Webinar - Panelists

Michelle Kirschner
Partner, Financial Institutions
mkirschner@gibsondunn.com
TEL: +44 (0)20 7071 4212
FAX: +44 (0)20 7070 9212

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
TEL: +44 (0)20 7071 4201
FAX: +44 (0)20 7070 4244

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
TEL: +44 (0)20 7071 4258
FAX: +44 (0)20 7071 9258

Martin specializes 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 ongoing compliance obligations of financial services firms.

Chris Hickey
Associate, Financial Institutions
chickey@gibsondunn.com
TEL: +44 (0)20 7071 4265
FAX: +44 (0)20 7071 4244

Chris advises on a range of UK and EU financial services regulatory matters. This includes the regulatory elements of corporate transactions, regulatory change management and ongoing compliance requirements to which firms are subject.

Any statements made in this presentation reflect the personal opinion of the author and do not necessarily reflect the views of Gibson, Dunn & Crutcher LLP. This material has been prepared for general informational purposes only and is not intended as legal advice.
## Agenda

<table>
<thead>
<tr>
<th></th>
<th>Agenda Item</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Criminal enforcement activity</td>
</tr>
<tr>
<td>2</td>
<td>Board governance – lessons from Aviva</td>
</tr>
<tr>
<td>3</td>
<td>New Prudential Regime for Investment Firms – CP21/7</td>
</tr>
<tr>
<td>4</td>
<td>Operational resilience</td>
</tr>
<tr>
<td>5</td>
<td>Crystal ball gazing</td>
</tr>
</tbody>
</table>
Criminal enforcement activity
FCA criminal enforcement: powers

Criminal enforcement powers

<table>
<thead>
<tr>
<th>General prohibition</th>
<th>Insider Dealing</th>
<th>Market Abuse</th>
<th>Money Laundering Regs</th>
<th>FSMA Other</th>
</tr>
</thead>
</table>

- FCA has powers under ss 401 and 402 of FSMA to prosecute a range of criminal offences
- *The FCA may also prosecute criminal offences where to do so would be consistent with meeting any of its statutory objectives* (Enforcement Guide Chapter 12)
- FCA can conduct “dual track” – criminal and regulatory – investigations
- FCA do not have the power of arrest, but will request the assistance of police
- FCA will invite criminal suspects to interview: conducted under caution, subject to PACE safeguards
- FCA can charge suspects (see e.g. cases earlier), issue a formal caution, but cannot offer a Deferred Prosecution Agreement
FCA’s use of criminal and regulatory options

Market Abuse
- Fine and prohibition against Mr. Adrian Geoffrey Horn, for market abuse
- Criminal proceedings commenced against Mohammed Zina and Suhail Zina in relation to insider dealing and fraud by false representation

Acting without approval
- Fine and prohibition against Simon Varley for knowingly performing a controlled function without approval and for providing investment advice to retail customers when he knew he was not qualified or approved to do so
- Criminal proceedings commenced against Larry Barreto and Tassib Hussain for fraud and unauthorised business relating to advice provided and arrangements made regarding a series of regulated mortgage contracts
FCA’s use of criminal and regulatory options

AML systems and controls
- Fine of £37.8 million imposed on Commerzbank AG’s London branch for failure to have effective policies and procedures in place to identify, assess, monitor and manage money laundering risks – June 2020
- Criminal proceedings brought against NatWest under regulation 45 of MLR 2007 for failure to maintain adequate and effective anti-money laundering systems and control

False and Misleading Statements
- Regulatory proceedings against 3 former directors of Carillion alleging market abuse in relation to false statements and failures to take reasonable steps to ensure announcements were not misleading.
- Criminal charges against 3 former directors of Redcentric alleging offences under the Companies Act, Theft Act and Fraud Act connected to allegations of false and misleading statements about the company’s finances
Factors determining FCA’s approach

Factors about the Offence

- Seriousness of the misconduct
- Impact on victims or the markets
- Scale of profit or loss
- Involving dishonesty or abuse of position or trust

Factors about the Offender

- Previous disciplinary history
- Likelihood of future misconduct
- Post-incident conduct – redress paid, systems improved etc.
- Cooperation
Assisting the FCA in making their decision

1. Balance the need to remediate with recognition that admissions of misconduct can raise issues later

2. Be aware that matters are likely to dual-track for some time

3. Consider which features differentiate your firm / your directors / your senior managers from those where FCA is likely to think criminal proceedings are appropriate

4. Consider at an early stage the impact that a criminal investigation could have on your firm / directors / senior managers (disclosure obligations, reputational, licensing)

5. Engage – post-incident behaviour and cooperation make a real difference and the dialogue can give you insight as to FCA’s current thinking and future intentions
Board governance – lessons from Aviva
FCA issued final notice against Aviva plc on 26 October 2020

Related to March 2018 announcement of preliminary year-end results, describing Aviva’s ability to cancel certain preference shares

FCA publicly censured Aviva for making announcement that had potential to mislead the market
FCA Final Notice (Aviva Plc): Lessons learned

- Make sure board asks the right questions
- Limitations of external advisers
- Certainty around decision-making and structure around follow-up steps
- Ensuring minutes accurately reflect discussions
- Oversight of content of certain management presentations
New Prudential Regime for Investment Firms – CP21/7
New Prudential Regime for Investment Firms

Overview

- Aims to streamline and simplify the prudential requirements for solo-regulated investment firms in the UK
- Refocus prudential requirements away from the risks that the firm faces to also consider and look to mitigate the potential for harm the firm can pose to consumers and markets
- Represents a major change for UK investment firms
### New Prudential Regime for Investment Firms

Consultation timeline, etc.

