BDO FS ADVISORY - MANAGED COMPLIANCE SERVICES

REGULATORY UPDATE

DECEMBER 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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ECONOMIC CRIME UPDATE

ECONOMIC CRIME UPDATE

FCA Dear CEO letter on its expectations for Wealth Management and Stockbroking firms

On 8 November 2023, the Financial Conduct Authority ("FCA") published a 'Dear CEO' letter setting out its expectations for wealth management and stockbroking firms.

The letter outlines the FCA's assessment of this sector's key harms and its updated supervisory priorities and included further confirmation of the FCA's expectations for firms for preventing financial crime.

The FCA outlines that it continues to see this sector as an inherently high-risk sector for enabling and/or participating in financial crime, which has damaging impacts on consumers, markets, wider society and the industry as a whole.

In relation to financial crime, the FCA expects firms to:

- Not knowingly facilitate frauds, scams or money laundering
- Understanding their financial crime risk by better understanding their clients
- Do not undertake 'tick box' compliance or outsource responsibility to third parties
- Ensure your systems and controls are effective and robust
- Ensure SMF 16/17 holders have the required skill and independence
- Share and report information of wrongdoing with the regulator immediately
- Read and implement their Financial Crime Guide: A firm's guide to countering financial crime risks (FCG) and Financial Crime Thematic Reviews (FCTR).

The letter concludes that the FCA's supervision of firms will become more targeted, intrusive and asserted. For example, the new dedicated financial crime function for consumer investments will focus solely on identifying firms with key fraud, scams or money laundering indicators.

The FCA also highlights that it has already started a major drive with short notice and unannounced visits, particularly for financial crime, and it is increasing the use of its supervisory tools and powers.

Finally, the FCA will consider in future engagement whether firms have taken appropriate action to rectify the root cause of any issues, which is often poor and ineffective leadership, governance, systems and controls and conflicts of interest management.

What should Compliance and Risk teams think about?

This again further highlights that the prevention of financial crime continues to be a key supervisory priority for the FCA. This letter reinforces the expectation for firms to have effective systems and controls for managing and monitoring financial crime risk and ensuring that there is clear understanding and ownership of these risks across the Three Lines framework.

In particular, compliance should ensure that:

- Financial crime is a standing agenda item for Senior Management and all discussion and challenge of key financial crime MI is documented in minutes and all action points are followed up and tracked to closure.
- Client on-boarding process and periodic review process are not just tick-box exercises and that all information gathered at on-boarding and throughout the relationship is considered, analysed and documented.
- Financial crime training is specific to the business (rather than generic) and considers the specific risks to which the business is exposed.
- There is a documented annual training plan in place for all employees which clearly outlines the expectations for financial crime training to be completed, this should include role specific training for staff with specific financial crime duties.
- A Training Needs Assessment is considered as part of the annual fit and proper process for staff with specific financial crime duties. This should also be considered as part of the recruitment process for an SMF 17.

Economic Crime and Corporate Transparency Act receives Royal Assent

After lengthy Parliamentary debate and a number of amendments, the Economic Crime and Corporate Transparency Act ("the Act") received Royal Assent on 26 October 2023.

The Act will allow UK authorities to proactively target organised criminals and others seeking to abuse the UK's open economy. Whilst the Act is broad and covers a number of areas, the most important changes for firms will likely be the introduction of the new 'Failure to Prevent Fraud' offence.

Under the new offence, an organisation will be liable where a specified fraud offence is committed by an employee or agent, for the organisation's benefit, and the organisation did not have reasonable fraud prevention procedures in place.

The offence applies to all sectors. However, to ensure that the burden on businesses are proportionate, only large organisations are in scope – defined (using the standard Companies Act 2006 definition) as organisations meeting two out of three of the following criteria:

- more than 250 employees;
- more than £36 million turnover; and
- more than £18 million in total assets.

ECONOMIC CRIME UPDATE

If convicted, an organisation can receive an unlimited fine. Organisations will be able to avoid prosecution if they have reasonable procedures in place to prevent fraud. The government will publish guidance about 'reasonable procedures' before the new offence comes into force.

What should Compliance and Risk teams think about?

- The 'reasonable procedures' defence mirrors that found in relation to the offence for failing to prevent the facilitation of tax evasion in the Criminal Finances Act 2017. Guidance is expected to be published by the Government and will likely be based on the equivalent guidance for Criminal Finances Act 2017. To avoid being behind the curve when the Government does finally publish its guidance, compliance and risk teams should, therefore, ensure that, as a minimum, their fraud risk management systems and controls meet the 'proportionate procedures', 'top-level commitment', 'risk assessment', 'Due Diligence', 'communication', and 'monitoring and review' guiding principles.
- Considering the increased scrutiny over fraud prevention, compliance and risk teams should also assure that Second Line teams are proactive in reviewing the firm's fraud prevention framework to ensure they meet regulatory expectations and provide sufficient mitigation of the internal and external fraud risks (including those relating to online as well as traditional fraud methods) to which they are exposed.

UK Government publishes formal guidance on ownership and control in respect of sanctions

In our last update, we highlighted the UK Court of Appeal judgment in the Boris Mints & others v PJSC National Bank Trust & PJSC Bank Okritie case ("the Mints case"). The case centred around the extent to which Vladimir Putin and other sanctioned (designated) public officials in Russia could be considered to 'control' entities in Russia for UK sanctions purposes.

Since then, the UK Office of Financial Sanctions Implementation ("OFSI") and the Foreign, Commonwealth and Development Office ("FCDO") issued joint guidance on the application of the UK's ownership and control test under financial sanctions legislation in circumstances involving designated public officials. In respect of control of public bodies, the Guidance states that:

- The FCDO does not generally consider designated public officials to exercise control over a public body in which they hold a leadership function.
- The FCDO does not intend for sanctions targeting public officials to prohibit routine transactions with public bodies, such as taxes, fees, import duties, licences, etc.
- The FCDO would look to designate the relevant public body if it considers that the designated public official exercises control.
- In determining whether a designated individual exercises control over a public body within the meaning of the UK sanctions regulations, a relevant consideration will be "whether the designated person derives a significant personal benefit from payments to the public body, such that they amount to payments to that person rather than the public body".

