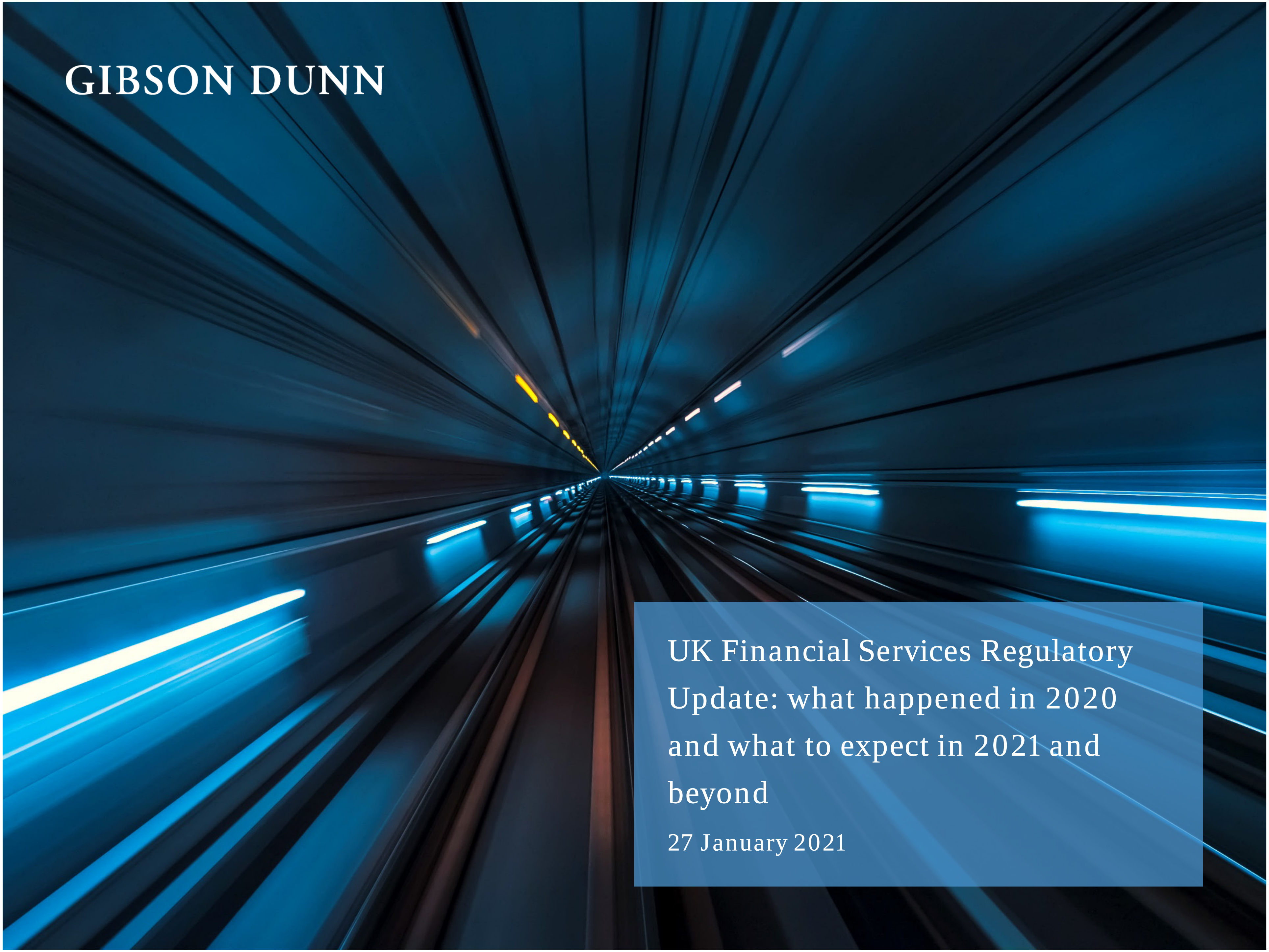

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UK Financial Services Regulatory Update: what happened in 2020 and what to expect in 2021 and beyond

27 January 2021

Webinar - Panelists

Michelle Kirschner
Partner
Financial Institutions
mkirschner@gibsondunn.com

Michelle advises a broad range of financial institutions, including investment managers, integrated investment banks, corporate finance boutiques, private fund managers and private wealth managers at the most senior level.

Matthew Nunan
Partner
Dispute Resolution
mnunan@gibsondunn.com

Matthew specialises in financial services regulation and enforcement, investigations and white collar defense having previously been the Head of Conduct Risk for EMEA at a major global bank. Prior to that he was Head of Wholesale Enforcement at the UK Financial Conduct Authority and has also been a case controller at the UK Serious Fraud Office.

Martin Coombes
Associate
Financial Institutions
mcoombes@gibsondunn.com

Martin specialises in advising on UK and EU financial services regulation, including a wide range of financial services and compliance issues including advice on UK and EU regulatory developments, the regulatory aspects of corporate transactions and the on-going compliance obligations of financial services firms.

Steve Melrose
Associate
Dispute Resolution
smelrose@gibsondunn.com

Steve is a member of the Dispute Resolution and White Collar Defense and Investigations groups. His practice focuses on domestic and cross-border corporate investigations, regulatory investigations and white-collar criminal matters.

Agenda

1	2	3	4
Governance, culture and individual accountability	Conduct and enforcement	Operational and financial resilience	Post-Brexit UK regulatory outlook

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Governance, culture and individual accountability

Governance and Culture

Not a new initiative – referenced in last 3 years' business plans:

2018/19: ***Firms' culture and governance should drive behaviours and produce outcomes that are likely to benefit consumers and markets***. *We will continue to support and engage with firms, sharing our expectations and working to promote effective cultures and governance across the industry*

2019/20 ***Good governance, which enables effective oversight of decision-making, is critical for reducing potential harm to consumers or markets.*** *Culture also plays a critical role.* ***A healthy culture, focused on delivering consumer outcomes, helps individuals in firms to make the right judgements that do not result in consumer or market harm***. *Conversely, weak governance or poor culture increase the likelihood that harm will occur*

