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BULLETIN | FINANCIAL SERVICES AND REGULATION

December 2013/January 2014

We return in 2014 with a bumper edition of our Financial Services and Regulation Bulletin, featuring a round-up of all the key regulatory developments in the UK over the past two months. December saw arguably the most important changes to financial services legislation in the UK come to fruition with the Banking Reform Act receiving Royal Assent. Both the FCA and the PRA have had a busy festive period and start to the new year too, publishing the final rules on CRD IV, guidance on inducements and conflicts of interest, and various consultation papers on matters such as mortgage date reporting and the PRA's new Rulebook. The Bank of England is promising to push remuneration issues to the top of the list again with a consultation on the recommendations of the PCBS expected in April. There have been a number of large enforcement actions making the headlines, and a confirmation that both regulators will be investigating Co-op Bank.

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SPEECHES

1. MARTIN WHEATLEY LOOKS AHEAD TO 2014

At the ICI Global Trading and Market Structure Conference, on 9 December 2013, Martin Wheatley spoke about the Financial Conduct Authority's ("FCA") regulatory agenda for 2014. In general, his view was that the coming year would be less "exciting" than 2013, since much of the reform process of previous years was now largely finalised and in the process of implementation. In addition, a new regulatory structure in the UK was now firmly in place. 2014 therefore will be a year to "bed in regulatory change and move things forward".

First, he touched upon the asset management industry and listed three questions, to which the FCA would pursue answers during the coming year. i) Are fund managers looking into spending to ensure that they were acting in the best interests of their clients? ii) How should the regulator support investors to help them understand what they are paying for and whether they are receiving value for money from their investment managers? iii) Does the system of corporate access compromise an investment manager's ability to act in his client's best interests? Therefore, it is clear that the FCA will be continuing its analysis of firms' culture in 2014.

Second, he explained that the FCA is to set up its own implementation project for MiFID II. Through this project the FCA will be "engaging with firms to help them meet the new obligations and to respond to queries". He argued that now is the key time for clarifying the application of the legislation and the legislation itself before it takes effect.

Third, he discussed the cross-border application of derivatives rules, including EMIR. The FCA has already begun to review firms' compliance with EMIR in terms of business conduct regulations already in place, but it will begin checking firms' preparations for the trade reporting start date in February over "the coming weeks". From 12 February 2014, all derivatives trades falling within EMIR must be reported to one of ESMA's recognised trade repositories.

The FCA will be looking to continue with its emphasis on cultural reform within firms during 2014, but also stay on top of the technical issues arising out of the major EU regulatory reforms.

UK PUBLICATIONS

1. FCA AND PRA PUBLISH CRD IV POLICY STATEMENTS

The Prudential Regulation Authority ("PRA") published its policy statement (PS 7/13), which contains the finalised rules and supervisory statements regarding the implementation of the Capital Requirements Directive IV ("CRD IV"). The finalised rules came into force on 1 January 2014.

The PRA statement offers feedback on responses received to the consultation paper, which was published in August, as well as clarifications to specific issues, and where relevant, updates on ongoing policy developments in relation to CRD IV. The necessary amendments to the PRA Handbook are set out in Appendix I, and the key supervisory statements, which provide clarity on specific issues within the rules are contained within Appendix II.

Currently, the CRD IV PRA rules are contained in pdf format within the PRA Handbook. A separate PRA Rulebook will be available on a separate PRA website from 2015.

Similarly, the Financial Conduct Authority ("FCA") published its policy statement on CRD IV implementation on 13 December 2013. Its policy statement (PS 13/10) relates to the final rules for investment firms. The appendix to the statement sets out the necessary amendments to the FCA Handbook and further general guidance for investment firms.

The new rules and guidance came into force on 1 January 2014, except for provisions on governance and remuneration and specific reporting requirements, which will come into force on

1 July 2014 or at a date to be confirmed in a future communication. Final rules on capital buffers are to be published by HM Treasury in the first quarter of 2014.

2. OUTSOURCING WORKING GROUP PUBLISHES RESPONSE REPORT ON OUTSOURCING ARRANGEMENTS IN THE ASSET MANAGEMENT SECTOR

In 2012 the Financial Services Authority ("FSA") published a Dear CEO letter on outsourcing arrangements in the asset management industry. On 9 December 2013, the Investment Management Association ("IMA") published the response by the Outsourcing Working Group ("OWG") to this letter, which comprises a representative number of 15 individuals from various asset managers, seven key service providers and the IMA.