Regarding control of private entities, the Guidance states that there is no presumption on the part of the UK government that a private entity is subject to the control of a designated public official simply because that entity is based or incorporated in a jurisdiction in which that official has a leading role in economic policy or decision-making.

The Guidance also provides a direct response to the Mints judgment stating that, from a sanctions perspective, the UK government does not consider that President Putin exercises de facto control over all entities in the Russian economy merely by virtue of his occupation of the Russian Presidency.

What should Compliance & Risk teams think about?

This again illustrates the continued prevalence and importance of sanctions compliance on the Government's wider economic crime prevention agenda.

The Guidance does not necessarily introduce any new concepts, but it does clarify the Government's stance in respect of ownership and control by public officials in the context of sanctions.

Firms should use the Mints case and the FCDO/OFSI guidance to revisit their own internal policies and procedures 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 public official.

02

DATA PROTECTION UPDATE

DATA PROTECTION UPDATE

ICO issues three fines to Financial Services organisations for illegal direct marketing

In November 2023, the Information Commissioner's Office (ICO) announced that three organisations offering financial services have been fined a combined total of £170,000 for illegal direct marketing under the Privacy and Electronic Communications Regulation (PECR).

The detail

In the recently published article, the ICO outlined the reasons for the financial penalties, which include:

- Sending 415,000 text messages to individuals, encouraging people to obtain free advice, simply by visiting the organisation's website, without valid consent.
- Making unsolicited calls to individuals about pensions, to over 20,000 individuals who were registered with the Telephone Preference Service (TPS).
- Sending and allowing third parties to send over 2.3 million direct marketing text messages to promote services, without holding valid consent from the recipient. Furthermore, none of the messages identified the sender of the message or gave individuals the opportunity to opt out of marketing communications.

The article also highlighted the potential harms and risks associated with high-pressure or predatory marketing communications on elderly or vulnerable individuals, who are most at risk.

What does this mean for financial services firms?

The recent ICO enforcement action highlights a heightened regulatory focus on the sector for financial services firms which do not comply with the UK Data Protection Act 2018 (UK GDPR) and the Privacy and Electronic Communications Regulation (PECR).

The recent enforcement action also serves to warn financial services organisations of the potential risks arising from non-compliance, which can include;

- Substantial financial penalties under both the PECR and the UK Data Protection Act 2018, noting that under recent UK data protection reform proposals the current maximum penalty of £500,000 under PECR will be brought into line with the UK Data Protection Act's penalty structure being the greater of £17.5 million or 4% of global turnover
- Erosion of trust
- Reputational damage arising from high profile action, and
- Increased regulatory scrutiny

What are the basics of processing personal data on the basis of consent?

Under Article 6 of the UK Data Protection Act 2018, organisations are required to cite a valid lawful basis for processing personal data. One of the options available to organisations is the use of consent and to avoid getting caught out, financial services firms should be mindful of the following requirements for data processing on the basis of consent;

- Processing personal data on the basis of consent, means providing individuals with a genuine choice and control over how their personal data is processed;
- Consent should be a positive indication of an individuals' wishes – this means 'opt in' and not 'opt out.' Passive consent is not permitted;
- Consents should be separated out for each data processing activity, to provide individuals with a genuine choice regarding how their personal data is processed – consents should not simply be bundled together;
- It is good practice to document the time and date consent was captured, in the event of a challenge, and to evidence compliance with consent requirements;
- Don't forget that individuals have the right to withdraw their consent at any time, at which point the processing of the individual's personal data should stop. Firms cannot simply 'switch' to an alternative lawful basis; and
- Individuals should have the ability to opt-out of direct marketing activities at any time.

What should Data Protection Officers think about?

Getting consent 'right' can lead to a competitive advantage, by helping to foster confidence and build trust with clients. Compliance and risk teams should consider reviewing the firm's:

- Data processing landscape - are you comfortable that senior management has visibility of processing on the basis of consent?
- Marketing activity on the basis of consent – are existing consent management processes robust and transparent? Can individuals exercise real choice? Would the firm be able to evidence consent in the event of challenge or regulatory scrutiny?
- Internal processes if an individual withdraws consent – is this manual or automated? Are you assured that your firm no longer sends marketing information to individuals who have withdrawn their consent?

03

DIVERSITY & INCLUSION (D&I) UPDATE

DIVERSITY AND INCLUSION (D&I)

On 25 September, the FCA and PRA published their respective Consultation Papers (CPs), focusing on diversity and inclusion (D&I) in regulated firms. These CPs had been long awaited following several regulatory initiatives over the last few years, with the FCA and PRA inviting feedback on the proposals by 18 December 2023.

The Regulators make their expectations clear on the role risk and control functions should play in ensuring the risks emerging from poor D&I practices are managed alongside other business risks. Supported by the Chartered Institute of Internal Audit's technical paper on 'Auditing Diversity and Inclusion', the CPs explain how control functions are uniquely placed to not only ensure compliance with regulatory and legal requirements, but also assess how effectively diverse and inclusive practices are embedded in firms' overall governance, culture and business processes. Internal audit, where this exists, is also seen to have an important role in supporting accountability, ensuring that findings from D&I reviews are being appropriately reported to senior leadership and the Board such that they can be used to monitor progress, inform improvements to strategy over time, address any deficiencies, and make targeted interventions as appropriate.

This article highlights some of the key PRA and FCA proposals as well as important next steps all control function teams should consider in preparation of the new rules expected to be published in 2024.

D&I Strategies

The Regulators propose that the Board is responsible for setting, approving and adopting an appropriate D&I strategy, with clear oversight over its implementation. Dual regulated firms (except for third country branches) are also expected by the PRA to have their own Board D&I strategy. Rules are being proposed which require Boards to develop and publish 'a strategy promoting diversity and inclusion', also applicable to Board sub-committees. The Regulators also propose that firms develop an evidence-based D&I strategy that contains, at a minimum:

- the firm's D&I objectives;
- a plan for meeting these objectives and measuring progress;
- a summary of the arrangements in place to identify and manage obstacles; and
- activities to ensure adequate staff understanding of the firm's D&I strategy.