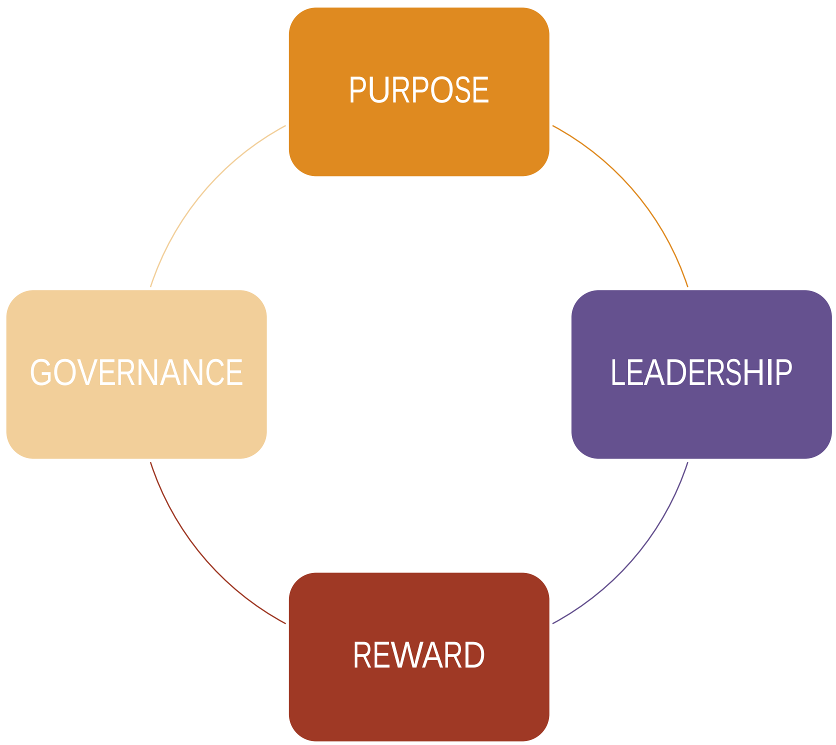
2020/21 ***Firms' culture shapes the outcomes for consumers and markets***, *which is why our aim is to assess and address the drivers of culture. This includes looking at firms' leadership, purpose, governance and approach to managing and rewarding their employees.*

We expect all solo-regulated firms to comply with the requirements of the SM&CR as they fall due. The regime aims to see firms across financial services foster ***healthy cultures*** *where conduct and fair customer outcomes are at the forefront of their business. We will continue to focus on the* ***4 key culture drivers*** *in firms –* ***purpose***, ***leadership***, ***approach to rewarding and managing people, and governance*** *– and their effectiveness in reducing the potential harm from firms' business models and strategies*

Approach to culture is very clearly linked to outcome focussed approach, reflecting principles based approach (vs rules based approach elsewhere)

Key Drivers of Culture

*" … **4 key culture drivers** in firms – **purpose**, **leadership**, **approach to rewarding and managing people, and governance** – and their effectiveness in reducing the potential harm from firms' business models and strategies"*



Governance

•What is the process for setting strategy?

•Is strategy intended to deliver good outcomes for clients and markets?

•What risks are involved in the strategy and its execution?

•How is risk monitored and who is responsible for it?

•How are staff encouraged to deliver objectives and within risk appetite?

•Who is responsible for ensuring everything works?

•Are there strategies in place to manage identified risks?

•Who is responsible for ensuring they are delivered?

Document: audit trail showing thoughtful process will be key if anything goes wrong

Individual Accountability: Sword and Shield

Sword: Express purpose is to make it easier to hold individuals to account for firm failings

- Ø Ability to identify who was at fault or who should have prevented harm is a key tool in regulatory enforcement
- Ø Makes it very dangerous to say:
    - *I didn't know*
    - *Out of my control*

Shield: Clarity around responsibility is essential for good governance,

- Ø Clear lines of responsibility lead to better decision making and less falls through the cracks
- Ø Personal liability empowers individuals in discussions about resources, authority, oversight etc.

Good governance structures should protect individuals:

- Ø Clarity around how decisions are made and who is authorised to make them
- Ø Thoughtful processes – well designed and executed
- Ø Documented risk identification and management

Documentation is key – ability to evidence governance, delegation and oversight when things go wrong is vital

What is new? Not much…
You are probably doing most of what you need to

There is an added administrative burden around process and records <u>but</u>

- Ø Can be scaled to each firm
- Ø Smart steps can lighten the burden
- Ø Steps only have to be reasonable

Collective decision making is not banned

- Ø Collective / committee consideration and decision making could be a reasonable step: applying collective expertise is almost certainly appropriate

Removes some of the wriggle-room around decision making in areas like reward and tackling misconduct <u>but</u>

- Ø Often difficult to justify inconsistency in any event
- Ø If there is a good reason to treat issues or people on a case-by-case basis, then that is still permissible

Senior managers need to be conscious of the aggregation of minor issues in their areas

- Ø They may be held responsible and deemed to be failing even if they are not personally involved
- Ø Multiple issues may lead to FCA asking the firm '*How are you confident the SM is conducting him/herself appropriately?*'

Practical Suggestions

Think about your firm's business model	• What are the risks of poor outcomes for clients or markets? • Where do they arise and how are they controlled?
Think about performance	• What is taken into account when determining good or bad performance? • Do you consider good outcomes for clients and markets or only profitability?
Think about reward	• What behaviours do your reward structures reinforce? • Do you reward good conduct/risk management or only profitability?
Think about responsibilities in the firm	• Are there gaps - remote booked business, whistleblowing, complaints? • Could anyone claim they were not aware of their responsibilities?
Think about evidence and feedback	• Do you document important decisions (Reward, strategy, risk) and processes? • How do you know the system is working as it should?