<table>
<thead>
<tr>
<th>Consultation</th>
<th>Date of issue</th>
<th>Topics covered</th>
<th>Status</th>
<th>Policy Statement date</th>
</tr>
</thead>
<tbody>
<tr>
<td>CP20/24</td>
<td>December 2020</td>
<td>Categorisation of investment firms, prudential consolidation, own funds requirements, transitional arrangements</td>
<td>Consultation closed</td>
<td>Late spring</td>
</tr>
<tr>
<td>CP21/7</td>
<td>April 2021</td>
<td>Remuneration, own funds requirements, liquidity requirements and expectations relating to risk management and governance</td>
<td>Consultation closes 28 May 2021</td>
<td>Summer 2021</td>
</tr>
<tr>
<td>?</td>
<td>Q3 2021</td>
<td>Residual matters such as disclosure and consequential amendments to the FCA Handbook</td>
<td>Unknown yet</td>
<td>Following enactment of Financial Services Bill</td>
</tr>
</tbody>
</table>
New Prudential Regime for Investment Firms CP21/7 – key points

- Sets out the FCA’s proposals for the new remuneration rules for FCA investment firms
- Further covers own funds requirements, liquidity requirements and expectations regarding risk management and governance
- Consultation closes on 28 May 2021
New Prudential Regime for Investment Firms
Remuneration overview

- Single MIFIDPRU Remuneration Code
- Differently sized firms subject to different rules within the Code
- FCA taking a different approach to proportionality than EU
### New Prudential Regime for Investment Firms
#### Remuneration - categories of firms, etc.

<table>
<thead>
<tr>
<th>Category</th>
<th>Threshold for categorisation</th>
<th>Applicable rules</th>
</tr>
</thead>
</table>
| **SNIs**            | To qualify as an SNI, a firm must not:  
• Activities that have the greatest potential to cause harm to its customers or the markets in which it operates ([deal on own account](#)); and  
• Activities on such a scale that it would cause significant harm to customers or to the markets in which it operates (see [quantitative criteria for being an SNI](#) on next slide) | Basic remuneration requirements only: clearly documented remuneration policy and basic principles (such as ensuring that fixed and variable remuneration are appropriately balanced) |
| **Smaller non-SNIs** | Firms which either deal on own account or exceed the quantitative criteria for being an SNI, but which do not meet the size criteria for being a larger non-SNI firm.                                                               | Basic remuneration requirements plus additional remuneration requirements, including: identifying MRTs, setting appropriate ratios between fixed and variable remuneration, applying requirements on performance assessment and risk adjustment, rules on use of guaranteed variable remuneration, retention awards, buyout awards and severance pay for MRTs |
| **Larger non-SNIs** | Value of on- and off-balance sheet assets over preceding 4-year period is a rolling average of:  
(1) more than £300m; or  
(2) £100m (but less than £300m) and trading book business of more than £150m and/or a derivatives business of over £100m. | Basic remuneration requirements and additional remuneration requirements, plus enhanced remuneration requirements: apply rules on deferral and pay-out of variable remuneration for MRTs and must have a remuneration committee |
# New Prudential Regime for Investment Firms

Remuneration – quantitative criteria for being an SNI

<table>
<thead>
<tr>
<th>Measure</th>
<th>Threshold</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets under management</td>
<td>&lt; £1.2 billion</td>
</tr>
<tr>
<td>Client orders handled – cash trades</td>
<td>&lt; £100 million per day</td>
</tr>
<tr>
<td>Client orders handled – derivative trades</td>
<td>&lt; £1 billion per day</td>
</tr>
<tr>
<td>Assets safeguarded and administered</td>
<td>Zero</td>
</tr>
<tr>
<td>Client money held</td>
<td>Zero</td>
</tr>
<tr>
<td>On- and off-balance sheet total</td>
<td>&lt; £100 million</td>
</tr>
<tr>
<td>Total annual gross revenue from investment services and activities</td>
<td>&lt; £30 million</td>
</tr>
</tbody>
</table>
New Prudential Regime for Investment Firms
Risk management and governance (1)

Opportunity to reset expectations
- Internal governance
- Risk management

Key expectation
- Firms to consider the potential harm they could cause to consumers and markets, as well as to their own safety and soundness
New Prudential Regime for Investment firms
Risk management and governance (2)

