change strategy and how they are progressing with reducing their climate-related risk and impact, enhancing green finance and getting closer to direct and indirect net zero emissions. As a result, there is a close link between the ESG Strategy and the outcomes of it that would go into the TCFD disclosures.



What should Internal Audit teams think about?

TCFD will be replaced by the International Sustainability Standards Board (ISSB), International Financial Reporting Standards (IFRS) S1, for climate-related disclosures, and IFRS S2, for wider sustainability disclosures in the next couple of years.

Firms can use the four practical actions to improve their management of climate change risks and opportunities under the current TCFD model and to transition to the new Standards when these are endorsed.

05

SUMMARY OF REGULATORY PUBLICATIONS IN OCTOBER 2023

REGULATORY ROUND UP FOR NOVEMBER 2023

General

Improving the UK regime for Asset Management

The FCA has published the address delivered by Chair Ashley Alder at the Investment Association's Annual Dinner.

What firms are impacted?
Wealth and Asset Management firms.

Summary of the address

The FCA Chair noted that the FCA's focus on competitiveness, following the passage of the Financial Services and Markets Act 2023, is an important step change for the regulator. Consideration of that competitiveness objective, alongside the aim for proportional regulation is driving the FCA's thinking about investment management.

Referring to Discussion Paper 23/2 (DP23/2) issued in February 2023, Mr Alder set out the following priorities for asset management:

- Making the regime for alternative fund managers (AFMs) more proportionate – The FCA would like to use a set of consistent rules across all AFMs, with the regime operating proportionately depending on the nature and scale of a firm's business. The FCA will be consulting on amending the AIFMD regime in 2024.
- Updating the regime for retail funds – The FCA would like a much clearer distinction between the requirements applied to managers of authorised retail funds and managers of alternative investment funds (AIFs); the result should simplify the retail rules for funds which are not undertakings for collective investment in transferable securities (UCITS) funds. The FCA will consult on this in 2024.
- Supporting technological innovation – The FCA has been working with the Technology Working Group under HM Treasury's Asset Management Taskforce on a blueprint for fund tokenisation, which will be published later this year. Mr Alder also noted that many firms are interested in use cases for distributed ledger technology (DLT), even though direct marketing of tokens may be some time ahead in the future.

There are some ideas from DP23/2 which the FCA will not be taking forward or which it will not be taking forward in the near term. For example, simplifying the FCA Handbook will come after targeted reforms intended to make a tangible, positive difference to the environment in which asset managers and investors operate. Mr Alder also spoke about productive investment, noting that there are several initiatives underway in this space.

When does it take effect?
The FCA will be consulting on amending the AIFMD regime and re-evaluating the AIFMD rules for non-UCITS retail funds next year. In 2025, the FCA will review the regulatory reporting regime.

What should firms be thinking about?
Impacted firms should review DP23/2: Updating and improving the UK regime for asset management, as well as ensuring the firm carries our regular horizon scanning to ensure awareness of changes in regulations.

REGULATORY ROUND UP FOR NOVEMBER 2023

General
Market Watch 75
The FCA has published Market Watch 75 in which it shares its observations on firms' practices around market sounding.
What firms are impacted? ***Issuers, firms acting as disclosing market participants (DMPs)***
Summary of the address The FCA reminds firms of the rules within MAR and ESMA's Market Sounding Guidelines. These provide formalised arrangements for issuers and their advisors acting as DMPs to legitimately disclose inside information. The FCA notes that it has observed instances where recipients of market sounding (MSRs) have traded the financial instruments during the period after the DMP initially communicated with them or sought their consent to receive the sounding and inside information but before the DMP had disclosed the inside information. Whilst the DMPs did not, during the initial communication, disclose the identities of the financial instruments or the nature of the proposed transaction, the MSRs were still able to identify those details using other information available to them. For example, when an issuer has previously held regular and similarly-sized funding rounds executed by the same advisory firms, or where an MSR holds a very small number of investments in its portfolio, the MSR might be able to identify the issuer. Therefore, MSRs who have determined the identity of the security in a market sounding before agreeing to receive the inside information should assess whether they possess inside information before trading. The FCA therefore cautions DMPs to take particular care when making market soundings on financial instruments that have few actors and where potential external information held by the MSR could be reasonably used to identify the relevant financial instrument. MSRs are also encouraged to consider putting in place 'Gatekeeper arrangements highlighted in Market Watch 51 and 58. Appropriate training should also be organised for those staff who receive and process market soundings. In addition, the time interval between the DMP's initial communications and requests for consent; and the MSRs consent to such request should be minimised.
When does it take effect? Immediately.
What should firms be thinking about? Impacted firms should review their market soundings systems and controls and ensure these reflect the suggested additional measures to prevent market abuse offences taking place.