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Conduct and enforcement

Conduct and enforcement:
The FCA's approach to enforcement

- The FCA's approach to enforcement has not changed.
- But it has reiterated that it will take enforcement action where warranted, and we expect to see a significant amount of enforcement activity involving systems and controls weaknesses and conduct arising from the pandemic.
- In it's 2020/2021 Business Plan the FCA reiterated that:

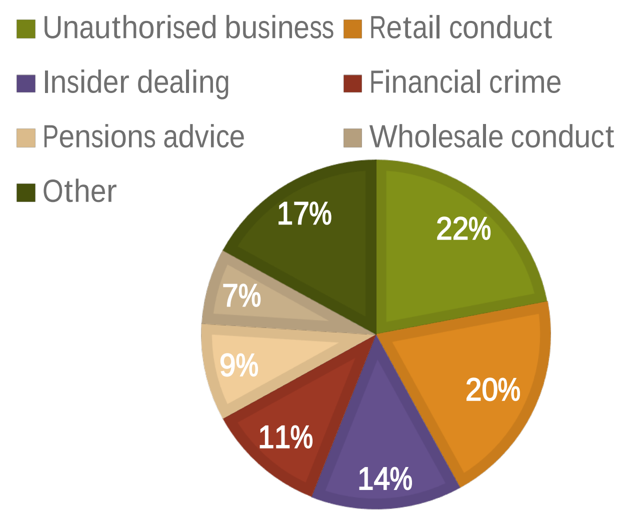
"We will remain vigilant to potential misconduct. There may be some who see these times [i.e. the pandemic] *as an opportunity for poor behaviour – including market abuse, capitalising on investors' concerns or reneging on commitments to consumers. Where we find poor practice, we will clamp down with all relevant force. We are working with a range of partners, including other regulators, law enforcement agencies and firms and consumer groups, to raise awareness of the increased risk of scams in the current uncertain context and help consumers protect themselves."*

"***<u>We will not compromise on our expectations of firms</u>***, *particularly that they make consumers' interests the foundation of their business models and behave accordingly."*
- 2020/2021 Business Plan

Conduct and enforcement:
2020 Enforcement key statistics

- FCA Annual Report 2019/2020 Enforcement data shows us that:
  - The average length of regulatory and civil cases resolved by agreement has increased from 32.3 months in 2017/2018 to 37.4 months, and the cost of such cases has increased from c. £290,000 in 2017/2018 to c. £341,000.
  - The FCA opened fewer new cases than in 2017/2018 and 2018/2019 but closed a similar number of cases as in prior years.
  - There were 176 variation/cancellation of permissions or withdrawal of approvals published. This represents 81.1% of the total outcomes for the year (217). In addition, there were 9 criminal outcomes (4.2%), 15 fines (6.9%), 4 civil outcomes (1.8%), 1 public censure (0.5%) and 12 prohibitions (5.5%).
- The FCA announced no money laundering or market abuse criminal charges in 2020.
- The FCA issued three prohibition orders, following convictions for the following serious (non-financial) criminal conduct, that took place when the individuals were approved persons.

Open cases as at 31 march 2020



Conduct and enforcement:
2020 Enforcement key statistics

- 10 fines issued to firms:
  - 7 involved a breach of the Principles for Businesses
  - 2 involved a breach of the Consumer Credit (CONC) Rules
  - 1 involved a breach of the Financial Promotions, Customer Communications Rules (CAPR)
  - 1 involved a breach of the Client Money and Assets (CASS) Rules
  - 1 involved a breach of the Short Selling Regulation [first fine]
- Only 1 fine issued to an individual:
  - Breaches of the Fit and Proper and Market Abuse Rules.
  - The FCA also sought to impose a financial penalty in relation to misleading market announcements, although his financial circumstances resulted in censure only.

Total fines - firms and individuals (£ mil)					
2015	2016	2017	2018	2019	2020
905	35	229	60	392	193

Conduct and enforcement:
Key case: Commerzbank AG £37,805,400

- FCA fine for Commerzbank AG for breach of Principle 3, for inadequate money laundering controls.
- The FCA determined that Commerzbank London's failings were "particularly serious" because they occurred following visits by the FCA to Commerzbank London in 2012, 2015 and 2017 regarding the risks underlying the fine.
- The FCA identified the following concerns:
  - A failure to conduct periodic reviews on clients to assess new and emerging risks.
  - A failure to address long-standing weaknesses in its automated money laundering risk tool.
  - A failure to implement adequate policies and procedures to address money laundering risks.
- Mitigating factors that reduced the level of the fine:
  - A "significant" remediation exercise to bring its money laundering controls in line with regulatory expectations.
  - An "extensive" look-back exercise to identify suspicious transactions.
  - A "wide-ranging" business restriction, including a temporary stop on high-risk customers.

Conduct and enforcement:
Key case: TFS-ICAP £3.44 million

- FCA fine for TFS-ICAP for breaches of Principles 2, 3 and 5.
- Key themes from this case:
  - Risk identification should drive control design
    - Firms must consider the <u>specific risks</u> within their business, relevant to their market.
    - The obligation to assess risk lies not only with Risk and Compliance Departments but also with the business.
  - Governance structures and documentation of key decisions are crucial parts of reasonable oversight processes
    - Governance and oversight must be about more than just delivering financial performance and results. Structures and processes are required to ensure risk is properly managed, conduct is appropriate, delegation and oversight mechanisms work and culture meets expectations.
    - Any governance structure which cannot produce evidence of its consideration of risk will struggle in the face of the regulatory scrutiny that follows any kind of incident.
  - Conduct Risk management and robust internal reviews are key in meeting SMCR responsibilities
    - Firms and Senior Managers must implement procedures to address allegations of misconduct. A failure to have a process to manage conduct risk has been deemed to be a breach of Principle 3, and therefore could in post-SMCR terms be a breach of a Senior Managers Conduct Rule.

Conduct and enforcement:
Key case: Goldman Sachs International £96.6 million

- FCA and PRA fine for **Goldman Sachs International** in connection with 1MDB transactions (part of a US$2.9 billion globally coordinated resolution reached with Goldman Sachs Group Inc. and its subsidiaries).
- Breaches of Principles 2 and 3 and SYSC rules.
- Key messages for anyone in Legal and Compliance:
  - Importance of escalating information regarding financial crime risks to appropriate personnel, and doing so in a timely manner.
  - Importance of presentating information about possible risks in a manner that enables decision makers to appreciate the risk and make informed decisions.
  - Importance of properly documenting decisions, and the reasons for them.