The report sets out a series of "Guiding Principles" and "Considerations" which firms should take into account when outsourcing. How such principles and considerations should apply to each firm depends on the nature, size and scope of their outsourced arrangements.

The conclusions are set out under three headings, which are:

- Oversight: Firms should consider modifications to their oversight framework throughout the lifecycle of an outsourced relationship. They should ensure they have a full understanding of the scope, nature, locations and contractual terms of their arrangement so that they may manage and oversee the relationship with service providers. They are advised to carry on a risk-based assessment of outsourcing arrangements to ascertain the potential impact on the firm and the end client, as well as identifying an appropriate level of ownership at senior levels for the outsourcing.
- Exit planning: Firms in the asset management sector need to have a comprehensive exit plan, which is subject to review regularly and which is overseen by the firm's governance bodies. The report defines exit planning as the process of transitioning from one outsourcing service provider to another.
- Standardisation: The OWG assesses the challenges and opportunities associated with achieving greater standardisation within the industry and focuses on terminology and documentation, data interfaces and testing methodologies.

The OWG also encourages firms to review their outsourced arrangements in the light of these principles and considerations and to consider how much is appropriate for their specific business models. Firms should, as a matter of good practice, document their rationale and procedures in order to help demonstrate compliance with regulations.

3. FCA PROVIDES WEBPAGE REGARDING ADDITIONAL DISCLOSURE REQUIREMENTS FOR UCITS SCHEMES AND NURS SCHEMES

On 9 December 2013, the FCA published a new webpage on the implementation of rule 4.2.5 R(3)(ca) of the Collective Investment Schemes Sourcebook ("COLL") of the FCA Handbook.

The rule at COLL 4.2.5 R(3)(ca) relates to UCITS schemes' or non-UCITS retail schemes' ("NURS") offers to deliver positive returns in all market conditions and, where there is no guarantee of such returns, through the use of phrases such as "absolute return" or "total return" in its investment objectives or fund literature. Where this sort of phraseology is used, the rule states that the firms must use additional disclosures in their prospectuses, which state that capital is in fact at risk; the investment period over which the fund aims to achieve a positive return; and that there is no guarantee that this will be achieved over that specific, or any, time period.

The webpage sets out examples of how certain authorised fund managers have complied with the rule. In some cases references to "total return" have been removed, in others fund documentation is being amended to clarify the objectives of the fund, even though terms such as "absolute return" or "total return" are not used. The rule disclosures would be required in such circumstances, since the fund objectives look to exceed benchmarks, which are generally

perceived as being positive at all times, such as Base Rates, the Consumer and Retail Prices Indices or LIBOR.

These additional disclosure requirements came into force on 26 January 2014. They may have applied earlier where a fund's prospectus had been updated prior to that date, following the expiry of a transitional provision.

4. IMPORTANT BANKING REFORM BILL RECEIVES ROYAL ASSENT

On 18 December 2013, the Financial Services (Banking Reform) Act 2013 received Royal Assent in the House of Lords ("Banking Reform Act"). The Banking Reform Act commits to statute many of the recommendations of the Independent Commission on Banking and those of the Parliamentary Commission on Banking Standards.

The key provisions in the Banking Reform Act are as follows:

- HM Treasury and the PRA have powers to implement the ring fencing rules proposed by the independent commission on banking.
- A new Payment Systems Regulator is to be set up.
- The FCA will have a duty to cap costs of payday loans.
- The Banking Act 2009 will be amended to provide a bail-in stabilisation option as part of the new special resolution regime.
- However, by far the most contentious change is the introduction of a senior persons regime for key staff in the banking sector, which will replace and overlap with the current approved persons regime in the banking sector. This new regime is unlikely to be in place before 2015, since the UK regulators wish to consult on the rules needed to make such provisions effective.
- On the same day HM Treasury also published responses to its consultation regarding the secondary legislation required by the Banking Reform Act. HM Treasury intends to provide final versions of this legislation "at an appropriate point" before the end of the current Parliament.