The PRA also expects the strategy to include details around the firm's core values and the culture that it is trying to create, the role of the firm and staff in fostering an open and inclusive environment.

Through some of the reviews BDO has recently performed, it has become clear that there is a great variance in maturity across the sector. Some firms are at early stages of developing their D&I strategy and have not yet embedded it, whilst others have a strong alignment between their overall business strategy, talent and D&I strategy, with established roles and responsibilities, inclusive practices across the employee lifecycle and clear D&I ambitions and action plans.

Reporting

Both Regulators propose for all FSMA firms with a Part 4A permission and CRR and Solvency II firms of any size to be required to annually report on their total UK employee numbers at an individual level. Firms with >251 UK employees are required to complete a joint regulatory return covering the following demographic characteristics:

- age;
- ethnicity;
- sex or gender;
- religion;
- disability or long-term health conditions; and
- sexual orientation.

Gender identity, sex or gender, socio-economic background, parental and carers responsibility are voluntary to report against. The Regulators also expect firms with >251 UK employees to report annually on workplace inclusion, introducing consistent measures of inclusion reporting to provide a baseline of data within firms and across the sector.

Irrespective of a firm's size and whether it is required to publish their D&I data externally, management and the Board should be receiving and reviewing D&I Management Information (MI), using it to inform the D&I strategy, make timely interventions and monitor progress against the firm's strategic objectives. In many of the D&I reviews BDO has conducted, this is an area that often requires the greatest improvement. Firms' D&I dashboards typically have limited data sets (for example, due to low disclosure rates, or limited data collection) with little root cause analysis or qualitative input.

Disclosure

The PRA's proposals for disclosure build upon the FCA's, further requiring firms to disclose their Board and firm-wide D&I strategies, in addition to details around the policy for achieving the D&I targets, supporting narrative and rationale for the targets.

Control functions have a key role to play in assessing D&I data controls, ensuring governance and accuracy over data collection and reporting, ahead of firms making public disclosures alongside their annual reports, often for the first time.

Setting targets

With regards to setting D&I targets, the Regulators are largely aligned in their proposals. All firms with 251 or more employees are required to have targets, which firms set for themselves, to address underrepresentation of demographic groups for the Board, senior leadership, and throughout the employee pipeline.

DIVERSITY AND INCLUSION (D&I)

The PRA proposes that targets are set for gender and ethnicity at a minimum, should firms identify under-representation in these groups. The FCA, on the other hand, does not propose to mandate which demographic characteristics the targets should cover.

Whilst Regulators make it clear that "failure to achieve quantitative targets related to diverse representation of demographic characteristics would not necessarily amount to failure in meeting their responsibilities overall", control functions can support a firm in the evidencing of 'reasonable steps' being taken. The CPs describe reasonable steps as "efforts to implement a well-developed and evidence-based strategy, and an understanding of how a firm should address strategic shortcomings on diversity and inclusion over time".

What should Compliance & Risk teams think about?

Whilst the new rules will come into force 12 months from publication of the Policy Statements, Compliance & Risk teams should consider D&I as a business risk and ensure it is managed alongside other business risks.

Compliance & Risk teams should support their firm by developing a clear picture of what its unique D&I position is, identifying the gaps and preparing for the new rules coming into force in 2024. Avoiding a compliance 'tick box' approach and working in a silo, firms should use this time to review and assess the design, and where possible, the effectiveness of their D&I strategies, ensuring they are embedded in existing ESG strategies, as well as risk, control and governance frameworks.

04

BEHAVIOURS & CULTURE

WHY IT MATTERS – PART 2

BEHAVIOURS & CULTURE

Why it matters – Part 2

People's behaviour is driven by what they see and hear around them. The social norms are perceived as 'rules of behaviour', with those rules informing people how to feel and behave in certain situations.

If we think about the social norms which impact us every day, for example, queuing etiquette when we wait for a coffee, or holding the door open for someone when their hands are full. It is these 'unwritten rules' which influence our reactions. The workplace is no different.

Going back to the example of UBS' rogue trader, Kweku Adoboli, understanding the organisational context within UBS and how this was likely to have been connected to Adoboli's unauthorised trading would have been useful to understand. For example, whether there were examples of dysfunctional leadership and ineffective reward and incentives structures which impacted Adoboli's behaviour.

As Part 1 of this series addressed in our last update, understanding behaviours is critical to understanding the risks that organisations face. To do so, we need to understand the context within which individual teams operate, and the shared attitudes and beliefs which create that teams' 'sub-culture'.

It is often assumed that organisational values, purpose and strategic intent are mirrored throughout the company and that once you have understood one culture, you have understood them all. This certainly is not the case.

Sub-cultures exist where groups of people create their own shared norms, values and practices. It should be noted that sub-cultures do not necessarily equate to 'bad behaviour', as is sometimes the assumption, but the specific attitudes and mindsets in these groups should be explored and understood in firms when thinking about risk and culture.

The following approach could be considered when trying to understand behaviours and sub-cultures.

Understand where to look

- As mentioned in November's update, start by asking questions about the firm's wider culture and use that information to form a view of where you may want to focus your efforts. Are there specific teams/business areas which are of a concern?
- Look across your current and previous audit plan and think about which business areas have been subject to coverage. Are there teams who have had problematic relationships with other parts of the firm or failed to appropriately prioritise risk management?

Hypothesis-driven or blank sheet of paper?

- You may know of a particular issue you want to address (e.g., poor leadership behaviours) and, therefore, using a hypothesis-based approach may be effective. The testing in this scenario will likely be targeted to prove or disprove your hypothesis;
- The broadest approach to understanding behaviours, and the risks that they drive, is to start with a blank sheet of paper: no assumptions or prior knowledge of specific issues. This will facilitate a deep analysis of various aspects of behaviours and culture and may unearth multiple issues.

Use a variety of testing methods

- Gathering a range of data using qualitative and quantitative methods is the most effective for identifying patterns of behaviour. It also provides the auditee confidence that your conclusions can be corroborated with multiple sources of information;
- Group your questions around specific topics (i.e., leadership style, communication etc) to better support the subsequent analysis and reporting stages;
- Consider using the following methods: semi-structured 1:1 conversations; surveys; observations and walkthroughs; and desktop review of HR reports.