> Firms have a crucial role to play in tackling financial crime, and in helping to maintain the integrity of the financial system. GSI's failure to take appropriate action in this case shows that it did not take this responsibility seriously. **When confronted with allegations of bribery and staff misconduct, the firm's mishandling allowed severe misconduct to go unaddressed**. There is **no amnesty** for firms that tackle financial crime poorly, and the size of GSI's fine reflects that.
> - Mark Steward, Oct. 2020

Conduct and enforcement:
Key case: Asia Research and Capital Management £873,118

- First FCA fine for breach of the Short Selling Regulation.
- ARCM is a Hong Kong-based asset manager that trades infrequently in EU markets. From February 2017 to July 2019, ARCM failed to make 155 notifications to the FCA and 153 disclosures to the public of its net short position in a UK listed company. By July 2019, ARCM had built a net short position equivalent to 16.85% of the issued share capital of the UK listed company. This position was held for a further 106 trading days before being notified to the FCA and disclosed to the public.
- The FCA considered the failings to be particularly serious given:
  - the failures to comply were multiple and occurred over a long period of time;
  - ARCM did not inform it promptly on discovering its failure and instead notified it only after it had reviewed and collated the relevant data for disclosure; and
  - the size of the position was the largest net short position held in an issuer admitted to the FCA's Official List with shares admitted to trading on the Main Market of the London Stock Exchange.
- All firms trading in the UK and EU markets should maintain systems and controls to ensure ongoing compliance with the SSR.

Conduct and enforcement: 2021 and Beyond

- We expect to see an increase in enforcement outcomes in 2021.
- Enforcement risk arising from conduct during the pandemic will begin to materialise.
- "The pandemic" will not be accepted by the FCA as a justification for misconduct or relaxed standards.
- Ongoing enhancements and additions to the FCA's market surveillance capabilities will also lead to greater identification of misconduct and enquiries from the regulator.
- Known risks arising from the pandemic and related announcements signpost areas of regulatory focus / enforcement: **scams, unauthorised business, fair treatment of customers, mis-selling, and financial crime risk**.

Financial crime systems and controls during coronavirus situation

First published: 06/05/2020 | Last updated: 08/01/2021

Discover our expectations on how firms should apply their systems and controls to combat and prevent financial crime during this crisis.

Conduct and enforcement: 2021 and beyond

2021 areas of enforcement focus

- **Individual conduct, including non-financial misconduct**
  - Ø Firms needs to look at conduct, inside and outside the regulatory perimeter and inside and outside the office.
  - Ø Managers need to focus on governance and embedding a culture driven by appropriate standards.
- **Firm conduct**
  - Ø Sound systems and controls, including changes re working from home.
  - Ø A focus on forbearance and good outcomes for clients. The Principles for Businesses must drive all decision-making.
  - Ø Whistleblowing, escalation and investigation procedures and practice.
  - Ø Information handling.
- **Financial crime**
  - Ø Money laundering is a key enforcement focus in the FCA's 2020/2021 Business Plan.
  - Ø Market Abuse will remain high on the enforcement agenda.

Conduct and enforcement:
Key practical steps for firms

- Take steps now to address conduct risk:
  - Ø Test monitoring and review capabilities and adapt accordingly. This must include a review of communications monitoring and related policies.
  - Ø Reinforce messages that managers and the business have a key role to play in addressing financial crime risks. Risk management is not the sole responsibility of control functions.
- Take steps now to address financial crime risks:
  - Ø Take a joined-up approach to assessing and addressing financial crime risk.
  - Ø Revise risk assessments in light of risks arising from the pandemic.
- Firms must document any new risks that were identified in 2020 and changes to controls that were made to address them.

  - o Investigate now, before the FCA comes knocking.
  - o Firms should take steps <u>now</u> to get comfortable that changes in business practices arising out of the pandemic did not relate in potential breaches, particularly in areas where the FCA have indicated they will conduct look-back reviews.
  - o If breaches are identified proactively consider remediation and if relevant, redress.

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Questions

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Operational and financial resilience

Operational and financial resilience: Overview

“We expect all firms to have contingency plans to deal with major events and that these plans have been properly tested.”

“…financial pressures could give rise to harm to customers if firms cut corners on governance or their systems and controls – for example, increasing the likelihood of financial crime, poor record keeping, market abuse and unsuitable advice and investment decisions.