5. FCA PUBLISHES POLICY STATEMENT ON DATA REPORTING IN THE MORTGAGE MARKET.

On 16 December 2013, the FCA published a Policy Statement containing the final rules on data reporting as part of the Mortgage Market Review ("MMR"). The Policy Statement (PS13/12) is the final publication in a series of MMR policy documents from the FCA. The MMR was instigated by the Financial Services Authority to ensure that the United Kingdom mortgage market is sustainable and works better for customers through more responsible lending, better distribution and disclosure, arrears management and more stringent prudential requirements for non-deposit taking mortgage lenders. The majority of the reforms are due to take effect form 26 April of this year.

The new rules on data reporting, which come into force on 1 January 2015, relate to the submission of product sales data and the mortgage lending and administration return once a quarter. Firms will be required to submit the first new return on product sales data within 20 working days of the end of the first quarter following 1 January 2015. Performance data will need to be reported every six months, within 20 days of the end of the reporting period. Firms will need to submit the new mortgage lending and administration returns for their first return following 1 January 2015.

The FCA amended the proposed product sales data set, following feedback received on its consultation paper, published in May 2013, and discussions with the mortgage lending industry. The rules in relation to data reporting have not been altered significantly from those consulted

on. The FCA did not receive many responses in relation to the mortgage lending and administration return, but a few issues were raised.

The FCA is expected to publish guidance to assist firms needing to submit product and sales data to it, the FCA is expected to do this in early 2014.

6. HM TREASURY PUBLISHES SAR FINAL REPORT

Following his interim report of April 2013, Peter Bloxham has produced his final report on the review of the Special Administration Regime ("SAR") for investment banks.

The SAR was established in 2011, in particular to allow for the prompt return of client assets. Mr Bloxham's final report, published on 14 January, focuses on identifying the definitive recommendations for reform to the SAR. These include:

- ensuring that client positions may be transferred at an early stage in administration without the need for individual client consent;
- making amendments to the "Bar Date", which enables an administrator to set a cut-off date for client, affiliate and third party claims to client assets when planning a distribution. He recommends particularly that the Bar Date is extended to include client money as well as client assets claims;
- ensuring that the Client Assets Sourcebook ("CASS") of the FCA's Handbook works more closely together with the SAR. This includes clarifying the basis on which clients are entitled to make Client Money shortfall claims, and ensuring that an administrator's role under the SAR is to apply the applicable distribution regime laid down by CASS;
- making additional amendments to the Financial Services Compensation Scheme ("FSCS"). Mr Bloxham states that a further consultation on this will follow once HM Treasury decides which recommendations within this final report it proposes to accept.

7. CARNEY ANNOUNCES CONSULTATION ON PCBS REMUNERATION RECOMMENDATIONS FOR APRIL 2014

On 15 January 2014 Mark Carney, Governor of the Bank of England ("BoE"), gave oral evidence to the House of Commons Treasury Committee, which was published by the United Kingdom Parliament on 20 January 2014. The Governor stated that the PRA will consult on how to implement the remuneration recommendations of the Parliamentary Commission on Banking Standard ("PCBS") in April of this year. More specifically, the PRA will look at implementing measures to lengthen the deferral of compensation to more than five years, and more stringent methods in connection with clawback of past compensation and deferred compensation.

This announcement follows the BoE's response to the PCBS report, published in October 2013, which stated that the PRA would consult on amendments to the Remuneration Code in 2014 in order to accommodate recommendations made by the PCBS. The PCBS report (Volume I and Volume II) had provided recommendations on remuneration for bankers, including provisions for deferral of compensation for up to 10 years.

8. PRA CONSULTS ON PRA RULEBOOK

The PRA published a consultation paper on its proposed PRA Rulebook ("CP2/14") on 21 January 2014. This consultation represents the first of a number of consultations which the PRA will issue in relation to the replacement of the PRA Handbook, containing the rules and guidance created by the Financial Services Authority ("FSA"), with the PRA Rulebook.

The PRA intends to replace the Principles for Businesses ("PRIN"), carried across from the FSA Handbook, with what the consultation paper calls the Fundamental Rules. These are intended to form the basis on which the PRA makes all of its rules going forward. Changes to the Supervision

Manual ("SUP") are also proposed, including those chapters relating to information gathering, auditors, reports by skilled persons, permissions and notifications. In addition, the PRA wishes to replace Chapter 1 of the Financial Stability and Market Confidence Sourcebook ("FINMAR") with a statement of policy on the use of financial stability information power conferred by Section 165A of FSMA.

