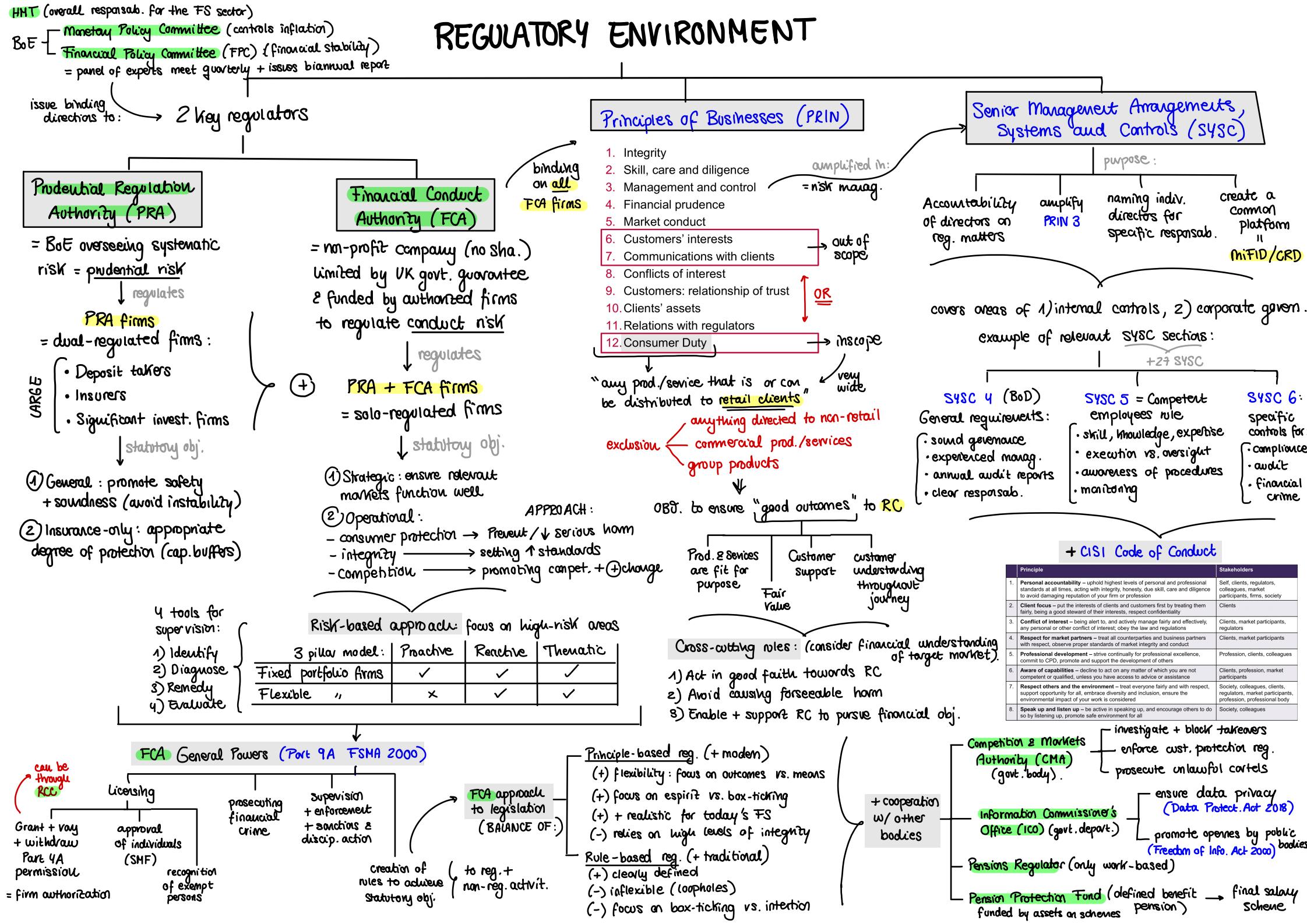
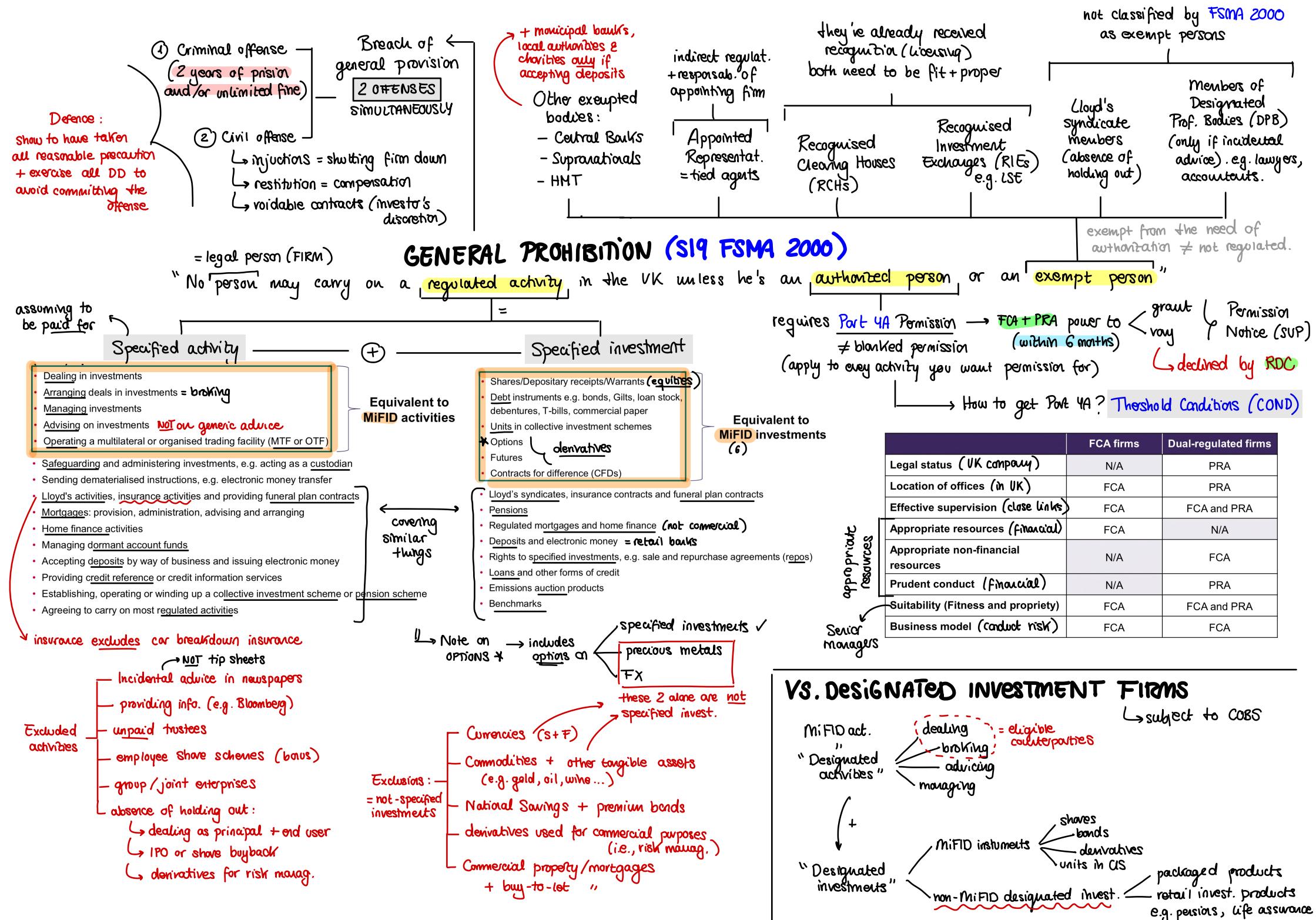