Operational and financial resilience: Operational resilience

Regulatory expectations during the pandemic

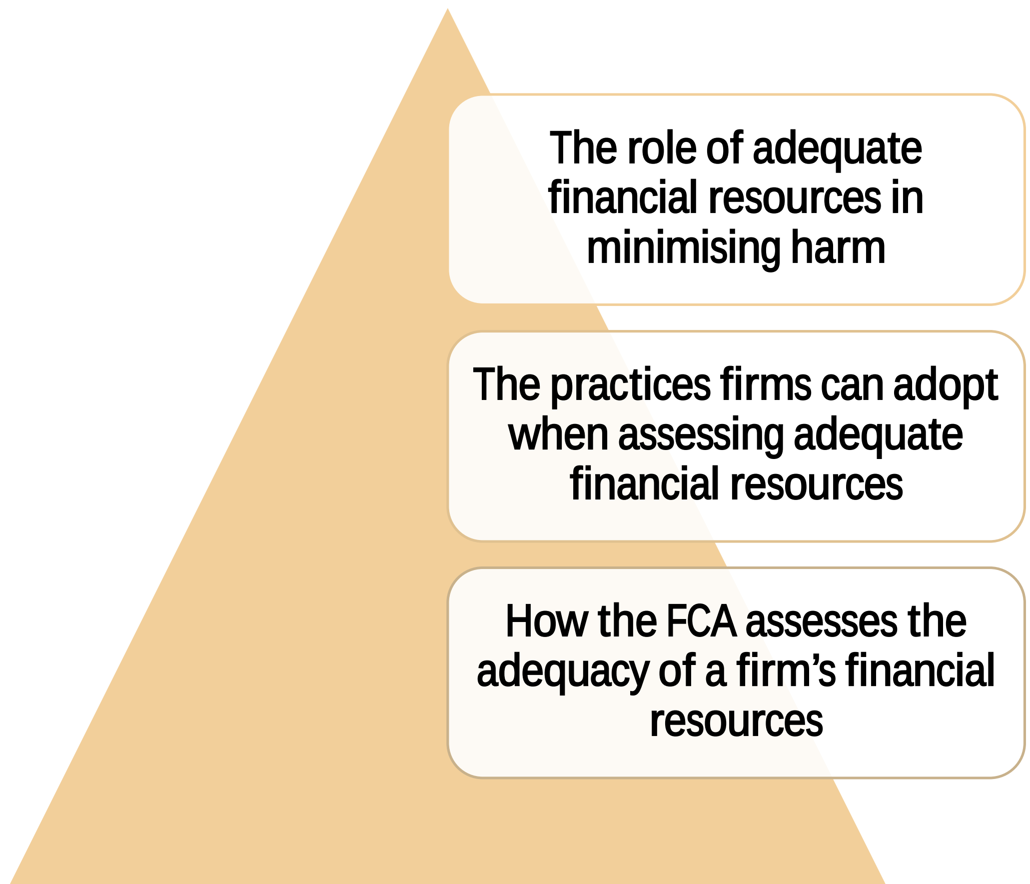
→

Joint Bank of England, PRA and FCA consultation paper – December 2019 (closed October 2020)

Operational and financial resilience: Financial resilience

“Our role isn’t to prevent firms failing. But where they do, we work to ensure this happens in an orderly way. By getting early visibility of potential financial distress in firms we can intervene faster so that risks are managed and consumers are adequately protected.”

Operational and financial resilience:
FCA guidance on assessing financial resources