The consultation paper also discusses implementing recommendations of the PCBS within the PRA Rulebook, so that it includes a requirement that banks must operate in accordance with the safety and soundness of the firm, and that directors' responsibilities to shareholders should be interpreted in the light of this requirement.

The consultation paper sets out how the PRA will transfer existing materials from the PRA Handbook to the new Rulebook. Any rules within the existing PRA Handbook which the PRA intends to keep will be placed in the Rulebook, along with any previous guidance which the PRA wishes to convert into rules. Guidance in the PRA Handbook which relates to process issues will be moved to the PRA website, and any material within the PRA Handbook which the PRA believes will support firm judgments and clarify the PRA's expectations will be moved in to supervisory statements.

The final version of these new rules is expected at some point later in 2014, and the deadline for responses to this consultation paper is 14 March 2014. The PRA Rulebook will be published in a separate online website in 2015.

9. FCA PRODUCES FINALISED GUIDANCE ON INDUCEMENTS AND CONFLICTS OF INTEREST FOLLOWING RDR

The FCA has produced Finalised Guidance relating to inducements and conflicts of interest in relation to retail investment advice ("FG14/1"). The final version of the Guidance comes four months after it initially consulted on this area in September.

The Guidance is of relevance to all providers of retail investment products to be sold by advisers and any advisory firm providing personal recommendations in relation to retail investment products. It includes those circumstances when payments are made by providers to unregulated third party firms that are for the ultimate benefit of an advisory firm. The inducements rules and conflicts of interest rules also apply to firms within the same group which manufacture and distribute their own retail investment products, or to situations where the advisory firm is an associate of the provider.

The Guidance makes it clear that both the provider and advisory firm are responsible for making sure any payment is compliant with the inducement rules and that they are managing the conflicts of interest fairly. Examples of good and poor practice, together with guiding principles to assist the industry are set out within the Guidance.

The FCA stresses that it does not expect to see payments which could result in a channeling of business to a particular provider which is in line with the objectives of the Retail Distribution Review ("RDR"). It stresses that payments made or received should always enhance the quality of the service provided to customers. In addition, payments from providers to advisory firms for services which represent anything other than the reimbursement of costs incurred by advisory firms would not be allowed. Payments which do go beyond the reimbursement of costs would create unmanageable conflicts of interest.

The Guidance touches on matters such as IT development and maintenance, hospitality and gifts, promotional activity, outsourcing and management information amongst others. Following publication of this Guidance, the FCA expects firms to review any existing agreements and to revise them where they fall short of the standards set within it. It expects this to be completed within three months of the publication of the Guidance.

Together with the Finalised Guidance, the FCA published a summary of feedback received on the consultation.

10. GOVERNMENT PUBLISHES CONSUMER CREDIT DRAFT STATUTORY INSTRUMENTS

On 15 January 2014, draft versions of two statutory instruments, which relate to the transfer of consumer credit regulation from the Office of Fair Trading ("OFT") to the FCA were published by the Government. The draft Financial Services and Markets Act 2000 (Consumer Credit) (Designated Activities) Order 2014 ("Designated Activities Order") is the first order to be made under Section 23(1B) of the Financial Services and Markets Act 2000 ("FSMA"). The default position under FSMA is that where an authorised person carries on regulated activity for which he or she does not have the appropriate permission, he or she will not be guilty of a criminal offence. Section 23 FSMA sets out exceptions to this in relation to credit-related regulated activities. As a result of the Designated Activities Order, debt-collecting and entering into, or exercising rights under, a consumer credit agreement will be specified regulated activities under Section 23, except for instances where the activity relates to an agreement under which the obligation of the borrower is secured on land. The explanatory memorandum, published with the Order, provides further guidance.

The draft Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2014 ("Regulated Activities Amendment Order") inserts additional credit-related activities as regulated activities under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ("RAO"). It also inserts a number of exclusions from certain regulated activities, including, exclusions for local authorities and insolvency practitioners which replace existing exemptions within the RAO. An explanatory memorandum which was published alongside provides further guidance on the reasoning for the inclusion of these exemptions. The draft Regulated Activities Amendment Order also makes it clear that local authorities only need apply for authorisation to carry on credit-related activities, if such activities are within the scope of the EU Consumer Credit Directive.