Analysing and reporting the data

- Tie the data back to your controls where appropriate, but also link to your specific topics;
- Think about patterns of behaviour, where are you seeing similar things emerge from the data (e.g., people's perceptions of management are that they don't want to be challenged);
- Applying judgement is key here, therefore ensure there is quality assurance from a subject matter expert or cosource advisor who can also provide benchmarking against comparable teams in other firms. This will help to minimise any bias and constructively challenge your conclusions;
- Use verbatim quotes from conversations and the survey. Verbatim comments are incredibly powerful when reported to management;
- Always tie results to risk. What are the unintended consequences of the behaviours that you are observing? What would the senior management and Board of the firm reasonably expect to know from this review?

What should Compliance & Risk teams think about?

- Avoid scripting your 1:1 conversation – there is more value in being semi-structured, i.e., not using a list of questions, but rather some high-level areas to explore with open questions and seeing where the conversation goes
- Take verbatim notes where it could be helpful. Using direct quotes in your reporting to management can have a substantial impact
- Incorporate as many free-text questions in the survey as possible – this gives a richness of data which does not always come through the questions. It also gives employees the opportunity to share their views.

05

ESG UPDATE

NEW SUSTAINABILITY DISCLOSURE REQUIREMENTS (SDR)

ESG UPDATE

New Sustainability Disclosures Requirements ("SDR") - what are the new reporting obligations for the financial services sector?

On 28 November 2023, the FCA published the final rules for its (Policy Statement PS23/16) aimed at preventing greenwashing. It includes sustainable investment labels, disclosure requirements and restrictions on the use of sustainability-related terms in product naming and marketing to prevent greenwashing.

The publication of the regime follows a consultation undertaken in October 2022 – January 2023.

The policy statement was originally due to be published by 30 June this year, and then by the end of Q3, before finally being published on the 28 November. The FCA stated the delays were due to the significant volume of written responses to the consultation paper. We understand that other factors, such as the need to consider and align to other international regulatory developments in respect of ESG and sustainability, also contributed to the delay.

What are the key new requirements?

The regime introduces a package of new measures which aim to inform and protect investors, also referred to as 'consumers', and to improve trust in the market for sustainable investments.

The Policy Statement includes an expected anti-greenwashing rule for all authorised firms, four investment labels, and new rules and guidance for firms marketing investment funds in relation to their sustainability characteristics.

Labelling

There will be four voluntary fund labels: Sustainability Focus, Sustainability Improver and Sustainability Impact, along with a fourth label titled 'Sustainability Mixed Goals' to accommodate multi-asset funds.

The threshold for the Sustainability Focus category remains at 70% minimum threshold to all labels. Whilst the sustainability objective should represent the aims of the overall product, the product may invest in other assets for liquidity and risk management purposes, so long as 70% of the gross value of the product's assets are invested in line with the sustainability objective Independent assessment via internal processes or third parties applications.

Disclosure

Funds can voluntarily opt for a label. Consumer-facing disclosure for products not using labels but with sustainability-related terms in their names and marketing must include a statement to clarify that the product does not have a label. Firms with a sustainability objective must identify and disclose whether pursuing the positive sustainability outcomes may result in material negative outcomes through KPIs. There is a requirement to identify and disclose any other assets held in the product for other reasons (e.g., cash, derivatives), including why they are held.

Reporting at the product level will be implemented gradually; for firms with AUM greater than £50 billion subject to the product level reporting requirements from 2 December 2025 and at the entity-level from 2 December 2026.

Naming and marketing rules

The SDR Regime introduces an anti-greenwashing rule which imposes a requirement for all regulated firms to ensure that sustainability-related claims in all marketing materials and communications are clear, fair and not misleading. These include restrictions on the use of sustainability-related terms in the naming and marketing of products and services.

In addition to the anti-greenwashing rule for all firms, sustainability-related terms can only be used in product names and marketing when a label is used, provided that, where the 'sustainability focus', 'sustainability improvers' or 'sustainability mixed goals' labels are used, the word 'impact' is not used in the product's name. Alternatively, they can be used when a label isn't applied but comply with the product name and marketing sections specified in the Policy document.

The naming and marketing rules are effective from 2 December 2024.

Distributors

As in the rules proposed at the consultation phase, distributors must communicate the labels and provide access to consumer-facing disclosures to retail investors. They will be required to keep the labels and consumer-facing disclosures up to date with any changes that the firm makes to a label or the disclosures and will further have obligations to include a notice in overseas products to clarify that they are not subject to SDR.

Who it applies to?

The SDR regime applies to:

- All FCA-regulated firms under the scope of the new general 'anti-greenwashing' rule that requires sustainability-related claims are to be clear, fair and not misleading, effective as of 31 May 2024
- The labelling and classification, disclosure, naming and marketing and distribution rules apply to investment funds and managers (primarily those marketed and marketing to retail investors in the UK), and can be implemented by firms wishing to do so as of 31 July 2024
- Firms that manage or distribute those products also fall under the scope of these rules effective as of 31 July 2024

ESG UPDATE

What is the anti-greenwashing rule?

Some firms are making misleading sustainability-related claims about their investment products. It is well acknowledged that greenwashing damages consumer trust in the market for sustainable investment products and causes potential harm, such as consumers buying unsuitable products.

The new anti-greenwashing rule, therefore, imposes a requirement for all regulated firms.

What are the specific requirements for Authorised Fund Managers?

In a publication, released on 16 November 2023, the FCA stated that it expects Authorised Fund Managers (“AFM”s) to assess their approach to meeting the current ESG guiding principles, as well as the incoming SDR rules, guidance and principles in relation to their ESG and sustainable investment funds. This request came out of the FCA’s findings following review of how 12 AFMs comply with existing regulatory requirements and expectations on the design, delivery and disclosure of ESG and sustainable investment funds.