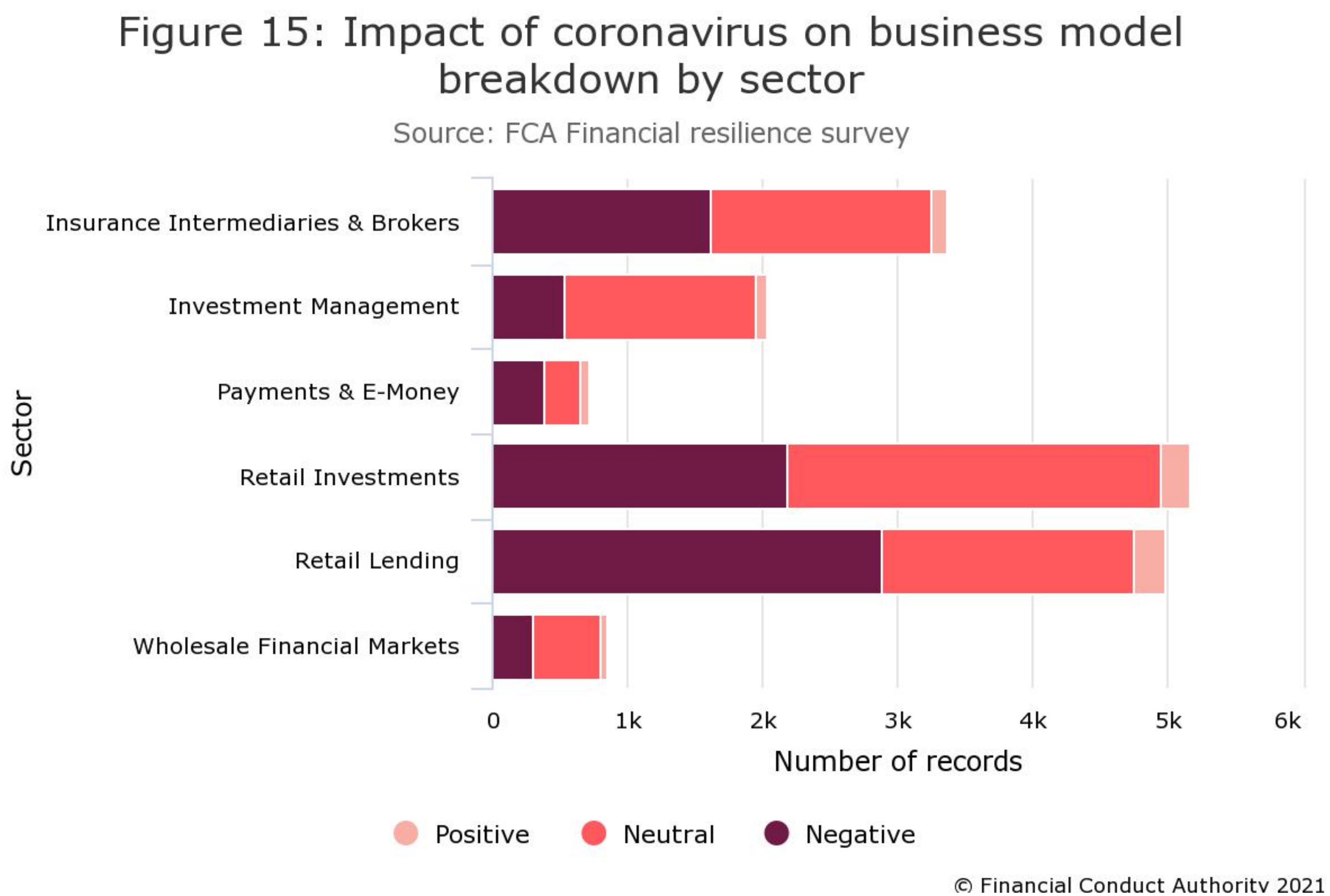


Operational and financial resilience: Monitoring financial resilience

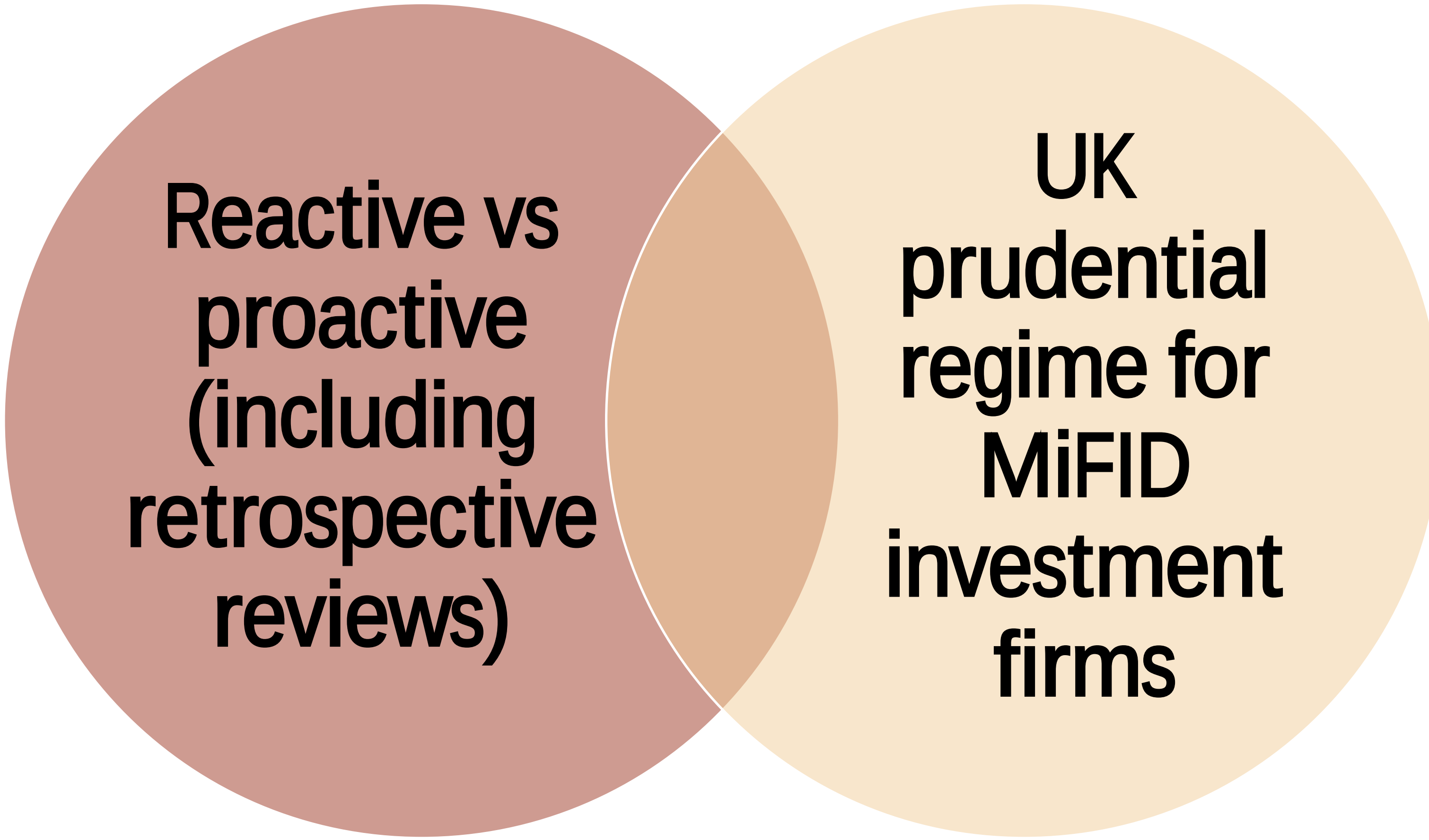
The FCA's four methods of monitoring financial resilience:

- Existing regulatory reported data
- Enhanced data purchased from a third-party provider
- In-depth analysis of liquidity for a number of the most significant firms
- Financial resilience survey

Operational and financial resilience: FCA financial resilience survey



Operational and financial resilience: Forward looking priorities



Operational and financial resilience:
Prudential regime for MiFID investment firms

Categorisation	Own funds requirement (PMR, FOR, K-factors)	Prudential consolidation	Liquidity	Remuneration

Prudential regime for MiFID investment firms: Investment firm vs "SNI"

Measure*	Threshold
Assets under management**	< £1.2 billion
Client orders handled – cash trades**	< £100 million per day
Client orders handled – derivative trades**	< £1 billion per day
Assets safeguarded and administered	Zero
Client money held	Zero
On- and off-balance sheet total**	< £100 million
Total annual gross revenue from investment services and activities**	< £30 million

*Except on-/off-balance sheet total, only relate to MiFID activities

**Assessed on a combined / group basis

Prudential regime for MiFID investment firms: Own funds

Definition of own funds – CET1, AT1, T2

Calculation of own funds

Initial capital requirement - £75k, £150k, £750k

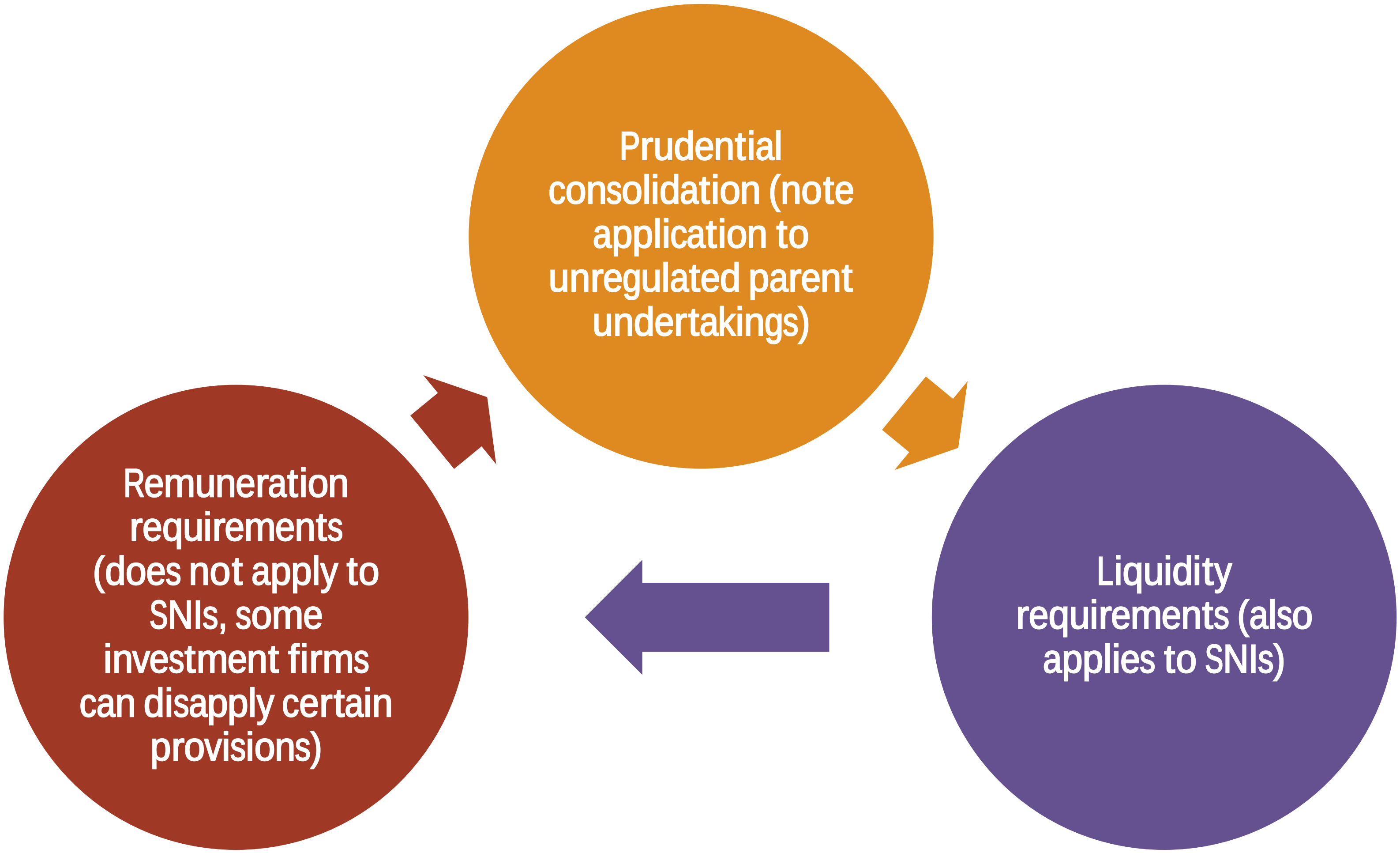
Own funds requirement – higher of: (1) permanent minimum capital requirement; (2) a quarter of fixed overheads; and (3) K-factor requirement