The Regulated Activities Amendment Order also makes amendments to other primary and secondary legislation including FSMA, the Consumer Credit Act 1974 and a whole host of secondary legislation, including the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005. It also sets out the basis on which the FCA may review the Consumer Credit Act 1974 after 1 April 2014 to look into which of its other remaining provisions could be replaced by FCA rules and guidance.

Both of the draft Orders have been laid before Parliament and are due to come into force on 1 April 2014 following approval by a resolution of each House of Parliament.

INVESTIGATIONS AND ENFORCEMENT

1. LLOYDS BANKING GROUP FINED BY THE FCA FOR SERIOUS FAILINGS IN CONTROLS OVER SALES INCENTIVE SCHEMES

On 11 December 2013, the FCA published the final notice (dated 10 December 2013), which it issued to Lloyds TSB Bank plc and Bank of Scotland plc in connection with serious failings in their controls over sales incentive schemes. The banks were fined collectively £28,038,800, which is the largest fine ever imposed by the FCA or the FSA in respect of retail conduct failings.

The FCA found that the banks had breached Principle 3 (management and control) of the FCA's Principles for Businesses, due to serious failings in their systems and controls governing the financial incentives given to sales staff selling protection and investment products on an advised basis. The focus of the investigation was on advised sales of investment products (for example, share ISAs) and protection products, such as critical illness or income protection, between 1 January 2010 and 31 March 2012.

The incentive offered to advisors included a number of higher risk features, for example, variable salaries, bonus thresholds that involved disproportionate rewards for marginal sales and an advanced payment option that could lead to reduced bonus payments if sales targets were not

met. Advisors were able to access details of their performance against sales targets on a daily basis. The FCA found that there was a significant risk as a result that if these features were not controlled adequately, advisors would sell products to customers that they did not need or want, as the advisors attempted to reach salary and bonus incentive thresholds.

The FCA found serious flaws with the competency standards that advisors had to meet in order to be eligible for promotions and bonuses. For example, a number of advisors received their monthly bonus, even though a high proportion of the sales they made were found to be unsuitable or potentially unsuitable by the banks themselves. Serious conflicts of interest were evident, in that the managers who were responsible for insuring good practice by advisors also had their own performance measured against sales targets. The careful management that such a system needed was distinctly lacking.

In the final notice, the FCA comments that remuneration schemes play an important part in setting the sales culture of a firm, influencing how and what staff sell to customers. If mis-managed, they can create a culture of mis-selling and may undermine a firm's positive efforts to treat customers fairly. The FCA does recognise that firms may wish to incentivise staff to sell particular products, but must ensure that their systems and controls are sufficient in order to mitigate the risk of any adverse impact these incentives may have on the behavior of staff. At least, they should include appropriately focused risk-based monitoring.

The fine levied on the banks by the FCA was increased by 10 per cent, because the FSA had previously warned them about the use of poorly managed incentive schemes over a number of years. Also, the banks had a poor previous disciplinary record, including an FSA fine on Lloyds TSB Bank plc for the unsuitable sale of bonds in 2003, caused in part by the general pressure to meet sales targets.

However, the banks agreed to settle at an early stage in the FCA's investigation, thereby qualifying for 20 per cent discount under the FCA's settlement procedures. Without the discount, the fine would have amounted to £35,048,500.

Both banks are currently carrying out a review of sales conducted by higher risk advisors during the relevant period and have pledged to provide redress to customers, where it is appropriate to do so.

2. INSIDER DEALING INVESTIGATION TERMINATED

The FCA has terminated its investigation against three individuals.

On 27 February 2013, the FSA announced that three men had been arrested and were in custody to be questioned in connection with an investigation into insider dealing and market abuse. The individuals arrested were Carl Linderum, founding partner of the Lodestone Natural Resources Hedge Fund; Tim Whyte, chief investment officer at Lodestone and Carl Esprey, an analyst at Man Groups GLG.

The FCA has now confirmed that the three individuals are no longer under investigation.

3. £30,000 FINE FOR FORMER BRADFORD AND BINGLEY GROUP FINANCE DIRECTOR

The former Finance Director of Bradford & Bingley, Christopher Willford, has been fined £30,000 by the FCA for failing to act with due skill, care and diligence and breaching Principle 6 of the FCA's Statements of Principle and Code of Practice for Approved Persons.