REGULATORY ENVIRONMENT





FSMA 2000 + FSA 2012

this section is
(+ focused on indiv.)

Senior Manager & Certification Regime (SM&CR)

= Individual Accountability Regime

Senior Management Functions (SMF)

- All directors (also Non-ED)
- All heads of functions
- MLRO

Sign Statement of Responsibilities (SoR)
+ keep records for 6 years from any change

Form A

↓ send to:

Regulator (FCA/PRA)
for approval

Certification Functions (CF)

= significant harm functions (SHF)
to customer
firm
markets

e.g. client adviser

Other conduct rules staff (OCRS)

= most of remaining employees

Firm issues a certificate

on 1) recruitment
+ 2) annually

carries out the test (immediately)

Ancillary Staff

(job has no to do w/
reg. activit.)
e.g. cleaner

→ carries out the test (response within 90 days)

both are subject to:

Fit & Proper test (FIT) → can only do their job once approved / certified as FIT

Honesty, integrity, reputation:

- 6 years emp. history
- criminal convictions
- Breaches of rules
- Complaints

Competence:

- Exam success
- Experience + training

Financial soundness:

- Bankruptcy (personal or comp. involved)

SMF + CF + OCRS subject to **Conduct Rules (COCON)**

ALL employees need to observe proper standards of market conduct

Individual Conduct Rules (COCON)

↓ 6 rules

FIRST TIER (SMF + CF + OCRS)

1. You must act with integrity
 - A breach would be to deliberately mislead by act or omission
2. You must act with due skill, care and diligence
 - A breach would be to act without full understanding or approval
3. You must be open and co-operative with the FCA, the PRA and other regulators
 - A breach would be a failure to inform the FCA of anything of a nature that it would reasonably expect to be informed
4. You must pay due regard to the interests of customers and treat them fairly (outside Cust. Duty scope)
5. You must observe proper standards of market conduct
 - A breach would be a failure to comply with the Code of Market Conduct
6. You must act to deliver good outcomes for retail customers (inside scope of Cust. Duty)

OR

↓ + 4 rules

SECOND TIER: (SMF-only)

7. **SM1:** You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively.
8. **SM2:** You must take reasonable steps to ensure that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system.
9. **SM3:** You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively.
10. **SM4:** You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice.

