



5-7 Questions





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## 2. Introduction to Financial Markets

### The role of the government

- Economic policy
  - Inflation target of 2.0%
  - Monetary policy committee sets interest rates
    - Monthly meetings
- Regulation
- Taxation
  - Controlled by government to influence economy
- Social welfare
  - Government spending on health, housing, education etc.
  - Affected by wealth, age, health, etc. of the population

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### 3. European Union

The European Commission has three supervisory authorities

- The European Securities and Markets Authority (ESMA)
- The European Banking Authority (EBA)
- The European Insurance and Occupational Pensions Authority (EIOPA)

In addition to these there is another body

- The European Systemic Risk Board (ESRB)
  - Takes a macro-prudential view of the financial services

#### Further information

The Lamfalussy approach is based on the recommendations of the Committee of 'Wise Men', chaired by Baron Alexandre Lamfalussy. It comprises a four-level procedure that speeds up the legislative process. It divides the legislation into high level framework provisions and implementing measures.



#### Further information

An example of European regulation is the European Market Infrastructure Regulation (EMIR). It places greater emphasis on risk management and transparency of OTC markets.



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### 3. European Union

European Securities and Markets Authority (ESMA)

- Draft legally binding rules
  - Fast track where necessary
- Powers to resolve disagreements between national authorities
- Consumer protection
  - Including product intervention
- Monitor systemic risk of cross-border firms
- Wider supervisory role
  - Including credit rating agencies

### Hints

*EU Directive vs. EU Regulation*

EU Directive – EU law implemented through local rules and legislation

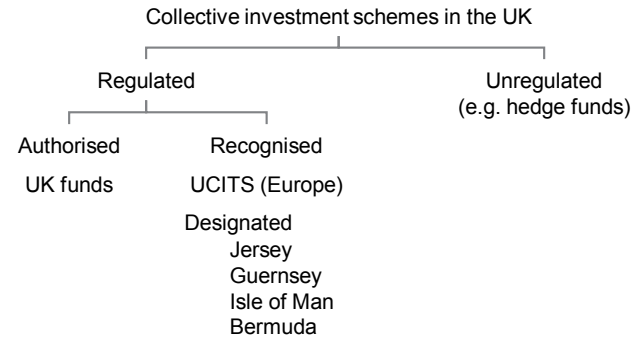
EU Regulation – EU law implemented directly

NOTE: EU regulation is an attempt to create a single EU rule book. There is no scope for modification of EU regulation.



### 3. European Union

#### The role of EU Directives: UCITS



### Hints

Collective investment schemes (CIS) in the UK are:

1. Unit trusts
2. Investment companies with variable capital (ICVC)

Note: ICVCs are also referred to as open-ended investment companies (OEIC)



### Further information

|              | Unit trust     | ICVC/OEIC      |
|--------------|----------------|----------------|
| Legal status | Trust          | Company        |
| Type of fund | Open-ended CIS | Open-ended CIS |



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### 3. European Union

#### UCITS directive

- CISs in the European Union (EU) are regulated by a directive known as the undertakings for collective investment in transferable securities directive, or the UCITS directive
- Before a CIS may promote itself across the EU, it must:
  - Obtain a passport from its home regulator
  - Be open-ended
  - Not invest in any asset class prohibited by the directive, i.e. property or commodity derivatives

### Further information

#### *UCITS III*

UCITS III is split into two parts:

**Management Directive** increases the scope of management companies' activities that can be passported to include discretionary management, safekeeping and fund administration.

**Product Directive** expands the range and type of financial instruments that are permitted within UCITS funds, in particular allowing investment in derivatives for investment as well as for existing risk reduction purposes and investment in other funds.

#### *UCITS IV*

Covers the following areas:

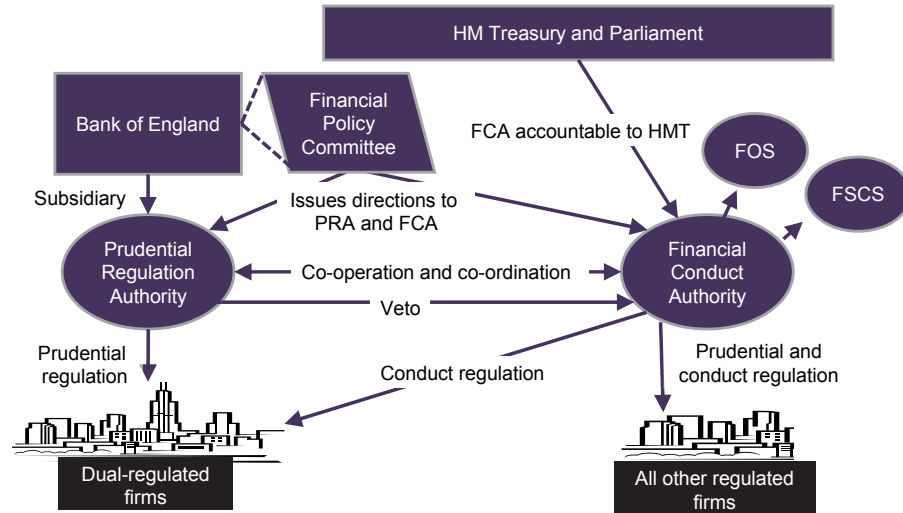
- Management company passport – a management company located in one country will be able to set up and run a fund in another
- Supervision – a management company will be subject to the supervision and regulation of the country where it is based
- Notification procedure – quicker, more simplified regulator-to-regulator communication
- Key investor information document (KIID) – product brochures to be simpler than the existing 'simplified' prospectus
- Mergers – a standardised framework governing both domestic and cross-border mergers between funds
- Master-feeder structures – allow funds to build economies of scale across borders





## 4. The Regulatory Environment: an Overview

### The FCA and PRA (Financial Services Act 2012)



## Further information

### Responsibilities

The FCA is accountable to the Treasury and must make annual reports that are then presented in parliament.

The FCA is not a government body. It is not founded by the government and its employees are not civil servants.

The FOS is accountable to the FCA, and the FSCS is jointly overseen by the FCA and the PRA. The Chairman and directors of these bodies are appointed by the FCA.



## Keeping on target

The FCA is funded via contributions from which of the following?

- A. The Treasury indirectly through taxes
- B. The LSE through a levy charged on transactions
- C. Regulated firms authorised under FSMA 2000
- D. The FCA funds itself through its own activities in the marketplace



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## 4. The Regulatory Environment: an Overview

### The Bank of England

- Responsibilities of the Bank of England:
  - Overseeing financial markets infrastructure (FMI)
    - E.g. payment systems and recognised clearing houses
  - Broad overview of the financial system
  - Maintaining stability in the financial system
  - Appointing the chairman of the Panel on Takeovers and Mergers
- Financial Policy Committee
  - Meets at least quarterly
  - Monitors financial system and identifies risks to its stability
  - Makes recommendations and has powers of intervention to ensure action is taken

### Further information

Memoranda of understanding between HM Treasury, the Bank of England's Financial Policy Committee and the two regulators identify the different responsibilities each body has for regulating the UK financial system.



**Answer to the question on the previous slide:**

C. Regulated firms authorised under FSMA 2000

## 4. The Regulatory Environment: an Overview

### The PRA (FSA 2012)

#### PRA firms

- Deposit takers
- Insurers
- Significant investment firms

#### PRA objective

To promote the safety and soundness of PRA-authorised firms

- Avoid instability
- Minimise adverse effect the failure of a PRA-authorised firm would have upon the stability of the UK financial system

### Further information

#### *Proactive regulation*

The FCA and PRA seek to anticipate problems before they arise, concentrating their regulatory activities on where they believe problems could occur.



### Further information

#### *Dual regulated firms*

The FCA and PRA have separate authorisation functions, but a single administrative process for dual-regulated firms. Firms that are dual-regulated will apply to the PRA for authorisation. The application will be considered by both the PRA and FCA, following one of two processes:

- Consent: The FCA gives or refuses consent to the PRA. If the FCA does not give consent, the PRA can refuse the application.
- Consult: For certain permissions, the PRA must consult the FCA. The PRA must consider the response of the FCA, but need not be bound by it.

When considering the application, the FCA concentrates on conduct, the PRA upon prudential supervision. Both regulators have their own threshold conditions. Dual regulated firms have to meet both sets of conditions.