In the FCA's final notice dated 11 December 2013, the FCA explains that Mr Willford failed to provide the board with up to date information about the bank's financial position, ahead of its 2008 rights issue. The FCA found that between the 16 May 2008 and 18 May 2008, Mr Willford failed to have proper regard to the available financial information and its relevance to the aborted rights issue and he failed to advise the board of the bank appropriately. In particular, he did not adequately review the financial information he received on 16 May 2008 and as a result,

he failed to appreciate that the documents indicated a possible material change from the financial outlook of the bank.

The FCA considered Mr Willford's failings to be particularly serious, due to his level of experience and his position held at the bank. In addition, on account of the importance of the rights issued to the bank, the FCA stated that Mr Willford should have ensured that the board was adequately advised regarding the substance and significance of the financial information he reviewed.

The FCA published an accompanying press release, in which, Tracey McDermott, FCA Director of Enforcement and Financial Crime, warned senior managers in no uncertain terms to expect the FCA to take action, if they failed to show due skill, care and diligence.

4. LLOYD'S NOTICE OF CENSURE FOR UNDERWRITER FOR LLOYD'S MANAGING AGENT

The Society of Lloyd's Market Bulletin published on 13 December 3013 contains the notice of censure that has been issued by it to Nicholas Conway, an underwriter for the Lloyds managing agent, Marketform Managing Agency Limited, which manages Syndicate 2468, following a charge of "detrimental conduct" in proceedings brought before the Lloyds enforcement board.

Mr Conway accepted the charge, which relates to the improper provision of confidential and sensitive business information belonging to Mr Conway's employer to a competitor managing agent, during the process of his recruitment by the competitor managing agent.

The notice explains the terms that have been agreed by the parties and approved by the Lloyd's enforcement board. Accordingly, Mr Conway is required to pay a fine of £35,000 and to be censured accordingly. In relation to the fine, it would have been £50,000, but Mr Conway settled proceedings at the earliest opportunity and so was given a 30 per cent discount on the final amount of the fine. However, Mr Conway is also required to pay a contribution of £9,500 to Lloyds in respect of the costs of the proceedings.

5. PORTA VERDE FINED FOR FAILINGS IN APPOINTED REPRESENTATIVES' SALES PRACTICES

Porta Verde Financial Services Limited has been fined £25,000, for failings relating to the appointment, management and monitoring of appointed representatives.

The FCA's final notice (dated 24 October 2013) explains that between October 2010 and June 2012, Porta Verde breached Principles 3, 6 and 7 of the FCA's Principle Businesses, on account of two of the firm's Appointed Representatives mis-selling insurance, in many instances, to elderly and vulnerable customers. The FCA, in the Final Notice explains the circumstances of the failings as follows.

- The firm appointed Appointed Representatives, despite being aware that it had insufficient staff with the necessary skills, knowledge and expertise to maintain adequate control and oversight of those Appointed Representatives. As a result of this, these Appointed Representatives were not adequately monitored and supervised and the firm failed to take adequate remedial action when it became aware of concerns regarding the telephone sales of insurance contracts.
- The firm failed to take reasonable steps to ensure that the Appointed Representatives did not pressurise or mislead customers to conclude insurance contracts over the telephone and failed to ensure that the Appointed Representatives obtained appropriate consent from customers. The FCA has published a related press release, summarising examples of poor conduct and mis-selling.
- Porta Verde did not take reasonable steps to ensure that the Appointed Representatives did not mislead customers. In particular, the Appointed Representatives used telephone sales scripts to sell insurance contracts for satellite television equipment and emergency home plumbing and drainage cover that were not clear, fair and not misleading.

Porta Verde qualified for a 30 per cent discount to its fine, having settled at an early stage of the investigation, but without this, the fine would have been £385,500. The firm is now in voluntary liquidation and the £25,000 fine reflects its total remaining financial resources.

6. FOUR PEOPLE BANNED FOR FAILINGS RELATING TO OCCUPATIONAL PENSIONS SCHEMES

On 17 December 2013, the FCA published the final notices issued to Daniel Conway, Michael Conway, Martin Gwynn and Andrew Powell. The final notices concern failings relating to occupational pension schemes in connection with two independent financial advisers ("IFAs") appointed by CBW Trustees Limited and CBW Pension Forensics Limited (collectively, "CBW"). Michael Conway, Andrew Powell and Martin Gwynne have been prohibited from carrying on any regulated activity, whilst Daniel Conway has been prohibited from holding any controlled function.