Training and Competency (T&C) Sourcebook

≈ SYSC 5 (employee's competent rule)

↓ Requirements:

- Demonstrate + be competent
 - Exam success (within 30 months)
 - Firm responsab. to assess
- Appropriate supervision
- Competence regularly reviewed (Continuous Professional Development)

Whistleblowing

Public Interest Disclosure Act (PIDA) 1998

= protects the ability for an employee to make protected disclosure,

has been / is being / likely to be

- Criminal offences
- Breach of legal requirements
- Miscarriage of justice
- Endangering health and safety
- Damage to the environment
- Concealment of the above = hiding

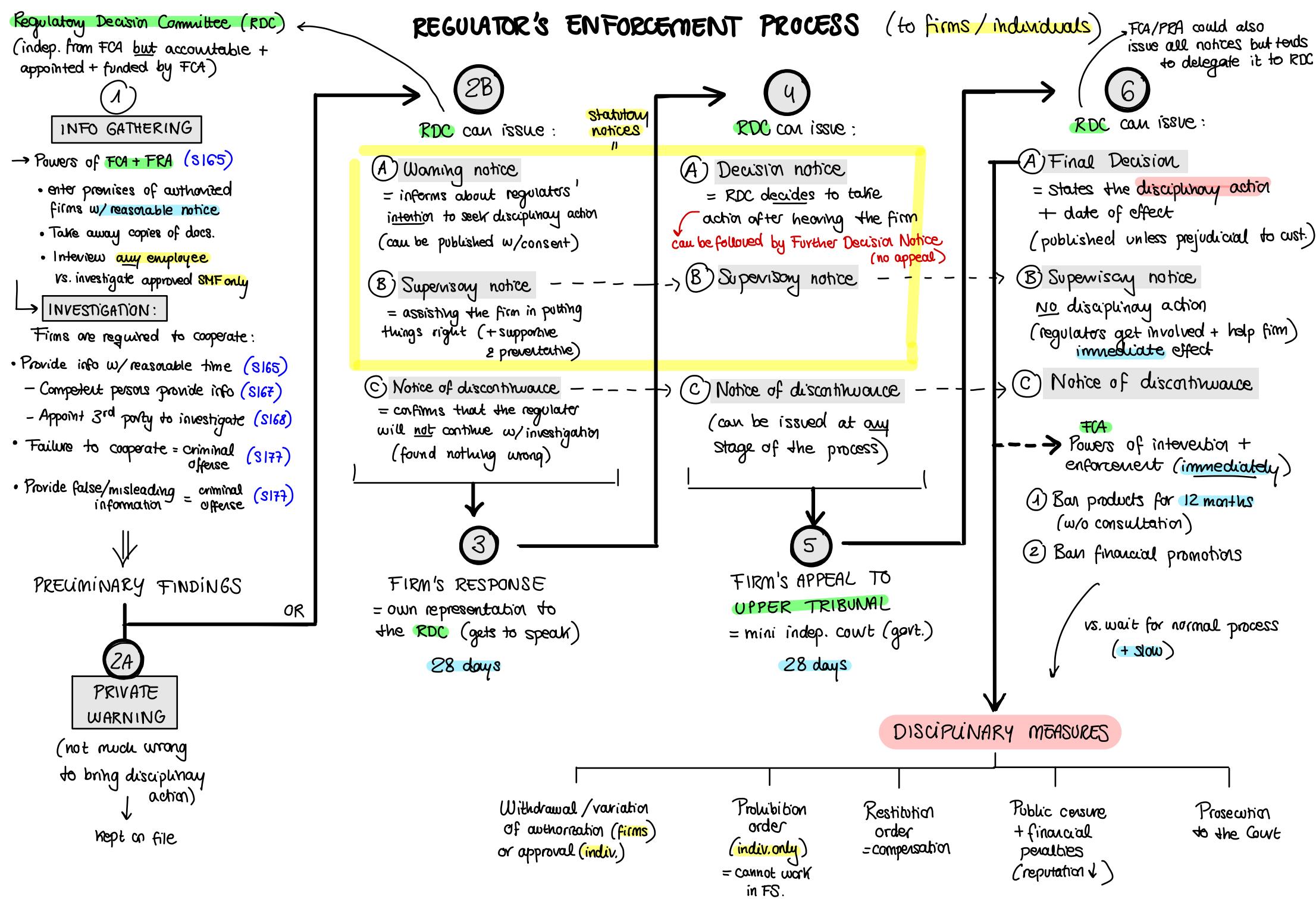
Reasons for disclosure
(committed anywhere)

whistleblower champion
= appointed SMF by the firm

- The proper way to disclose
- Failures that are worthy of disclosure
- Assurances of protected disclosure
- Avenues of external disclosure (including the FCA)
- Penalties for making false or misleading disclosure