## 4. The Regulatory Environment: an Overview

### Data protection: introduction

- Basic principle:
  - ‘Public should know or be able to find out who is processing their personal data and for what purpose’
- Data protection Act (DPA) 1998 requirement: firm must register with the Information Commissioner’s Office as ‘data controller’
- DPA 1998: principles of data protection
  - Fairly and lawfully processed
  - Processed for limited purposes
  - Adequate, relevant and not excessive
  - Accurate
  - Not kept longer than necessary
  - Processed in accordance with the data subject’s rights
  - Secure
  - Not transferred outside EEA without adequate protection

### Further information

The Data Protection Act allows individuals to request access to information being held about them by a firm/organisation. The individual may be charged a maximum of £10 for access to their records (£2 in the case of credit reference agency records). This request is submitted to the firm/organisation, which must normally respond to it within 40 days.

If the Information Commissioner considers that a data controller is in breach of any of the data protection principles, it can serve an enforcement notice. If the data controller fails to comply with the enforcement notice, they are committing an offence and can be fined up to £500,000.



### Links

*Other regulatory bodies:*

1. Competition and Market Authority
2. Tax and Chancery Chamber of the Upper Tribunal
3. Pensions Regulator

These bodies will be covered in the relevant parts of the course.



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## 5. The Financial Conduct Authority

### FCA statutory objectives (FSA 2012)

#### Strategic objective

- To ensure that relevant markets function well

#### Operational objectives

- Consumer protection
  - Securing an appropriate degree of protection for consumers
- Integrity
  - Protecting and enhancing the integrity of the UK financial system
- Competition
  - Promoting efficiency and choice in the market for financial services

## Further information

Combating financial crime is part of the 'Integrity' operational objective.

As well as its stated objectives, the FCA will:

- Focus on the conduct regulation of all firms, including those prudentially supervised by the PRA
- Be responsible for the prudential supervision of all firms not prudentially supervised by the PRA
- Supervise investment exchanges and over-the-counter (OTC) markets and oversee the market abuse regime
- Have criminal powers to investigate and prosecute insider dealing
- Take on the FSA's responsibilities as the UKLA
- Be responsible for overseeing the FOS, the Money Advice Service (MAS) and (jointly with the PRA) the FSCS



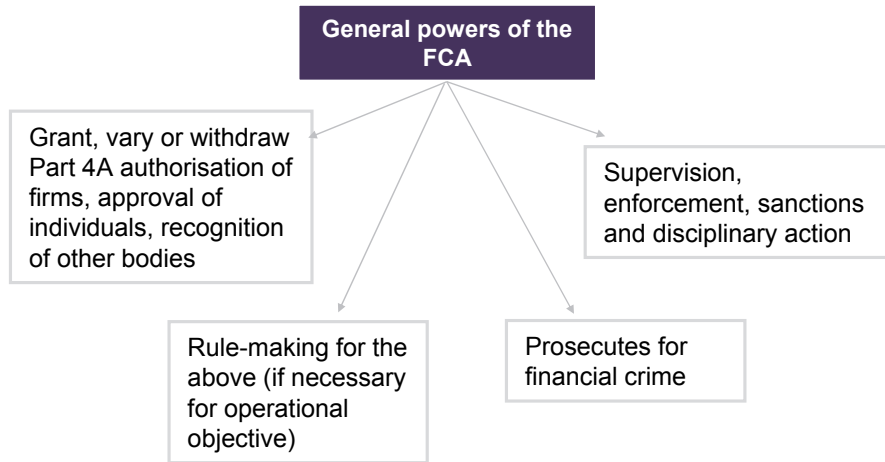
## Links

The 'appropriate degree of protection' is based on the client's knowledge and the nature of the investment. This will be looked at further in chapter three – client categorisation.



## 5. The Financial Conduct Authority

### General powers of the FCA (Part 9A FSMA 2000)



## Further information

### *Temporary product intervention rules (TPIR)*

FCA has been given powers of intervention over products by FSA 2012. It can ban products posing unacceptable risks to consumers.