REGULATORY ROUND UP FOR NOVEMBER 2023

General
Responses to AI Discussion paper
The FCA and PRA have issued Feedback Statement 2/23 (FS2/23) which summarises responses received to their jointly-issued Discussion Paper 5/22 AI and machine learning (DP5/22).
What firms are impacted? All firms within the Financial Services.
Summary of the regulatory update The feedback statement (FS) provides a summary of the responses to DP5/22. Its aim it to acknowledge the responses to the DP, identify themes and provide an overall summary. The DP5/22 received 54 responses from a wide range of stakeholders. Industry bodies accounted for almost a quarter of respondents with banks accounting for a further fifth. The key points made by respondents were: • A regulatory definition of AI would not be useful. Many respondents pointed to the use of alternative, principles-based or risk-based approaches to the definition of AI with a focus on specific characteristics of AI or risks posed or amplified by AI. • As with other evolving technologies, AI capabilities change rapidly. Regulators could respond by designing and maintaining 'live' regulatory guidance, in other words regulators could periodically update guidance and examples of best practice. • The regulatory landscape is complex and fragmented with respect to AI. More coordination and alignment between regulators, domestic and international, would therefore be helpful. • AI systems can be complex and involve many areas across the firm. Therefore, a joined-up approach across business units and functions could be helpful to mitigate AI risks. In particular, closer collaboration between data management and model risk management teams would be beneficial
When does it take effect? N/A. The aim of the FS is to acknowledge the responses in the DP.
What should firms be thinking about? Firms should consider the DP and FS and consider the points raised.

REGULATORY ROUND UP FOR NOVEMBER 2023

General
AI in Financial Services Speech
The FCA has published a speech by its Chief Data, Information and Intelligence Officer, Jessica Rusu, on AI in financial services at the City and Financial Global AI Regulation Summit 2023.
Summary of the speech The FCA believes that digital infrastructure, resilience, consumer safety and data are key to getting AI integration right and beneficial innovations from AI will be better harnessed via regulation. The FCA views its responsibility as including that firms providing financial services adopt AI in a safe and responsible manner. **Digital Infrastructure:** It is recognised that many of the large incumbent Big Tech firms are major suppliers of UK technology infrastructure, including cloud and data services. This creates digital infrastructure or Critical Third Parties (CTP) risks. The FCA's approach is to seek to address the systemic risk posed to UK financial services firms' resilience as a result of the services of CTPs. The FCA will consult on potential rules and guidance relating to providers of critical services under the Financial and Services Markets Act later this year. **Resilience:** The FCA has reiterated that firms remain responsible for their own operational resilience, including any services they outsource to third parties. **Consumer Safety:** AI scams are already on the rise. Audio deepfake technology, vishing scam calls and biometric theft pose real risks to consumers. And it is not just consumers at risk from AI scams – both large and small firms are also at risk for tailored and sophisticated AI-powered cyber-attacks. Firms risk assessment frameworks should be considering what new risks AI scams could pose to them and to their customers. **Data:** Data considerations are of paramount importance to the safe and responsible adoption of AI. Responsible AI depends upon data quality, data management, data governance, data accountability and data protection. Firms should think about what data sets they are using in their AI systems and ensure these do not impinge on the FCA's objectives. **Regulation and Governance:** The FCA's approach to consumer protection around AI is based on a combination of the FCA's Principles for Businesses, other high-level detailed rules, and guidance, including the Consumer Duty. The senior managers and certification regime (SMCR) is also relevant for firms in ensuring sound governance arrangements are in place for the activities of firms.
What should firms be thinking about? Firms should consider the points raised and ensure their systems and controls in relation to AI development and deployment are in line with the FCA's expectations.