NOT just single avenue

Procedures:



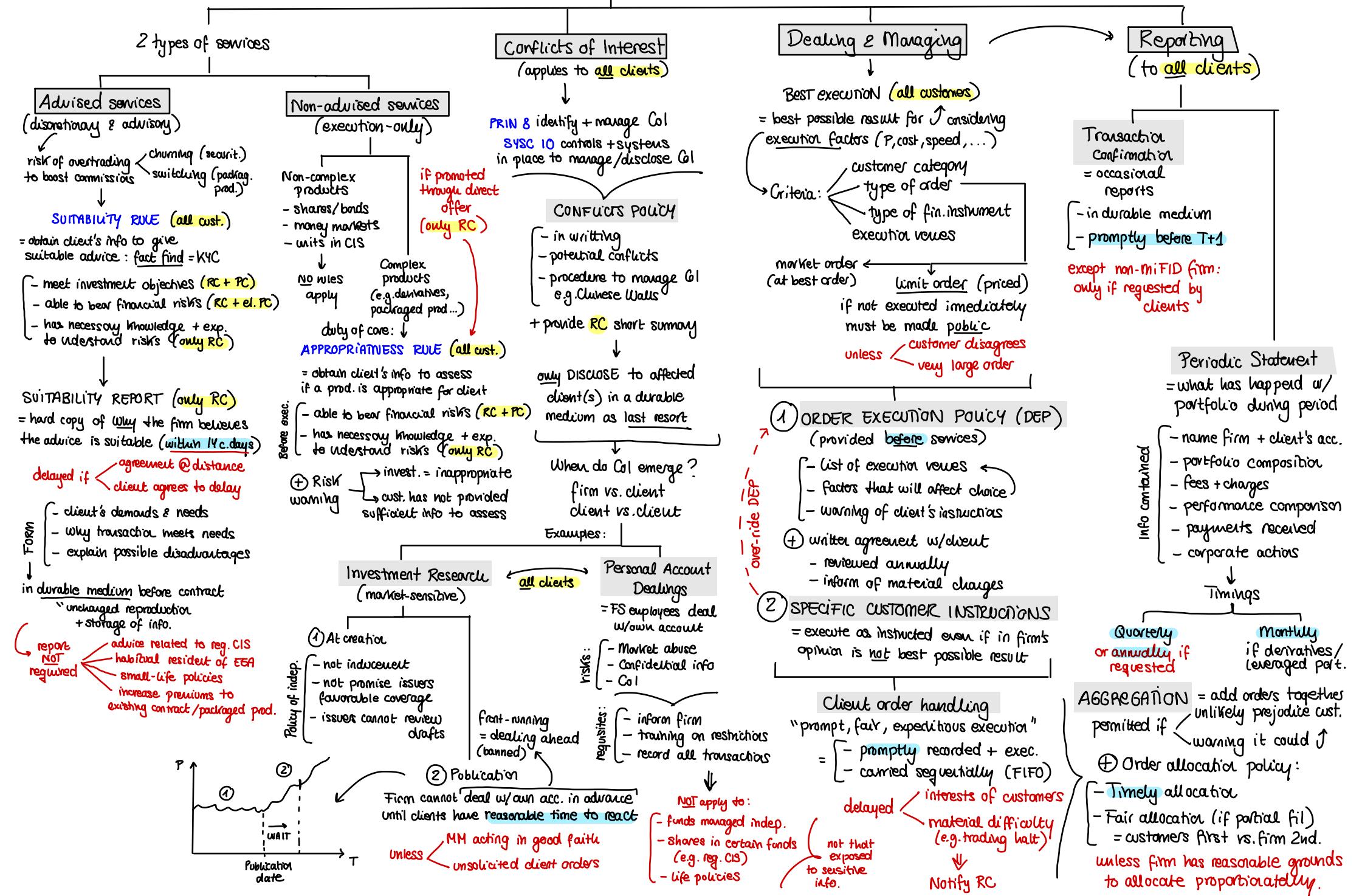
Fair treatment = clients' best interest rule
"act honestly, fairly & professionally"

CONDUCT OF BUSINESS RULES (COBS)

→ Application
 ↗ designated investment firms
 ↗ insurance firms (not general ins.)
 ↗ appointed representatives → indirectly



CONDUCT OF BUSINESS RULES (COBS) Cont.



Conflicts of Interest (applies to all clients)

PRIN 8 identify + manage Col
SYSC 10 controls + systems in place to manage/disclose Col

Dealing & Managing

BEST execution (all customers)

= best possible result for ↑ considering execution factors (P, cost, speed, ...)

customer category
type of order
type of fin. instrument
execution venues

market order ←
(at best order) ↓ limit order (priced)
if not executed immediately must be made public
unless customer disagrees
very large order

Reporting (to all clients)

Transaction Confirmation
= occasional reports

- in durable medium
- promptly before T+1

except non-MiFID firm:
only if requested by clients

Periodic Statement

= what has happened w/ portfolio during period

- name firm + client's acc.
- portfolio composition
- fees + charges
- performance comparison
- payments received
- corporate actions

Timings

Quarterly or annually if requested
Monthly if derivatives/ leveraged port.