Internal Capital and Risk Assessment ("ICARA") for all FCA investment firms

Firms will be expected to meet an Overall Financial Adequacy Rule ("OFAR") – will be used to determine whether or not a firm has adequate financial resources (and, in turn, whether it continues to meet the threshold conditions)

Firms must use the ICARA process to determine their own funds threshold requirement and liquid assets threshold requirement
New Prudential Regime for Investment Firms
Risk management and governance (3)

Minimum standards of internal governance

- General high-level requirements
- All firms must have robust governance arrangements in place
- Intended to ensure all firms meet minimum standards of internal governance
- Expectation that firms will then develop and maintain arrangements tailored to their specific business model and operations

Risk, remuneration and nomination committees

- Largest non-SNI firms will be required to have risk, remuneration and nomination committees
- Threshold for these committees will be set lower than is currently the case (currently, only significant IFPRU firms must establish these committees)
- Must be established at entity level, although FCA plans to permit firms to apply for a modification of this rule
- Committees must be made up of at least 50% non-executives and chair must be a non-executive
- No current plans to introduce diversity requirements (contrast to EU position for remuneration committees which must be gender balanced)
New Prudential Regime for Investment Firms
Own funds

CP20/24 FCA consulted on permanent capital requirement and the K-factors that apply to firms with permission to deal as principal.

CP21/7 FCA consulting on the K-factors that apply to any type of investment firm (based on assets safeguarded and administered, client money held, assets under management and client orders handled).

FCA also sets out how firms should calculate an adjusted co-efficient for use in times of stressed market conditions in relation to the daily trading flow own funds requirement (one of the K-factors consulted on in CP20/24).

FCA proposing to introduce a fixed overheads requirement (“FOR”) that will apply to all firms within the IFPR.

FCA sets out specific requirements for firms that are clearing members and for indirect clearing firms.
New Prudential Regime for Investment Firms
Liquidity requirements

Basic liquid assets requirement

- All firms will have a basic liquid assets requirement
- Based on holding core liquid assets equivalent to at least one third of the amount of their FOR and 1.6% of the total amount of any guarantees provided to clients
- First time that all investment firms have a quantified liquid assets requirement.
- May apply on an individual and consolidated basis

Core liquid assets

- FCA will set out a list of core liquid assets that firms can use
- Core liquid assets must be denominated in pounds sterling
- For overheads or guarantees that are in other currencies, firms will be allowed to use comparable core liquid assets denominated in the relevant currency, in the same proportion as the relevant expenditure or guarantee
New Prudential Regime for Investment Firms
Application to CPMIs and international firms

CPMI firms
- These firms will need to apply the IPFR methodology to calculate the FOR on behalf of the whole firm
- Many other IFPR requirements will apply to the MiFID business only, not to the collective investment management business

International firms
- International firms established overseas and seeking UK authorisation (i.e. for a UK branch) will not be subject to IFPR requirements directly
- However, FCA would have to be satisfied that the firm will be subject to broadly equivalent prudential supervision in its home jurisdiction. Otherwise, the firm will be required to establish a UK subsidiary which would fall under IFPR directly
What should firms be doing now?

1. Check firm categorisation (SNI / non-SNI)
2. Perform gap analysis and impact assessment
3. Prepare rules matrix
4. Calculate new capital requirements and assess transitional arrangements
5. Update policies and procedures
6. Implement changes
Operational resilience
Operational resilience: FCA Policy Statement (PS21/3)

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

FCA Policy Statement (PS21/3) – published 29 March 2021

**PS21/3: Scope**

- Banks
- Building societies
- Designated investment firms
- Insurers
- Recognised Investment Exchanges
- Enhanced SMCR firms*
- Payment services firms
- E-money firms

*Note – SMCR “Core” firms may also consider familiarising themselves with the regime.*
PS21/3: Requirements (1)

1. Identify important business services that, if disrupted, could cause harm to consumers or market integrity, threaten the viability of firms or cause instability in the financial system.

2. Set impact tolerances for each important business service, which would quantify the maximum tolerable level of disruption they would tolerate.

3. Identify and map the people, processes, technology, facilities and information that support their important business services (including those of their suppliers).

4. Take actions to be able to remain within their impact tolerances through a range of severe but plausible disruption scenarios including developing a testing plan and carrying out scenario testing.
Conduct lessons learnt exercises to identify, prioritise, and invest in your ability to respond and recover from disruptions as effectively as possible.

Develop internal and external communications plans for when important business services are disrupted.

Maintain an updated self-assessment document detailing how the firm has assessed its compliance with the regulatory requirements.
PS21/3: Timeline

31 March 2022
- Identify important business services.
- Set impact tolerances for the maximum tolerable disruption.
- Carry out mapping and testing to a level of sophistication necessary to do so
- Identify any vulnerabilities in operational resilience.

31 March 2022 - 31 March 2025
- Perform mapping and testing so that firm is able to remain within impact tolerances for each important business service.
- Make the necessary investments to enable them to operate consistently within their impact tolerances.
Crystal ball gazing