- Products can be banned for up to 12 months without consultation
- During this time FCA will either consult on a permanent remedy, or work to find another way to resolve the problem



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## 5. The Financial Conduct Authority

### **The FCA handbook [with example sourcebooks relevant to your syllabus]**

Block 1: high-level standards [PRIN, SYSC, COND, APER, FIT, TC]

Block 3: business standards [COBS, CASS, MAR]

Block 4: regulatory processes [SUP, DEPP]

Block 5: redress [DISP, COMP]

Block 6: Regulatory guides [EG]

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## 5. The Financial Conduct Authority

### Outcomes-focused (or 'principles-based') approach

What 'principles-based' means:

- Fewer rules
- More high-level objectives (principles)

Rationale

- Flexibility to support innovation
- Accessibility for firms
- Focus on purpose of regulation

Example

- Treating customers fairly (TCF)

## Further information

### Treating customers fairly (TCF)

TCF is an example of the FCA's outcomes-focused regulation. It is based on six objectives.

- Outcome 1: Fair treatment of customers is central to the corporate culture of all firms.
- Outcome 2: Products and services meet the needs of identified consumer groups and are targeted accordingly.
- Outcome 3: Consumers are provided with clear information before, during and after the point of sale.
- Outcome 4: Any advice is suitable and takes account of their circumstances.
- Outcome 5: Products and services perform as firms have led consumers to expect.
- Outcome 6: Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.





## 5. The Financial Conduct Authority

### Supervision: Risk-based approach

- Application
  - To assess the impact and probability of risks crystallising in the financial industry
- Initial assessment based on potential impact to FCA's objectives
  - More effort allocated to firms posing largest threat to consumers or market integrity
- FCA Firm Systematic Framework (FSF)
  - Key question posed
    - Are the interest of consumers and market integrity at the heart of how the firm is run?

## Further information

### *Firm Systematic Framework (FSF)*

FSF will use a common framework across all sectors, which is targeted to the type of firm. The common features involve:

- Business Model and Strategy analysis – to give a view on how sustainable the business is
- Assessment of how the firm embeds fair treatment of customers and ensures market integrity. The assessment has four modules:
  - *Governance and culture*
  - *Product design*
  - *Sales or transaction processes*
  - *Post-sales/services and transaction handling*
- Deciding what actions are required by the firm – addressing issues highlighted by the FCA.
- Communication to the firm – setting out the assessment and actions required.



## Hints

The FCA categorise firms on a risk basis from C1 (most risky) to C4 (least risky).



## 5. The Financial Conduct Authority

### Information gathering by the FCA/PRA

- Powers of FCA/PRA enforcement officers
  - Enter the premises of an authorised firm without notice
  - Demand documents, file, tapes, data
  - Interview any employee

### Supervision of firms: cooperation

- The FCA/PRA has the legal power to demand information/documentation
  - Must be provided within a reasonable time period
  - Failure to cooperate or provide false or misleading evidence is a criminal offence

## Hints

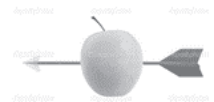
The FCA enforcement officers have the power to interview any employee, not investigate any employee.



## Keeping on target

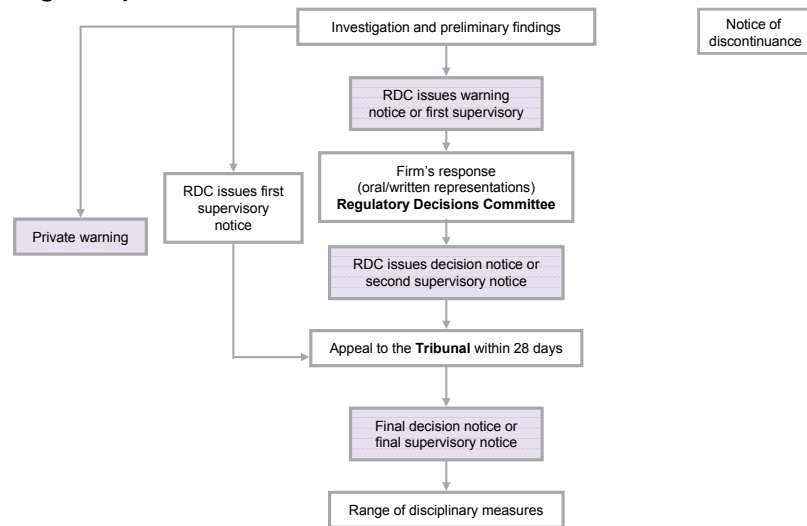
All of the following are true with regard to FCA investigations, **except**:

- A. An approved person must cease all regulated activities immediately if they are served with a notice of investigation
- B. Surveillance staff may take copies of any document or record relevant to an investigation
- C. An investigation may be started as a result of an allegation of a breach of the rules
- D. An investigation notice can be served on either an approved individual, or an authorised firm



## 5. The Financial Conduct Authority

### Investigation process



### Further information

#### *Regulatory Decisions Committee (RDC)*

Exercises certain decision making powers on behalf of the FCA.