AGGREGATION = add orders together unlikely prejudice cust. permitted if warning it could ↑

Order allocation policy:

- Timely allocation
- Fair allocation (if partial fil)
 - = customers first vs. firm 2nd.
- unless firm has reasonable grounds to allocate proportionately

NOT apply to:

- funds managed indep.
- shares in certain funds (e.g. reg. CIS)
- life policies

delayed interests of customers
material difficulty (e.g. trading halt)
not that exposed to sensitive info.
Notify RC

Investment Research (market-sensitive)

all clients

① At creation

- not inducement
- not promise issuer's favorable coverage
- issuer cannot review drafts

② Publication

Firm cannot deal w/ own acc. in advance until clients have reasonable time to react

MM acting in good faith unless unsolicited client orders

Personal Account Dealings

= FS employees deal w/ own account

- Market abuse
- Confidential info
- Col

front-running = dealing ahead (banned)

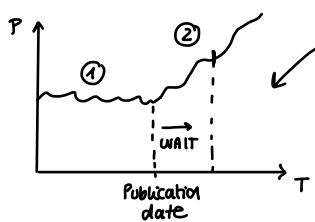
- inform firm
- training on restrictions
- record all transactions

Client order handling

"prompt, fair, expeditious execution"

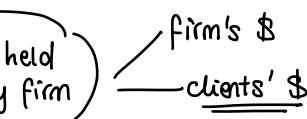
- promptly recorded + exec.
- carried sequentially (FIFO)

delayed interests of customers material difficulty (e.g. trading halt)
not that exposed to sensitive info.
Notify RC



Client Asset Sourcebook (CASS)

provide adequate protection
(all clients)



governs \$ held by an authorized that belongs to a client, held in a client account

1 SEGREGATION OF ASSETS



held in an approved bank:
designated account

- Central Bank
- BCD credit institution
- Bank authorized by 3rd country
- Money market fund

OBJ.

Provide adequate protection to client money + assets vs. firm using if for own purposes

CASS 6
Custody rules

MiFID +
non-MiFID

CASS 7
Client money rules

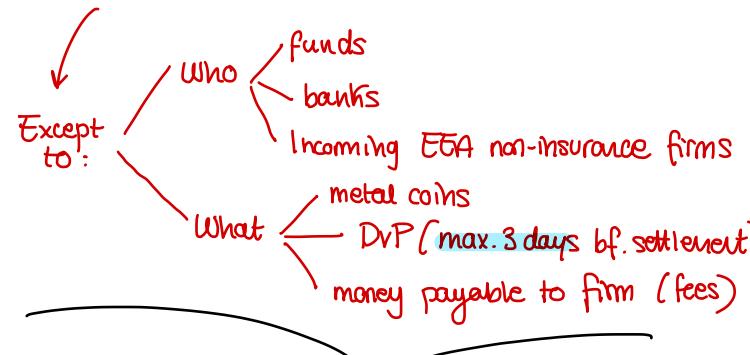
MiFID only
non-MiFID can opt-in

Custody Investments
Designated Investments

Other invest.
(e.g. gold...)

2 RECONCILIATIONS

- reconcile records as often as necessary (within 10 b. days)
- if shortfalls / discrepancies, correct ASAP (some day)
- if unable to reconcile, write to FCA



3 RECORD KEEPING

General rule (from dispatch)
can be kept offsite as long as "readily accessible"

MiFID

5 years

Non-MiFID

3 years

Exceptions

non-MiFID

"Pensions +
life assurance

5 years

Recordings of
phone communicat.

5 years

FSA/VCs
(occupational
pensions)
Indefinitely

Enhancing CASS regime

CASS Audit

annually + submitted
to FCA within 4 months

Right of use

agreement if can
be used by firm
= Title Transfer
Collateral Ag. (TTCA)

CASS Resolution Pack

= docs required by
liquidator in case
of default

CASS MANDATE

"any means that give firm the ability to control client's assets/liab."

CASS 6 + CASS 7 do not apply

CRIMINAL OFFENSES

(only to indiv.)

Insider Dealing

S52 Criminal Justice Act 1993

3 offenses

- Dealing on...
- Encouraging others to deal...
- disclosure of...