Overall, the FCA warned fund managers that “further work” was needed to ensure the regulator’s guiding principles for ESG and sustainable investment funds are being embedded, signalling that ESG and sustainability is very much a priority for the FCA.”

What should Compliance and Risk think about?

Before the 31 May 2024 deadline, Compliance and Risk teams can support the firm’s anti-greenwashing arrangements. This can be through reviewing their risk assessments and communications, as well as the current approach to promoting and marketing products and services. Asset managers with sustainability-labelled products should also ensure that these are aligned with the new regime before the 31 July 2024 implementation date.

In addition, The FCA expects that AFMs will carry out work to identify and address any shortcomings in the design, delivery and disclosure of their funds, making sure that their products are designed, delivered and disclosed in a way which is consistent with the Guiding Principles, as otherwise they can cause harm to customers.

Watch out for our upcoming publications with a more in-depth analysis of the policy statement on our website and participate in our webinars to be held in January and February 2024.

06

SUMMARY OF REGULATORY PUBLICATIONS IN NOVEMBER 2023

REGULATORY ROUND UP FOR DECEMBER 2023

General
FCA publishes the latest edition of its Regulatory Initiatives Grid.
The FCA has published the latest edition of its Regulatory Initiatives Grid which sets out the planned regulatory initiatives for the next 24 months.
What firms are impacted? All firms in the financial services industry and their stakeholders
Summary of the address The Grid sets out the regulatory pipeline and provides detail on the timing of initiatives over a 24-month horizon. It highlights key examples of closely interconnected initiatives to help stakeholders easily identify these. It is published twice a year to help manage the operational impact on firms of implementing initiatives from the Financial Services Regulatory Initiatives Forum members. The FCA have also published the Grid in the form of an interactive dashboard and an Excel spreadsheet to help users interact with the underlying data. The FCA welcome feedback on the Grid. They are particularly looking at ways in which the Grid has been useful for stakeholders in their planning for regulatory initiatives and where the FCA can improve on this. You can provide feedback by completing their online survey or via email at FSRIFSecretariat@fca.org.uk. Some of the key initiatives included in the pipeline include the Access to Cash consultation, reforms to Solvency II, and the Consumer Duty coming into force for closed products.
When does it take effect? N/A
What should firms be thinking about? Managing the operational impact of implementing initiatives described in the Grid.

REGULATORY ROUND UP FOR DECEMBER 2023

General
Dear CEO Letter - FCA sets out expectation for wealth management & stockbroking firms.
The FCA has written to the CEOs of wealth management and stockbroking firms about their assessment of the key harms posed by some firms in the sector and their updated supervisory priorities.
What firms are impacted? Wealth management and stockbroking firms
Summary of the regulatory update The Dear CEO letter sets out the FCA's assessment of this sector's key harms and the FCA's updated supervisory priorities: preventing financial crime and meeting Consumer Duty outcomes. Due to the significant scale of consumers in this sector, the level of assets under management and the seriousness of the key harms, this makes this sector one of the higher risk sectors of financial services firms regulated by the FCA. The FCA views this sector as being high risk for enabling and/or participating in financial crime either through money laundering or through frauds and scams, therefore, the FCA has high expectations that firms in this sector carry out sufficient due diligence, KYC and transaction monitoring on their clients to ensure the firm has a good understanding of the financial crime risks to which it is exposed. Additionally, Compliance Officers and MLROs should have the required experience, skills and independence. It is suggested that firms should read and fully implement the FCA's Financial Crime Guide: A firm's guide to countering financial crime risks (FCG). The FCA expects firms to have implemented the Consumer Duty in full, which should have resulted in meaningful changes to the firm's business, service and proposition to further drive good consumer outcomes. The letter sets out failings that the FCA has seen in the following areas: • Products & Services and Consumer Understanding • Price and Value The letter highlights that while the FCA has called out these two key priorities, this is not an exhaustive list. The FCA refers to their supervision shifting to become more assertive, intrusive, proactive and data driven. The FCA are conducting more short notice and unannounced visits where they deem it appropriate. And they are significantly increasing the use of their formal intervention powers for the worst cases.
When does it take effect? N/A
What should firms be thinking about? Firms in this sector should revisit the systems and controls they have in place to prevent financial crime and should ensure they have fully implemented the Consumer Duty. As part of the Consumer Duty implementation, firms should ensure they are gathering meaningful MI in order to monitor consumer outcomes.

REGULATORY ROUND UP FOR DECEMBER 2023

General

FCA review ESG compliance by AFMs.

The FCA has published the findings of its multi-firm review into how Authorised Fund Managers (AFMs) are complying with existing regulatory requirements and expectations on the design, delivery and disclosure of environment, social and governance (ESG) and sustainable investment funds.

What firms are impacted?

Investment funds that market themselves as having ESG or sustainable characteristics.

Summary of the regulatory update

The review focused on both active and passive authorised retail funds that included a reference to ESG and/or sustainability-related terms in their name, such as ‘responsible’, ‘ethical’, ‘climate’ or ‘social’. Key findings include:

- Despite some products having a reference to ESG or sustainability in their name, some did not have an explicit ESG or sustainability objective (although ESG and sustainability outcomes were typically reflected in the investment policy and/or strategy).
- The design of AFMs’ stewardship approaches generally did not meet FCA expectations. It was often difficult to identify the nature of stewardship activities from fund literature alone and identify clear examples of progress from engagement.
- In some instances, fund holdings appeared inconsistent with a fund’s ESG or sustainability objectives. Some AFMs were not able to explain how these holdings were consistent with the ESG or sustainability characteristics of the fund.
- Key ESG and sustainability information was often not explained or put into context in disclosures. In some instances, relevant ESG and sustainability information was not included in disclosures.
- Firm-level disclosures were not easily reconcilable with fund-level disclosures. We often found the contribution of an individual fund to firm-wide ESG and sustainability goals was not disclosed.
- In a number of cases, key ESG and sustainability information was not clearly presented and made accessible.

The findings from the review are relevant to AFMs, their governing bodies and portfolio managers of investment funds that market themselves as having ESG or sustainable characteristics.

When does it take effect?

N/A

What should firms be thinking about?