Features:

- Appointed by the FCA board.
- Accountable to the FCA board.
- Only the chairman of the RDC is an FCA employee.
- The FCA must give a firm at least 28 days to respond to a warning notice.

#### *The Tribunal*

Tax and Chancery Chamber of the Upper Tribunal (TCCUT) provides a forum for independent review of FCA decisions. It is totally outside the management structure of the FCA. It forms part of the Ministry of Justice's tribunal service.



### Hints

Although the RDC is given the role of issuing notices, it is possible for the FCA to do so instead.



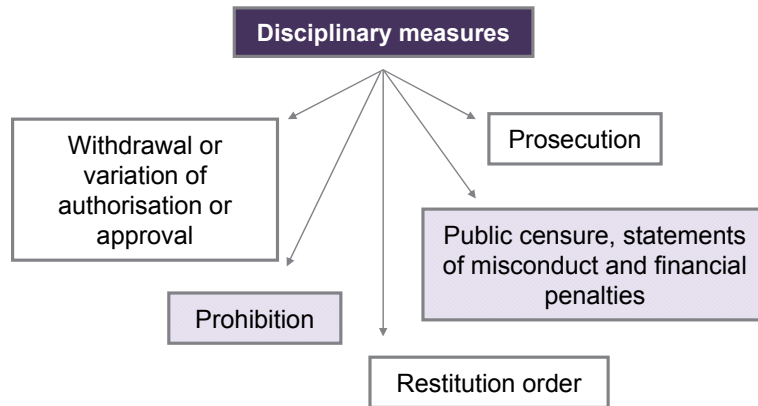
#### **Answer to the question on the previous slide:**

A: An approved person must cease all regulated activities immediately if they are served with a notice of investigation



## 5. The Financial Conduct Authority

### Disciplinary processes and measures



### Further information

#### *Prohibition order*

The prohibition is defined under S56 of FSMA 2000

It can be issued to an individual only

There are many levels of prohibition, from prohibiting a person from conducting a particular activity, to preventing a person conducting all regulated activities



### Answer from previous slide

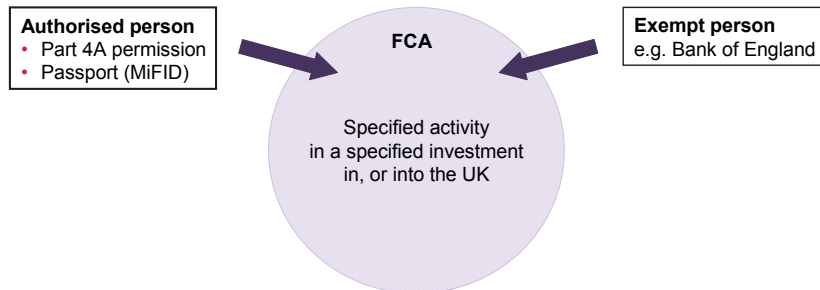
C: Final notice

These notices take effect on a specified date and have no right of appeal.

## 6. The Regulated Activities Order (RAO)

### General prohibition (S19 FSMA 2000)

- 'No person may carry on a regulated activity in the UK unless he is an authorised person or an exempt person'
- Regulated activity:
  - Regulated activities order
    - Specified activity undertaken with a specified investment



## Further information

### Legal person

The 'person' referred to in S19 is **not** generally an individual. It, instead, refers to a legal person: a company, a partnership or a trust.

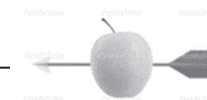
Individuals can get authorised, if they were, for example, a local or sole trader.



## Keeping on target

How should a firm that has gained Part 4A permission be described?