REGULATORY ROUND UP FOR NOVEMBER 2023

General
Rules relating to securitisation
On 16 October 2023, the FCA published an addendum to Consultation Paper 23/17 (CP23/17), which sets out proposed rules to replace the firm-facing provisions from the UK Securitisation Regulation (UK SR) which are being transferred into the FCA Handbook.
What firms are impacted? • Authorised firms that are involved in securitisation markets as either institutional investors or as manufacturers. • Unauthorised entities acting as an original lender, originator, or a securitisation special purpose entity (SSPE) of a securitisation subject to eh UK SR. • Individuals holding offices or positions that are responsible for taking management decisions at firms involved in securitisation markets. • Third Party Verifiers (TPV). • Securitisation Repositories (SR).
Summary of the addendum The addendum notes: • changes to the Draft Handbook text as published in Appendix 1 of CP23/17; • clarification regarding the exception to the new proposed rules on delegation of Occupational Pension Schemes (OPS); and • there will be a three-week extension to the consultation period for respondents to consider the changes made by the Annexes. Additionally, there are amendments to the glossary of definitions.
When does it take effect? The consultation period for Chapter 4 (Due diligence requirements for institutional investors) has been extended until 20 November 2023; otherwise, the consultation period for CP23/17 will close on 30 October 2023. Feedback will be considered, and the rules will be published in a Policy Statement in 2024 Q2.
What should firms be thinking about? Firms wishing to provide comments on this CP, should do so via the FCA's response form or by email.

REGULATORY ROUND UP FOR NOVEMBER 2023

General

Rules extending SME access to the Financial Ombudsman Service

The Financial Conduct Authority (FCA) has published a feedback statement on the findings of its review of rules extending SME access to the Financial Ombudsman Service (Ombudsman Service) for more small and medium-sized enterprises (SMEs), which came into force on 1 April 2019.

What firms are impacted?

- Providers of regulated and unregulated financial services to SMEs
- People who are self-employed, own or manage SMEs
- Those who provide business support to SMEs
- Those who represent SMEs

Summary of the regulatory update

The FCA launched the review with a call for input (CFI) in March 2023. The review's aim is to understand if the current thresholds for SMEs to be able to refer complaints to the ombudsman service remain appropriate to the FCA's policy objective. The objective is to provide access to the Ombudsman Service for SMEs that are unlikely to have sufficient resources to resolve disputes with financial services firms through the legal system.

The feedback statement sets out:

- A summary of responses to the CFI;
- The FCA’s response and if the threshold criteria remain appropriate; and
- Matters outside of the policy statement - points not covered by PS18/21 when it made the near-final rules providing SME access to the ombudsman service.

The conclusion of the feedback statement is that the FCA considers the current thresholds strike the appropriate balance between providing access to the ombudsman service to SMEs that do not have the resources to resolve financial services disputes through the legal system and broadening this access too far. Therefore, no changes are needed to the definition of a small business or micro-enterprise.

When does it take effect?

N/A

What should firms be thinking about?

N/A

REGULATORY ROUND UP FOR NOVEMBER 2023

General
Terms of Reference (ToR) for the Independent Review of disclosure and fraud offences
HM Government (HMG) has published the terms of reference (ToR) for the independent review of disclosure and fraud offences.
What firms are impacted? All firms.
Summary of the regulatory update There has not been an independent review of fraud since 1986 and since that time, the nature and scale of fraud has evolved considerably and now makes up over 40% of all offences in England and Wales. The government published the Fraud Strategy in May 2023 which committed to launching an independent review of how the disclosure regime is working in a digital age and if fraud offences, which fall under the provisions of the Fraud Act 2006, meet the challenges of modern fraud. The Review will investigate the application of the disclosure regime (i.e. the requirement for prosecutors to disclose to the defence all material that weakens the prosecution's case or strengthen the defendant's case) and the challenges arising for the investigation of all crime types, including fraud, that handle large volumes of digital material. It will also explore barriers to the investigation, pursuit, and prosecution of fraud offences in England, Wales and Northern Ireland. The Review will evaluate the nature of current penalties contained within the act and explore the role of civil powers to tackle fraud.
When does it take effect? The Review will report in two parts; Part 1 on the disclosure regime will report in Summer 2024 and Part 2 on fraud offences will report in Spring 2025.
What should firms be thinking about? Firms should consider the national Fraud Strategy, review their systems and controls to prevent and detect fraud and ensure these are operating effectively, particularly on digital platforms.