Firms should embed the Guiding Principles and the good practice identified in the FCA’s review in order to comply with proposed new requirements under the SDR and Investment Labels Rules, alongside their Consumer Duty obligations.

REGULATORY ROUND UP FOR DECEMBER 2023

General
FCA statement on communications in relation to PRIIPS and UCITS.
The FCA has published a statement related to concerns raised about costs and charges disclosure in the Packaged Retail Investment and Insurance Products (PRIIPs) Key Information Document (KID), the Undertakings for Collective Investment in Transferable Securities (UCITS) Key Investor Information Document (KIID) and MiFID II requirements.
What firms are impacted? Investment firms providing information regarding costs and charges in respect of PRIIPS and UCITS products to retail customers (including manufacturers of such products), specifically in respect of listed closed-ended funds.
Summary of the regulatory update The statement sets out the FCA's interim measure, pending broader reform, to provide for some disaggregation of costs and charges disclosure. This should provide firms with greater ability to explain their costs and charges, which in turn, will help consumers make better informed investment decisions. As the current cost disclosure requirements are set out in European legislation, this limits the FCA's ability to disapply the current rules or make changes until the relevant requirements are transferred to the FCA through legislation. To ensure the best possible transparency to consumers while the FCA works on longer-term reforms, the FCA has introduced short-term measures until the longer-term work has been finalised. Where listed closed ended funds and funds that invest in them (or manufacturers of such funds) are concerned that the costs required to be disclosed in key information documents do not appropriately reflect the ongoing costs, they can provide additional factual information (as well as the aggregated figure) such as the breakdown of costs to put the aggregate number in context. In considering the presentation of the information, firms should also consider their Consumer Duty obligations.
When does it take effect? • The short-term measures are effective immediately. • Feedback responses to DP 22/6 to be published in the first half of 2024.
What should firms be thinking about? Impacted firms should consider if their current disclosures regarding fees and charges provided to retail customers are understandable and fully reflect the fees and charges imposed. Where it is found that additional information could help provide additional clarity to the users of the disclosures, firms should consider the additional factual information that can be provided.

REGULATORY ROUND UP FOR DECEMBER 2023

General
FCA publishes Consultation Paper regarding the prudential assessment of acquisitions and increases in control.
The FCA are consulting on proposals to replace EU guidelines on the prudential assessment of acquisitions of qualifying holdings in the financial sector (Consultation Paper CP 25/23).
What firms are impacted? • All PRA and FCA authorised firms and all persons to which PART XII of FSMA applies. • Firms seeking to apply for PRA authorisation in identifying who their controllers are.
Summary of the regulatory update It is proposed that the current EU guidelines are replaced with a new PRA supervisory statement (SS) and new FCA guidance. The PRA's proposed SS and the FCA's guidance would set guidance and expectations on: • Identifying qualified holdings, including the concepts of significant influence, aggregated holdings and indirect controllers; • Submitting the change in control notification, the additional information the PRA and the FCA may require, and the approach to completeness; • The assessment criteria used to assess notifications to acquire or increase change in control in PRA and FCA authorised firms operating in the UK; and • How the PRA and FCA would use their statutory powers to impose conditions on an approval when it advances their objectives.
When does it take effect? The consultation closes on 23 February 2024. The FCA and the PRA invite feedback on the proposals set out in the consultation. Comments and/or enquiries should be addressed to - CP25/23@bankofengland.co.uk. The FCA and PRA propose that the implementation date for the PRA SS and the FCA guidance proposed in the consultation paper will be summer 2024.
What should firms be thinking about? Firms considering acquiring an FCA or PRA authorised firm should consider the proposed new guidance ahead of submitting a notification to the FCA or PRA.

REGULATORY ROUND UP FOR DECEMBER 2023

General
HM Treasury publishes report on fund tokenisation.
HM Treasury's Technology Working Group has published an interim report to the Asset Management Taskforce on fund tokenisation.
Summary of the regulatory update The report provides a blueprint for implementing fund tokenisation in the UK. It recommends a staged approach to fund tokenisation, starting with a baseline model that could be used within the existing legal and regulatory framework, and progressing to more advanced stages over time. The baseline, or 'stage one', model establishes the infrastructure for fund tokenisation in the UK funds market. Future stages may require legislative or regulatory rule changes and may also depend on other developments in the wider technological environment, such as digital forms of money. The collaboration between the industry and the authorities has delivered this step change to investment fund innovation: enabling the tokenisation of domestic funds indicates that the UK is open to new ideas and helps to ensure that investors have highly efficient vehicles available to them for their long-term investment needs in the 21st century. Alongside the report, the FCA has written to HMT confirming that it has identified no significant regulatory barriers to the blueprint model in its Collective Investment Schemes Sourcebook (COLL), Investment Funds Sourcebook (FUND) and Client Assets Sourcebook (CASS).
When does it take effect? N/A
What should firms be thinking about? Firms interested in in DLT and the digitalisation of funds, should consider the proposed model for tokenisation.

REGULATORY ROUND UP FOR DECEMBER 2023

General
FCA Director of Cross Cutting Policy and Strategy discusses the Consumer Duty
The FCA has published a speech about the Consumer Duty delivered by Nisha Arora, Director of Cross Cutting Policy and Strategy, at an event hosted by Deloitte.
What firms are impacted? Firms in retail financial markets
Summary of the regulatory update The FCA noted the following as highlights of the speech: • Three months on from the Duty coming into force, the good practices which the FCA has already seen underlines the importance of this work, and continuing this momentum will realise more and more benefits; • The Consumer Duty is not a once and done exercise, instead firms need to make sure they are learning and improving continuously, and must be able to evidence this in their annual board report; • Those firms with closed products and services should check they are on track to meet the 31 July 2024 implementation deadline; and • The Consumer Duty remains a top priority for the FCA and it will continue work across all sectors to test firms' implementation and embedding and will share good practice to support the industry. In addition, the FCA has published a new webpage of Consumer Duty resources, including key publications, podcasts, speeches and news. Alongside this, the FCA has published a new webpage on how it is using the Consumer Duty to set higher and clearer standards of consumer protection across financial services.
When does it take effect? N/A
What should firms be thinking about? Firms should ensure they have fully embedded the Consumer Duty and should ensure their implementation plans are on track to be delivered in line with the deadline for closed products and services.