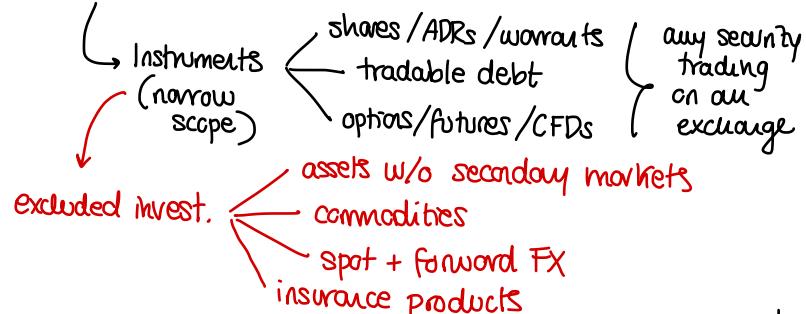
Inside Info:

- specific
- not public
- price-sensitive

BOTH NEED TO SHOW INTENT

beyond all reasonable doubt (↑ burden of proof)

MAX. PENALTY: 10 years and/or unlimited fine



DEFENSES = not considered inside dealing

General defenses
(anyone can use)

- 4
- not intended for profit
 - believed public info
 - acted some way regardless of info.
 - not expect recipient to deal

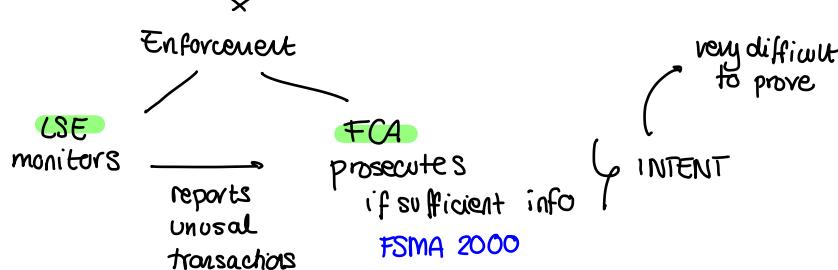
Special defenses
(only certain indiv.)

- 3
- Price stabilization
- Market info
- MMs acting in good faith

Reasonably believed
the act was not
false/misleading

Acted in conformity w/

- price stabilization
- control of info rules
(e.g. Chinese Walls)
- share buy-backs



Misleading statements & impressions

S89-91 FSA 2012

= form of market manipulation
2 methods:

Lying

Misleading statements (S89)

= lying to persuade
someone to deal

Misleading statements in relation to benchmarks (S91)

not lying
Misleading impressions (S90)
(e.g. abusive squeezes,
market rigging...)

DEFENSES

amplifies
COBS "fair, clear, not
misleading"

MARKET ABUSE

= CIVIL OFFENSE

(firms + indiv.)

if breach:

unlimited fine
(no jail)

Offenses:

UK MAR & FCA Sourcebook

takes 2 criminal offenses and
re-packages them as a civil offense

prove Effect only
(balance of probability)

lighter burden
of proof

↑

Staff must receive Training

Reporting of

all Plcs
(not just FS firms)

A - A person shall not:

- Engage or attempt to engage in insider dealing
 - Includes amending and cancelling orders
- Recommend or induce another person to engage in insider dealing
- Unlawfully disclose inside information

≈ Insider dealing
S52 CJA 1995

B - A person shall not engage in or attempt to engage in market manipulation

≈ Misleading stat. & imp.
S89-91 FSA 2012

Scope of MAR (+ broad)

Financial instruments trading on:

- regulated market
- MTF
- OTF
- OTC

Emissions allowance

Commodity spot markets

Commodity derivatives

What Yes

Market Abuse
FCA Market Conduct Handbook Guidance

What NOT

legitimate behavior
= defenses = safe harbour

A - Insider dealing
- Improper disclosure
- Manipulating transactions e.g. wash trade
- Manipulating devices e.g. pump & dump
- Dissemination e.g. leaking info.
- Benchmark manipulation

B - share buy-back
- FCA rules Δ
- Takeover Code
- Market Sounding
↳ requires disclosures
↳ NDAs
↳ record keeping

firm only
SANCTIONS

withdrawal
regulated status

unlimited fines

Public Statements

Injunctions or/and
restitution

NOT disclosure if
 $< 5,000 \text{ €/year}$

Disclose to:
 $\begin{cases} 1 \text{ Firm} \\ 2 \text{ FCA} \end{cases}$
within 3 b. days
BUT cannot deal
closed periods =
30 days prior publication
of FFSS

OBJ: protect
directors from
appearance of
insider dealing

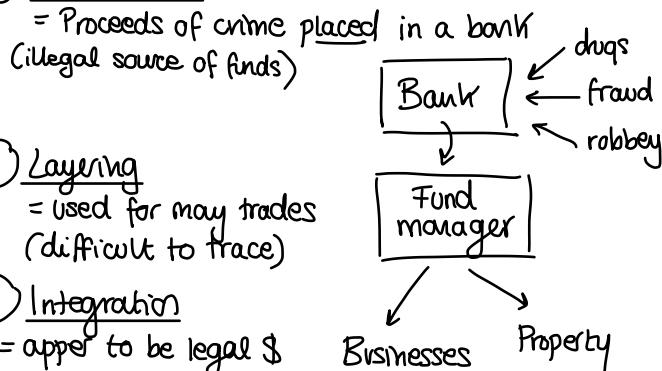
MONEY LAUNDERING (any firm)

approved by HMT

Proceeds of Crime Act (POCA) 2002

(sets out offenses & penalties)