Prudential regime for MiFID investment firms: K-factors

- K-AUM - Assets under management
- K-CMH - Client money held
- K-ASA - Assets safeguarded and administered
- K-COH - Client orders handled
- K-DTF - Daily trading flow*
- K-NPR - Net position risk*
- K-CMG - Clearing margin given*
- K-TCD - Trading counterparty default*
- K-CON - Concentration risk*

*Only relevant to investment firms that can deal on own account or underwrite or place on a firm commitment basis

Prudential regime for MiFID investment firms: Other key provisions



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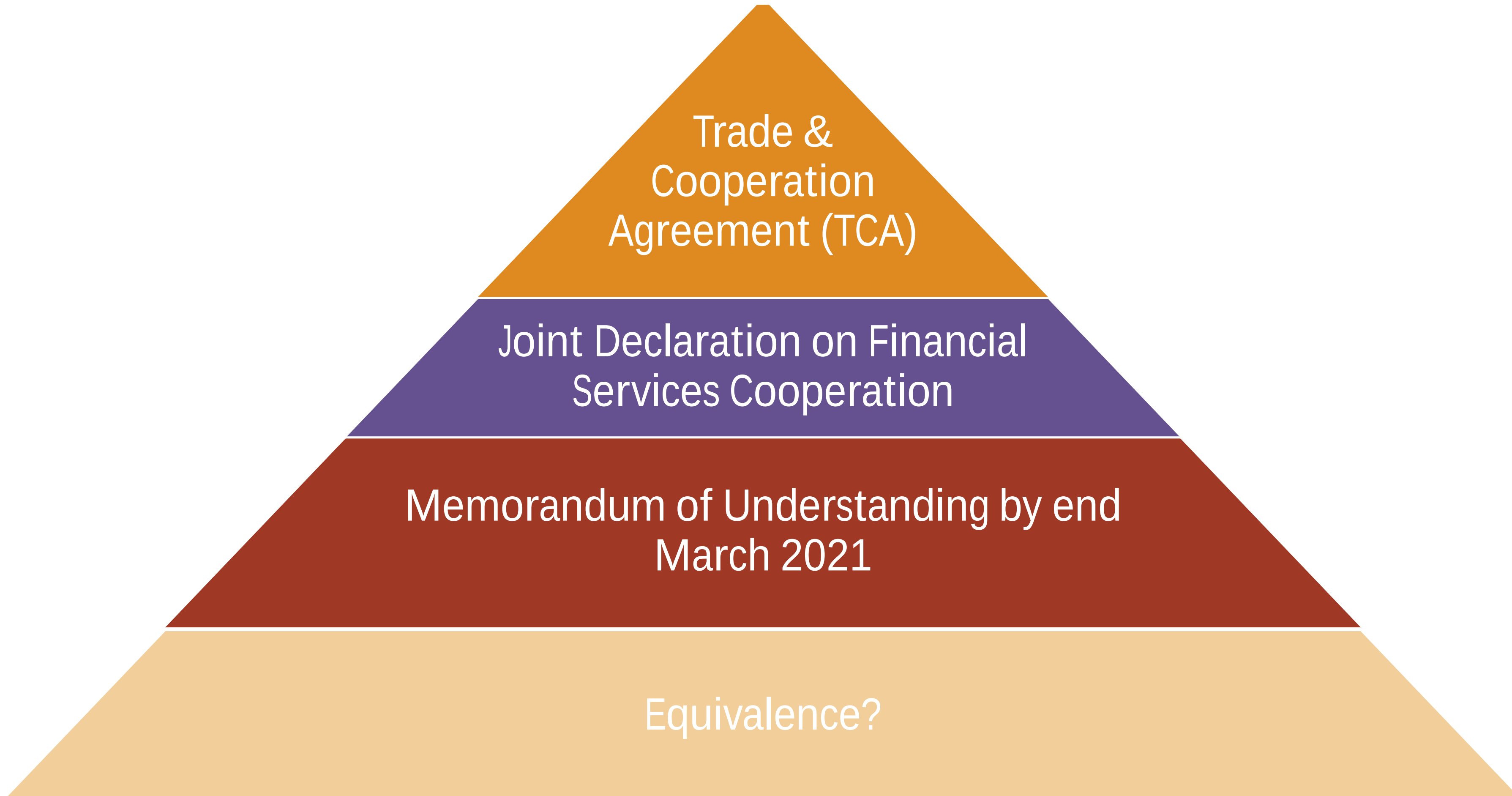
Post-Brexit UK regulatory outlook