REGULATORY ROUND UP FOR NOVEMBER 2023

General

FCA CEO comments on new competitiveness and growth objective at City Dinner

On 17 October 2023, the FCA has published a speech by Nikhil Rathi, CEO, delivered at the City Dinner 2023 at the Mansion House.

What firms are impacted?
N/A

Summary of the speech

The focus of the speech was the FCA's new secondary objective to support international competitiveness and growth over the medium to long term. The FCA highlighted the following key takeaways from the speech:

- the importance of long-term vision over short-term tactics to ensure that the UK continues to be a leader on regulation and innovation globally;
- the FCA's focus on bringing down authorisations times and on investing in digital capabilities and infrastructure;
- that the listing and asset management reforms which the FCA are proposing are designed to enhance the UK's competitiveness, reduce complexity and unleash capital for growth; and
- the need to take a balanced view of risk in the interests of not stifling innovation.

With regard to the listing reforms, Mr Rathi commented that the FCA had received 'good support' for merging premium and standard listing segments. He also highlighted the reshaping of Class Transactions, rationalising the related party transaction regime, and other proposals before confirming that final rules will be made in H1 of 2024.

On technology, Mr Rathi outlined the FCA's investment in digital and data infrastructure and also noted the intention to make more of the FCA Handbook machine readable. He also expressed admiration for the ability of the Reserve Bank of India (RBI) to trial innovations at scale, with trial and error being an accepted part of the process of innovation.

When does it take effect?
Final listing reform rules due to be made in H1 2024.

What should firms be thinking about?
Firms should consider the key takeaways from the speech and assess if any updates should be made to their internal controls and horizon monitoring.

REGULATORY ROUND UP FOR NOVEMBER 2023

General
Transition Plan Taskforce Disclosure Framework
The Financial Conduct Authority (FCA) has issued a press release welcoming the publication of the Transition Plan Taskforce (TPT) Disclosure Framework.
What firms are impacted? FCA – regulated firms
Summary of the regulatory update The TPT Disclosure Framework provides a set of good practice recommendations to help companies across the economy make high quality, consistent and comparable transition plan disclosures. It recommends disclosure of a company's strategic climate ambition, and how this is reflected in its implementation and engagement approaches, its governance and accountability arrangements, and its financial plans. The recommendations will ensure that investors are better equipped to assess companies' future prospects where they have better, forward-looking information available to them. The FCA is committed to drawing on the TPT Framework as further developments are made to the FCA's disclosure expectations for listed companies, asset managers and FCA-regulated asset owners. In Primary Market Bulletin 45, published in August 2023, the FCA set out its intention to consult in 2024 on rules and guidance for listed companies to disclose in line with standards developed by the UK-endorsed International Sustainability Standards Board (ISSB) and the TPT Framework as a complementary package.
When does it take effect? Listed companies and regulated firms are advised to engage early with the Framework and start implementing the recommendations.
What should firms be thinking about? Firms should consider the additional information which should be disclosed and any controls which should be implemented to ensure that the relevant information is being gathered, ahead of any disclosures being made.

REGULATORY ROUND UP FOR NOVEMBER 2023

General
Green Agreements Guidance
The Competition and Markets Authority (CMA) has issued new guidance on the application of the Chapter I prohibition in the Competition Act 1998 to environmental sustainability agreements.
What firms are impacted? All firms with environmental sustainability agreements.
Summary of the regulatory update The guidance explains how competition law applies to environmental sustainability agreements between firms operating at the same level of the supply chain, to help them act on climate change and environmental sustainability. The guidance sets out the key principles which apply, along with practical examples that businesses can use to inform and shape their own decisions when working with other companies on environmental sustainability initiatives. It explains that the CMA does not expect to take enforcement action against agreements that are in line with the guidance. There is also a chapter dealing specifically how agreements tackling climate change will be considered. In conjunction with the CMA's publication, the FCA has announced that it will have regard for the guidance in the application of its concurrent competition powers.
When does it take effect? The guidance provides clarity about what is and what is not, legal when working towards environmental sustainability goals.
What should firms be thinking about? Impacted firms should ensure they are familiar with the new guidance to avoid any breach of competition law.