① Placement



② Layering

= used for many trades
(difficult to trace)

③ Integration

= appear to be legal \$

Offenses: (even if not committed)

General (anybody)

14 years
and/or
unlimited
fine

5 years
+ unl. fine

④ SUSPICION must be reported

- A reluctance of a new client to provide identification documents
- An unnecessary use of a third party to act as an intermediary
- Continual patterns of unusual trading
- A request for non-market price transactions
- The constant use and transfer of bearer securities
- An introduction from a suspicious party or jurisdiction

= NO offense is NO defense

Money Laundering Regulations (MLR 2017)

(Sets out admin. procedures
for any firm at risk of ML)

Controls:

- Risk assessment
- Policies + controls
 - ↳ appoint MLRO officer
- Reliance if MiFID bus.
 - ↳ conduct high-risk country DD if non-MiFID

Training

- law on AML + CFT
- recognize suspicious
- proper ways to report
- = employee ↳ MLRO ↳ NCA
- = nominated officer
≠ compliance officer

Customer DD (CDD)

Keep records
for 5 years

- 1) Customer ID + proof of address + ownership (firms only)
- 2) Source of funds (not if < 7,500 €)

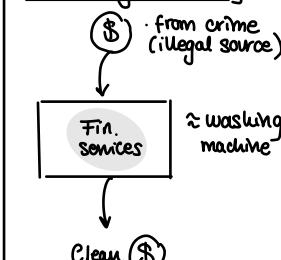
Enhanced DD (high-risk cust.)

high-risk factors
PEPs + close links

Simplified DD (low risk cust.)

e.g. most authorized firms
NOT pooled accounts

vs. Money Laundering



Joint Money Laundering Steering Group Guidance (JMLSG)

= industry best practices
on how to implement MLR

- guidance
- Identify cust. before acceptance
 - KYC ongoing basis
 - Adequate training on staff
 - Prompt reporting

⑤ Risk mitigation approach

(led by BoD / SMF)

- Summary assessment
- Responsible to specific persons
- Firm's procedures
- Firm's monitoring

FINANCIAL TERRORISM

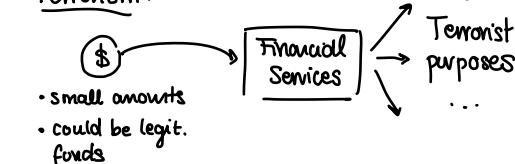
(Terrorism Act 2000 & Anti-Terrorism Crime 2001)

- Report suspicion
- provision of funds for terrorism
 - use/possession terrorist funds
 - laundering \$ that's terrorist property
- ↳ if breach: 5 years and/or 50 fine

Counter Terrorism Act 2008

- = extra powers to HMT to give directions of:
 - Customer DD + monitoring
 - Systematic reporting (directly to HMT)
 - Limiting / ceasing business
 - ↳ when FATF requires threat to national interests

Terrorism:



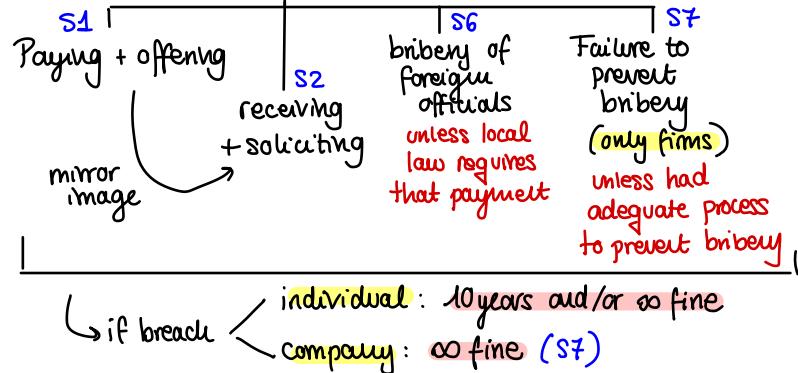
OTHER LEGISLATION

(all firms + indiv.)

Bribery Act 2010

= major anti-corruption reg. (worldwide scope)

↓
4 offenses
NOT bribes:
- legal fees
- hospitality
- fast-track services



Data Protection Act (DPA 2018)

= protection of any data that can be used to identify a data subject = living indiv.