Post-Brexit UK regulatory outlook:
EU/UK relationship on financial services (1)



Post-Brexit UK regulatory outlook: EU/UK relationship on financial services (2)

- Passporting
- WTO terms under GATS
- Free trade agreement
- Equivalence

Post-Brexit UK regulatory outlook: EU/UK relationship on financial services (3)

Preferential prudential treatment

- Enables EEA firms to apply the same preferential treatment to certain categories of exposures to entities in equivalent third countries as they apply to exposures to EU Member State entities regulation

Market access

- Firms from equivalent third countries can provide regulated services/activities into the EEA without seeking full authorisation in an EEA jurisdiction

Post-Brexit UK regulatory outlook: Key areas to watch

- EU/UK divergence
- Sustainability
- UK Future Regulatory Framework
- Overseas regime (market access)
- Patient capital
- AIFMD, MAR and MiFID II review
- UK funds regime

Post-Brexit UK regulatory outlook: Sustainability (1)

- UK to make TCFD-aligned disclosures fully mandatory across the economy by 2025
  - Aim: to ensure that the right information on climate-related risks and opportunities is available across the investment chain – from companies, to financial services firms, to end-investors
- What is the Taskforce on Climate-related Financial Disclosures (TCFD)?
  - Set up by the Financial Stability Board in 2015
  - Aim – to develop consistent climate-related financial disclosures to be used by industry participants in order to increase understanding of material risks.
  - Published its Final Report in June 2017 which set out a number of recommended disclosures
- UK one of the first to endorse the TCFD and UK became the first country to make TCFD-aligned disclosure mandatory across the economy (by 2025)

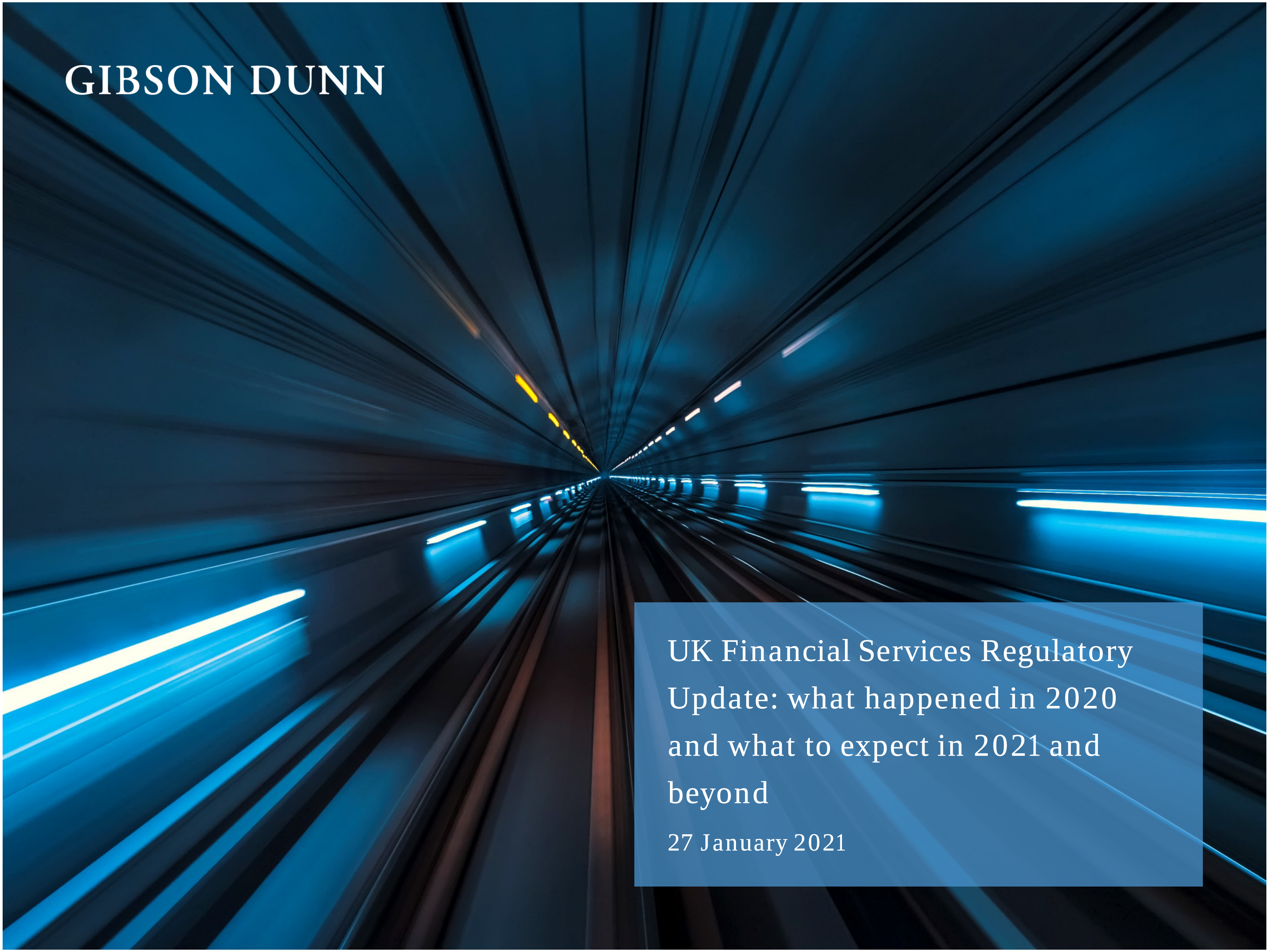
Post-Brexit UK regulatory outlook
Sustainability (2)

11 recommended disclosures across 4 core elements:

Governance	• Disclose the organisation's governance around climate-related risks and opportunities
Strategy	• Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material
Risk management	• Disclose how the organisation identifies, assesses, and manages climate-related risks
Metrics & targets	• Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material

Post-Brexit UK regulatory outlook
Sustainability (3)

- What's next?
  - FCA consultation paper expected H1 2021 – UK-based asset managers, life insurers and pension providers (in force for the largest firms by 2022)
- Interaction with EU Sustainable Finance Disclosure Regulation and Taxonomy Regulation



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