REGULATORY ROUND UP FOR NOVEMBER 2023

General
FCA complaints data for H1 2023
On 19 October 2023, the FCA published its data on the number of complaints received by FCA-regulated firms.
What firms are impacted? N/A
Summary of the regulatory update This comprises firm-specific data for individual firms and aggregate, or total, data at market-level. The data set includes details on the total number of opened complaints, closed complaints, complaints upheld, and the total redress paid by firms for a six-month period. Key findings include: • In H1 2023, financial services firms received 1.88 million opened complaints, an increase of 5% from H2 2022 (1.8 million); • The product groups that experienced an increase in their opened complaint numbers from H2 2022 to H1 2023 were the following: decumulation & pensions (20%), investments (18%), insurance & pure protection (6%), and banking and credit cards (3%); • The home finance product group saw a 10% reduction in opened complaints from 101,333 (H2 2022) to 91,469 (H1 2023); and • Since H2 2016, current accounts have remained the most complained about product – the number of current accounts opened complaints increased from 500,371 in H2 2022 to 509,923 in H1 2023 (2%). The FCA publishes its firm complaints data every six months, around April and October. H2 2023 data is due to be published on 25 April 2024. The full article can be found here.
When does it take effect? Ongoing.
What should firms be thinking about? Firms should take the opportunity to consider their complaints handling processes and ensure these remain fit for purpose and in line with the Consumer Duty obligations.

REGULATORY ROUND UP FOR NOVEMBER 2023

General
FCA publishes cryptoasset registration information for applicants
The FCA has published a new webpage with information for applicants on cryptoasset registration.
What firms are impacted? Firms looking to register with the FCA to carry out cryptoassets business.
Summary of the regulatory update The page contains questions and answers (Q&As) on preparing for registration and the submission of applications. The Q&A's cover a wide range of topics, such as: • requirements around firms' risk assessments; • Cryptoasset activities that are in scope of the of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017; • financial projections required; and • registration fees. The full review can be found here
When does it take effect? The updates are for information purposes only.
What should firms be thinking about? Any firms considering registering with the FCA to carry out cryptoasset activities that are in scope of the MLRs should read the requirements carefully before preparing and submitting an application for registration.

REGULATORY ROUND UP FOR NOVEMBER 2023

General
FCA warns about common issues with cryptoasset promotions
The FCA has issued a statement setting out three common issues the regulator has identified in relation to cryptoasset financial promotions, following the introduction of the new regime on 8 October 2023.
What firms are impacted? Authorised firms approving the financial promotions of cryptoasset firms.
Summary of the regulatory update The common issues involve: • Promotions making claims about the 'safety', 'security' or ease of using cryptoasset services without highlighting the risk involved; • Risk warnings not being visible enough due to small fonts, hard-to-read colouring or non-prominent positioning; and • Firms failing to provide customers with adequate information on the risks associated with specific products being promoted. The FCA reiterated that it continues to identify and act against firms that are illegally promoting cryptoassets to UK consumers. In this regard, the FCA has so far issued 221 alerts since the regime went live.
When does it take effect? The statement provides insights into the common issues in respect of cryptoasset financial promotions.
What should firms be thinking about? Any regulated firms approving the financial promotions of cryptoasset firms should ensure they are aware of the risks of non-compliance. All impacted firms should ensure they are familiar with the FCA's expectations for firms complying with the new rules.

REGULATORY ROUND UP FOR NOVEMBER 2023

General
FCA fines Equifax Ltd £11m for role in cybersecurity breaches
The FCA has fined a credit reporting agency £11,164,400 for failing to manage and monitor the security of UK consumer data it had outsourced to its parent company based in the US.
What firms are impacted? N/A
Summary of the regulatory update The breach, which took place in 2017, allowed hackers to access the personal data of millions of people and exposed UK consumers to the risk of financial crime. The FCA held that the cyberattack and unauthorised access to consumer data was entirely preventable. It stated that the firm did not treat its relationship with its parent company as outsourcing. As a result, it failed to provide sufficient oversight of how data it was sending was properly managed and protected. In its press release, the FCA emphasised that regulated firms must have effective cyber security arrangements to protect the personal data they hold. Firms must keep systems and software up to date and fully patched to prevent unauthorised access and remain responsible for data they outsource.
When does it take effect? N/A
What should firms be thinking about? Firms should consider the failures and ensure they have sufficient systems and controls in place to protect consumer data.

FOR MORE INFORMATION:

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