REGULATORY ROUND UP FOR DECEMBER 2023

General
FCA COO discusses culture and conduct at City & Financial Conduct Forum.
The FCA has published a speech delivered by Emily Shepperd, Chief Operating Officer (COO) and Executive Director of Authorisations, at the City & Financial Culture and Conduct Forum.
What firms are impacted? This speech should be of interest to all regulated firms.
Summary of the regulatory update Highlights from the speech are as follows: • As firms look to raise the bar under the Consumer Duty, they need to consider how their own culture can help to drive better outcomes; • New, flexible proposals on diversity and inclusion (D&I) will help firms to drive changes that are ultimately beneficial, but it's important that the purpose of this is understood and that the right policies and procedures are in place to ensure an inclusive culture with the right incentives; and • Enabling people to contribute, challenge and add value means listening, looking at processes and making changes to ensure people can perform at their best.
When does it take effect? *N/A*
What should firms be thinking about? Firms should consider what they can do to understand if the culture the Board and Senior Managers are seeking to embed within the firm has been fully understood by the wider organisation and if the culture of the firm fosters positive behaviour that can help to drive better consumer outcomes.

REGULATORY ROUND UP FOR DECEMBER 2023

General
HMT: Response to consultation on promotion exemptions for HNW individuals.
HMT has published the Government's response to the consultation on the financial promotion exemptions for high-net-worth (HNW) individuals and sophisticated investors.
What firms are impacted? Firms publishing financial promotions that may be marketed to high net worth or sophisticated investors.
Summary of the regulatory update This document details the government's response to the consultation on the financial promotion exemptions for high-net-worth individuals and sophisticated investors. It provides a summary of the consultation responses received by HM Treasury, as well as providing a government response to the feedback on each policy proposal included in the consultation. After considering all responses, the Government intends to update the exemptions by: • Raising the financial thresholds to qualify for the exemptions to account for inflation; • Tightening other eligibility criteria to reduce the risk of capturing ordinary consumers; and • Strengthening the statements that investors are required to complete when using the exemptions.
When does it take effect? 31 January 2024
What should firms be thinking about? Firms should familiarise themselves with the changes and ensure any financial promotions are published in line with the guidance, taking into consideration the amendments to the thresholds for high-net-worth individuals and sophisticated investors.

REGULATORY ROUND UP FOR DECEMBER 2023

General
Draft Legislation: The Financial Services and Markets Act 2023 (Consequential Amendments) Regulations 2023.
The Financial Services and Markets Act 2023 (Consequential Amendments) Regulations 2023 has been published. The draft legislation revokes (or, where appropriate, repeals) certain retained EU law. Those particular revocations and repeals take effect on 1 January 2024.
What firms are impacted? Firms carrying out regulated activities under Part 4A of the Financial Services and Markets Act 2000 (FSMA)
Summary of the regulatory update These revocations and repeals include: • the revocation of Article 92b of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012; • the revocation of legislation relating to Long-Term Investment Funds (“LTIFs”); • Part 2 of, and Schedules 1 and 2 to, the Payment Accounts Regulations 2015 (S.I. 2015/2038); and • the repeal of legislation containing certain restrictions on powers of the Financial Conduct Authority to make rules that modify, amend or revoke retained direct EU legislation. Those particular revocations and repeals take effect on 1st January 2024 by virtue of regulation 5 of the Financial Services and Markets Act 2023 (Commencement No. 1) Regulations 2023 (S.I. 2023/779 (C. 40)). An impact assessment has not been produced for these Regulations as no, or no significant, impact on the private, voluntary or public sector is foreseen.
When does it take effect? 1 January 2024
What should firms be thinking about? While it is unlikely the changes in regulations will have any significant impact, regulated firms should make themselves aware of the updates.

REGULATORY ROUND UP FOR DECEMBER 2023

General
HM Treasury announces pension reforms.
At Autumn Statement the government has announced a comprehensive package of pension reform that will provide better outcomes for savers, drive a more consolidated pensions market and enable pension funds to invest in a diverse portfolio.
What firms are impacted? Pension funds
Summary of the regulatory update HM Treasury has announced a package of pension reforms which aim to: • provide better outcomes for savers; • drive a more consolidated pensions market; and • enable pension funds to invest in a diverse portfolio. The measures represent the next steps of the Chancellor's Mansion House reforms. Additionally, the Chancellor and the Secretary of State for Work and Pensions have jointly written to the FCA and The Pensions Regulator (TPR) providing further information on the pension's investment measures. With regard to the reforms, the FCA, the Department for Work and Pensions (DWP), and the TPR have published a joint response to the consultation on a new Value For Money framework for defined contribution pensions. The FCA confirmed that it will work towards implementing the Value For Money framework in phases, starting with workplace default arrangements in accumulation. Further to this, in Spring 2024, the FCA will consult on detailed rules for contract-based schemes, working closely with the DWP and TPR for consistency with the development of requirements for trust-based schemes.
When does it take effect? Relevant regulatory updates will be published when they come into effect.
What should firms be thinking about? Pension funds should consider the autumn statement and consider any changes and updates to funds and future fund launches. Firms should also consider the FCA and TPR's proposed Value for Money framework.