The final notices describe the following failings, amongst other matters.

- Michael Conway was a director of CBW, but failed to disclose that he stood to gain financially from advice offered to CBW by an IFA (G&G Financial Services Limited - "G&G"). In April 2010, he actively influenced the financial advice given by Andrew Powell on behalf of G&G for personal gain.
- Andrew Powell acted as an independent advisor to CBW, whilst employed by G&G. Despite concerns about the suitability of the investment, he recommended that personal pension schemes should invest £8m in a high-risk and illiquid property fund chosen by Michael Conway. Andrew Powell personally benefitted by allowing CBW to influence his advice between March 2010 and April 2010.
- Martin Gwynne owned G&G and all of its shares. Between March 2007 and September 2010, he failed to seek the necessary authorisation from the FSA, when appointing Andrew Powell as a director and did not properly monitor the advice he offered to the affected pension schemes.
- Daniel Conway was a director of Staverton Wealth Management Limited, which was partially owned by Michael Conway. Daniel Conway was appointed without any previous experience advising occupational pension schemes. The FCA found that between January 2007 and April 2010, he failed to take steps to understand the requirements of his role, or to offer independent or suitable advice.
- An accompanying press release states that the FCA worked closely with the Pension Regulation to take action against the responsible individuals and to track down assets located outside of the UK.

7. BROKER FINED FOR FAILING TO MANAGE BRIBERY AND CORRUPTION RISKS

The FCA has imposed a fine of £1,876,000 on JLT Specialty Limited, for failing to manage bribery and corruption risks created by oversea payments, in breach of Principle 3 of the FCA's Principles for Businesses. The final notice was published on 19 December 2013.

JLT provides insurance broking, risk management and claims consulting services to a wide range of national and international corporate clients. The FCA found that between February 2009 and May 2012, JLT failed to have in place adequate risk management systems and controls for countering the risks of bribery and corruption associated with making payments to overseas third parties. These third parties, known as overseas introducers, helped JLT to win and retain business from overseas clients.

The final notice explains that in particular JLT failed to:

- Carry out proper due diligence before entering into relationships with, or making payments to overseas introducers, meaning that JLT failed to take adequate steps to assess whether the overseas introducers were connected with the clients they introduced or any public officials.

- Adequately assess the potential risk associated with each piece of new insurance business secured through overseas introducers.
- Adequately implement its own anti-bribery and corruption ("ABC") policies. In addition, the firm failed to carry out adequate checks, which would have enabled it to identify that its policies were not being implemented correctly.

The FCA found that between February 2009 and May 2012, JLT received almost £20.7m in gross commissions from business provided by overseas introducers and paid them over £11.7m in return. The FCA states that it believes that the inadequate systems and controls around these payments created an unacceptable risk that overseas introducers could use the payments made by JLT for corrupt purposes.

Despite this, however, the FCA found no evidence to suggest that JLT permitted any illegal payment or inducement to any overseas introducer, nor did it find any evidence to suggest that it intended to do so. However, JLT's fine was increased as the failings occurred during a period of heightened awareness of bribery and corruption risk, both within JLT itself and also across the insurance industry. The FCA requested that JLT vary its permission until the FCA was satisfied that that firm could adequately mitigate the risk of making payments to overseas third parties, which JLT has done.

In a related press release Tracey McDermott, FCA Director of Enforcement and Financial Crime warned that bribery and corruption from overseas payments is an issue that the FCA expects all firms to do all they can to tackle.

8. PRA AND FCA CONFIRM CO-OP BANK ENFORCEMENT INVESTIGATION

On 6th January, 2014 the PRA published a press release confirming that it is undertaking an enforcement investigation into the Co-operative Bank ("Co-op Bank"). In a separate press release the FCA has also confirmed that it will be undertaking enforcement investigations into events up to June 2013 at the Co-op Bank.

The PRA's press release states that part of the investigation will consider the role of senior managers, but no further information will be provided until the legal process has concluded and an outcome has been reached.