- A: Authorised
- B: Registered
- C: Regulated
- D: Permitted



## 6. The Regulated Activities Order (RAO)

### Specified activities

- Dealing in investments
- Arranging deals in investments
- Managing investments
- Advising on investments
- Operating a multi-lateral trading facility (MTF)
- Safeguarding and administering investments: e.g. acting as a custodian
- Sending dematerialised instructions: e.g. electronic money transfer
- Insurance
- Lloyd's activities
- Providing funeral plan contracts
- Regulated mortgages: provision, administration, advising and arranging
- Home finance activities
- Accepting deposits by way of business and issuing electronic money
- Establishing, operating, or winding-up a collective investment scheme or pension scheme
- Agreeing to carry on most regulated activities

### Hints

Most insurance contracts are covered under specified activities. A notable exception is car breakdown insurance.



### Further information

A regulated mortgage is:

- Residential mortgage; and
- Primary residence; and
- First charge



**Answer to the question on the previous slide:**

A: Authorised

## 6. The Regulated Activities Order (RAO)

### Excluded activities

- Newspapers
- Television broadcasts
- Providing information
- Unpaid trustees: e.g. nominees, executors
- Employee share schemes
- Dealing as principal and end user, where no service is offered to others

### Hints

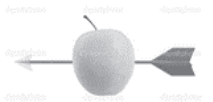
Newspapers are only excluded for incidental activities. Those publications that solely give advice, such as 'tip sheets', are not excluded.



### Keeping on target

With reference to the Regulated Activities Order, which of the following is a regulated activity?

- A: Operating an employee share scheme
- B: Providing custodianship services for shares held within an investment company with variable capital
- C: Arranging commercial mortgages
- D: Providing investment advice as part of a weekly radio programme





## 6. The Regulated Activities Order (RAO)

### Specified investments

- Shares/Depository receipts/Warrants
- Debt instruments
- Units in collective investment schemes
- Options on:
  - Specified investments
  - Currencies
  - Precious metals (gold, silver, platinum and palladium)
- Futures
- Contracts for difference (CFDs)
- Lloyd's syndicates
- Insurance contracts
- Funeral plans
- Pensions
- Regulated mortgages and home finance
- Deposits and electronic money
- Rights to investments: e.g. sale and repurchase agreements (repos)

### Further information

#### *Options and futures*

These investments are covered if they are for investment purposes, but not if they are used for commercial (risk management) purposes, i.e. hedging.

#### **Home finance** includes:

- Home reversion plan (equity release)
- Home purchase plan
- Regulated sale and rent back



### Hints

No derivative used for commercial purposes is a specified investment.



### Hints

#### *Precious metals*

There are only **four** precious metals.



### Answer to the question on the previous slide:

B: Providing custodianship services for shares held within an investment company with variable capital.

## 6. The Regulated Activities Order (RAO)

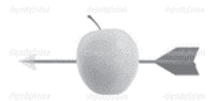
### Excluded investments

- Property
- Tangible assets (e.g. oil, metals, antiques, etc.)
- Currencies (spot and forward deals)
- Premium bonds
- National savings certificates (all national savings and investment products)

## Keeping on target

Which of the following would be considered specified investments under FSMA 2000?

|          | Share | Silver | Copper |
|----------|-------|--------|--------|
| Physical |       |        |        |
| Option   |       |        |        |
| Future   |       |        |        |



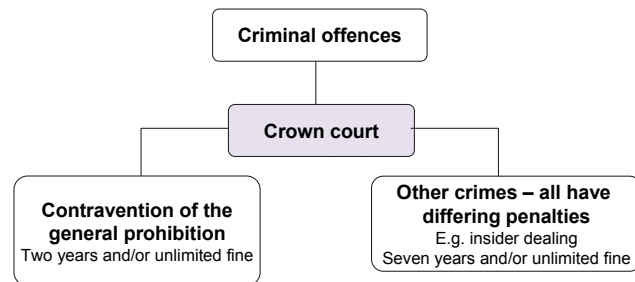
## Hints

Are there any types of secured loans where the collateral used is not a specified investment?  
Yes, mortgages.



## 6. The Regulated Activities Order (RAO)

### Criminal penalties



### Civil remedies

- Injunctions
- Restitution orders
- Contracts are voidable at the discretion of the investor

## Further information

### Definitions

'Injunction'

Where a firm is prohibited from continuing activities

'Restitution order'

Where a firm is instructed to pay back any losses to a client



### Answer to the question on the previous slide

|          | Share | Silver | Copper |
|----------|-------|--------|--------|
| Physical | ✓     | ✗      | ✗      |
| Option   | ✓     | ✓      | ✗      |
| Future   | ✓     | ✓      | ✓      |