REGULATORY ROUND UP FOR DECEMBER 2023

General
FCA secures confiscation order against convicted CFO.
The FCA has announced that it has secured a confiscation order of £355,369 against the former Chief Financial Officer (CFO) of an AIM-listed company, following his convictions in February 2022 for false accounting and making misleading statements to the market.
What firms are impacted? N/A
Summary of the regulatory update On 2 November 2023, Southwark Crown Court imposed a Confiscation Order of £355,369 against Timothy Coleman, former Chief Financial Officer of Redcentric Plc, following his convictions in February 2022 for false accounting and making misleading statements to the market. Redcentric, an IT service provider and AIM-listed company, issued false and misleading unaudited interim results in November 2015, and false and misleading audited final year results in June 2016. Both statements materially overstated Redcentric's cash position – by £13.1m and £12.2m respectively – and consequently downplayed its debt. Shareholders suffered losses when the true position was revealed. Mr Coleman had inflated the cash position that was presented to the Redcentric Board and had used the same false figures to assure key investors about Redcentric's financial position, persuading them not to sell down their investment in the company. As a result of the false statements, the share price of Redcentric shares was inflated, meaning investors paid more for shares than they were worth. The confiscation order of £355,369 represents the value of Mr Coleman's financial benefit from these offences. The Court imposed a default prison sentence of 3 and a half years on Mr Coleman, meaning that if he does not satisfy the terms of the confiscation order within a month, he will be liable to serve this further term of imprisonment in addition to the 5 and a half years he's already serving.
When does it take effect? N/A
What should firms be thinking about? Firms should consider the impact of misleading and fraudulent activities carried out by a CFO and the reputational damage it can cause. Where a new CFO is appointed to a firm, references should be sought, and background checks carried out. Where the CFO is not a SMF-holder, firms should consider a requirement for the CFO to complete the annual fit and proper test.

REGULATORY ROUND UP FOR DECEMBER 2023

General
The Commissioner warns the UK's top websites to make cookie changes.
The ICO has warned some of the UK's top websites they face enforcement action if they do not make changes to comply with data protection law.
What firms are impacted? All firms, web designers and developers
Summary of the address It has warned that some websites do not give users fair choices over whether or not to be tracked for personalised advertising. The ICO has previously issued clear guidance that organisations must make it as easy for users to "Reject All" advertising cookies as it is to "Accept All". Websites can still display adverts when users reject all tracking but must not tailor these to the person browsing. The ICO has written to companies running many of the UK's most visited websites setting out its concerns and giving them 30 days to ensure their websites comply with the law. The ICO has stated that firms need to be: • **Putting the user at the heart of design choices.** Firms must build their online interfaces around their customer's interests and preferences. • **Using design that empowers user choice and control**. Firms must help users to make effective and informed choices about their personal information and put them in control of how it is used. • **Testing and trialling design choices.** Firms must use design that has been tested and trialled, to ensure their design choices are evidence based. • **Complying with data protection, consumer and competition law.** Firms must consider the implications of these laws in your design practices. The ICO will provide an update on this work in January, including details of companies that have not addressed its concerns. This action is part of their broader work to ensure that people's rights are upheld by the online advertising industry.
When does it take effect? The warnings were issued on 21 November 2023.
What should firms be thinking about? Ensuring their websites comply with data protection law.

REGULATORY ROUND UP FOR DECEMBER 2023

General
FCA updates its guidance on principals and appointed representatives (ARs).
The FCA updated its guidance on principals and appointed representatives on 20 November 2023.
What firms are impacted? Principal firms for appointed representatives (AR).
Summary of the regulatory update The update adds information on the Consumer Duty. It confirms that principal firms have a responsibility for ensuring that their ARs continue to meet the necessary standards (such as the Consumer Duty). This applies to the regulated activities carried on by the AR for which the principal has accepted responsibility. If the principal's firm has retail customers, or they have a material influence over or determine retail customer outcomes (even if they do not have a direct customer relationship), they will also need to comply with the Consumer Duty. This sets standards of consumer protection across financial services and requires firms to put their customers' needs first.
When does it take effect? Immediately
What should firms be thinking about? Principals should be clear on their responsibilities, how to oversee their ARs and when they need to notify the FCA.

REGULATORY ROUND UP FOR DECEMBER 2023

General
FCA and BoE publish proposals for regulating stablecoins.
The FCA and the Bank of England (BoE) are requesting feedback on their proposed approach to regulating stablecoins.
What firms are impacted? Systemic payment systems using stablecoins
Summary of the speech The FCA has published Discussion Paper 23/4 – Regulating cryptoassets Phase 1: Stablecoins (DP23/4) which explores the proposed regulation around issuing and holding stablecoins that claim to maintain a stable value relative to a fiat currency by holding assets denominated in that currency. The BoE has published a discussion paper outlining how it would regulate operators of systemic payment systems using stablecoins – payments systems which, if widely used for retail payments in the UK, could otherwise pose risks to financial stability. The BoE would also regulate other entities providing services to these payment systems, such as stablecoin issuers and wallet providers, where they could otherwise pose financial stability risks. To accompany these publications, the FCA also published a joint 'Roadmap paper' with the Bank and Prudential Regulation Authority which aims to explain how their proposed regimes interact and their approach for dual regulation.
When does it take effect? Feedback should be submitted by 6 February 2024
What should firms be thinking about? Cryptoasset firms which issue/hold stablecoins should consider the discussion paper and provide feedback where appropriate. These firms should consider the impact of the proposed regulation of stablecoins. Payment services firms should consider if they will handle payments made using stablecoins and the impact this may have on their permission profile.

REGULATORY ROUND UP FOR DECEMBER 2023

General
FCA publishes guidance on cryptoasset promotions.
The FCA has published Final Guidance 23/3: *Finalised non-handbook Guidance on cryptoasset financial promotions* (FG23/3) which is intended to help cryptoasset firms comply with new rules on marketing cryptoassets to UK customers that came into force on 8 October 2023.
What firms are impacted? Cryptoasset firms
Summary of the regulatory update The guidance provides information on, and sets out expectations of, the communication and approval of financial promotions relating to 'qualifying cryptoassets'. It also details how authorised firms communicating or approving financial promotions should apply the Consumer Duty to their marketing. The guidance does not create new obligations but relates to firms' existing regulatory obligations. The FCA previously published examples of good and poor practice in relation to firms' preparations for the new financial promotions rules. The FCA has offered cryptoasset firms registered or authorised by the FCA flexibility under a modification by consent to implement parts of the rules that require greater technical development. If their application is successful, they will have until 8 January 2024 to implement the 24-hour cooling period, client appropriateness testing and client categorisation features. All other measures of the financial promotions regime came into effect from 8 October 2023.
When does it take effect? The statement provides information on, and sets out expectations of, the communication and approval of financial promotions relating to 'qualifying cryptoassets'.
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 guidance for firms complying with the new rules.

FOR MORE INFORMATION:

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