HM Treasury had indicated that the independent review announced by the Chancellor of the Exchequer in November 2013 would not start until it was clear that it would not prejudice any actions that the regulators may take. The PRA and FCA will work with HM Treasury to ensure that the enforcement investigation and the independent review are carried out appropriately.

9. BANKS' REVIEWS OF SALES OF INTEREST RATE HEDGING PRODUCTS

The FCA has updated its webpage on banks' reviews of sales of interest rate hedging products ("IRHPs"). The update was done on 10 January 2014.

In response to feedback from customers, the FCA has published detailed information about sophisticated customers, customers who have not opted into the review and also about the types of alternative products that some customers are being offered as redress. On the webpage, this information can be seen in an overall view progress table and a bank-by-bank progress table.

The FCA reports that the latest figures show a continued increase in the pace of the banks' reviews. The banks' projections show that they remain on track to provide a redress determination to all customers within 12 months of starting their reviews. However, the banks' ability to deliver against their projections will also require the engagement of customers. The FCA encourages the 3,700 customers yet to opt-in to the review to do so as quickly as possible. Over the next few months, the banks will start sending out final reminders to customers, in order to encourage as many as possible to participate, before the review is closed to new entrants.

10. FCA FINES STANDARD BANK FOR FAILURES IN ITS AML CONTROLS

On 23 January 2014, the FCA published the decision notice it has issued to Standard Bank plc. Standard Bank has been fined £7,640,400 in connection with failings relating to its anti-money laundering ("AML") policies and procedures over corporate customers connected to politically exposed persons ("PEPs").

The FCA found that between 15 December 2007 and 20 July 2011, Standard Bank failed to comply with the Money Laundering Regulations 2007 because it had failed to take reasonable care to ensure that all aspects of its AML policies were applied appropriately and consistently to its corporate customers connected to PEPs.

In the decision notice, the FCA states that in common with any financial services activity, commercial banking business can be used to launder money, particularly in the layering or integration stages of the money laundering process. Accordingly, banks conducting this type of business must have affective AML systems and controls in place to ensure that all the participants in commercial banking transactions are subjected to effective and appropriate due diligence. This is particularly important where the transaction involves PEPs or other high risk customers. Guidance issued by the Joint Money Laundering Steering Group ("JMLSG") provides that where a corporate customer is known to be linked to a PEP, such as through a directorship or shareholding, it is likely that this will put the customer into a high risk category and that enhanced due diligence ("EDD") measures therefore should be applied. During the relevant period, Standard Bank had business relationships with 5,339 corporate customers, of which 282 were linked to one or more PEPs.

The FCA found serious weaknesses in the application of Standard Bank's AML policies and procedures and that Standard Bank consistently failed to carry out adequate EDD measures before establishing business relationships with corporate customers that had connections with PEPs; and consistently failed to conduct the appropriate level of on-going monitoring for existing business relationships by keeping customer due diligence up to date.

The FCA has stated that it believes these failings to be particularly serious because Standard Bank provided loans and other services to a significant number of corporate customers who emanated from, or operated in jurisdictions that have been identified by industry-recognised sources as posing a higher risk of money laundering. In addition, Standard Bank identified issues relating to its ability to conduct on-going reviews of customer files early in the period under investigation, but despite this, failed to take the necessary steps to resolve the issues. The FCA also believes these failings to be particularly serious because it had previously brought action against a number of firms for AML deficiencies and has stressed to the industry the importance of compliance with AML requirements.

The FCA believes that the weaknesses in Standard Bank's AML systems and controls resulted in an unacceptable risk of Standard Bank being used to launder the proceeds of crime. However, in determining the penalty to be imposed on Standard Bank, the FCA did take into account the fact that Standard Bank had improved its customer risk assessment processes in April 2009, by introducing a more comprehensive risk classification process; and both the bank and its senior management co-operated fully with the FCA's investigation and have taken significant steps at significant cost towards remedying the issues identified, including seeking advice and assistance from external consultants. Standard Bank settled at an early stage of the investigation, thereby qualifying for a 30% discount on the fine. Without the discount, the fine would have been £10,900,000.

This is the first AML case the FCA, or its predecessor the FSA, has brought relating to commercial banking activity. This is also the first AML case to use the new penalty regime, which applies to breaches committed from 6 March 2010. Considerably larger fines are expected under the new regime.

EUROPE

Please see our separate EU Bulletin for European developments.

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