Disclosure rules of notifiable interest ^{own}
+ connected parties

UK disclosure (within 2 b. days)
EU
5%, 10%, 15%,
20%, 25%, 30%,
50% & 75%

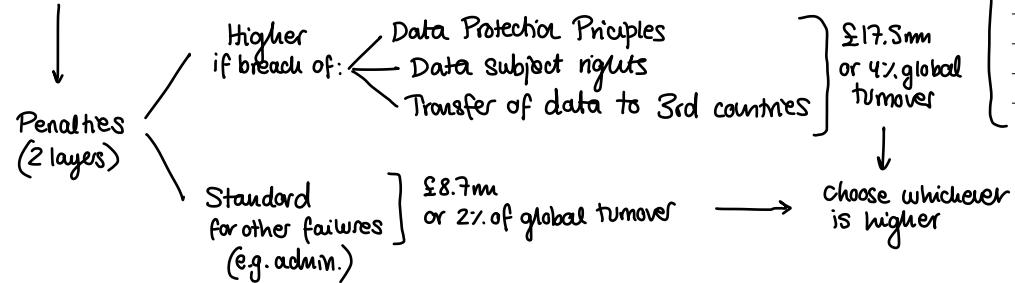
>3% + change ↑/↓ next % p.
fund manag. 5%, 10%, every % p.
Except MMs exempt <10%
except custodians of not beneficial owners
collateral

Companies Act 2006 S793 letter
requires disclosure of shares at present time
to the firm vs. LSE when acquisition last 3 years

PRINCIPLES:

- Processing must be lawful and fair
- Purposes of processing must be specified, explicit and legitimate
- Personal data must be adequate, relevant and not excessive
- Personal data must be accurate and kept up to date
- Personal data must be kept for no longer than is necessary
- Personal data must be processed in a secure manner

enforced by the **Information Commissioners Office (ICO)**



(all firms)

Data & Transparency rules

Reporting Transactions

	Trade report	Transaction report
Why?	MiFID post-trade transparency	Market surveillance = <u>regulatory purposes</u>
Who?	① Senior/Selling firm ② if not	Both counterparties
When?	Automatic Within 3 mins	By T+1
To whom?	To exchange order book	To the regulator via approved reporting mechanisms E.g. UnaVista and TRAX

⊕ Other reportable transactions:

- European Markets Infrastructure Regulation (EMIR) (EMIR)
 - EMIR is regulation of OTC derivatives to encourage greater transparency and better, more effective risk management
 - Reporting obligations
 - All derivative contracts must be reported to a trade repository, e.g.
 - Applies to both financial and non-financial counterparties
- Short Selling Regulations (SSR) (SSR)
 - Requirement to disclose net short positions
 - Could be private or public disclosure depending on the size
- Securities Financing Transaction Regulation (SFTR)
 - Securities financing transactions must be reported to a trade repository
 - Specific disclosure for rehypothecated assets
 - Financial counterparties only in the UK

when collateral is used ↗

PRIN 4

Prudential Standards

Capital Requirements Directive (CRD)

- Basel Framework
1. Min. Capital requirements
 2. Supervisory review
 3. Disclosure of risks

↓ if failure: notify immediately

Capital resources > Capital Adequacy requirement
NOT = set by FCA / PRA

COMPLAINTS & REDRESS

(all authorized firms)

can use FOS

can make a complaint

① Eligible complainants

≈ small retail clients

- A consumer = natural person + RC
- Businesses with fewer than ten employees and a turnover of less than €2m (a 'micro-enterprise')
- Charities with annual income of less than £6.5m
- Trusts with net assets of less than £5m
- Certain SMEs with an annual turnover of less than £6.5m and a balance sheet threshold of £5m, or fewer than 50 employees

② Complaints Procedures

≈ firm's policy

- in writing
- disclose when (to the client)
 1st point of contact
- on request
- complaint received
- unless resolved in 3 b. days
- both written + orally
- receiving complaints
- responding to "
- investigating ", → someone w/ sufficient power
- Notifying ", to the FOS
- indep.

Keep records for:

MiFID + UCITS
5 years

Others
3 years

③ Stages & timings

- written acknowledgement promptly
- final written response within 8 weeks
 - if unresolved // not ↗ w/response:
 - explain why + when to be resolved
 - inform they can approach FOS within 6 months



Transparency: FCA uses data to embarrass poorly-performing firms

(only when +500 complaints in 6 months)

- publish:
 - Total all complaints
 - # complaints closed in 8 weeks
 - % complaints upheld

FINANCIAL SERVICES COMPENSATION SCHEME (FSCS)

(accountable to FCA + PRA)

+ funding from authorized firms

= all members

= mutual protection system

↓ OBT,

Allows clients to claim losses when a firm goes into liquidation

Claims under the FSCS

Small ≈ Eligible claimants only
RC

Deposits
Maximum claim
£85,000 per indiv.
per bank

Investments
Maximum claim
£85,000

Home finance
Maximum claim
£85,000

Maximum payout for the scheme
Unlimited

All clients

Compulsory insurance
100% of claim
General insurance
90% of claim

authorized firms cannot claim!
or govt.

eligible counterparties can never claim unless they're small business

insurance only

brought to FSCS
within a set time
(usually 6 years)

authorized firms
subject to FOS jurisdiction