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Wealth Management 2020: A year in review

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Editors' note

Welcome to our first annual Wealth Management and Retail Investments review. On behalf of all our lawyers and consultants working across the 'consumer investments' sector, we hope you had a good break and we wish you a prosperous, less disrupted and lower regulatory risk New Year.

Last year's priority for firms and regulators alike was Covid-19 and getting through it with good conduct, client outcomes and operational resilience. Wealth managers have, in our experience, adapted well to remote working and have not faced the same conduct challenges as, say, insurance and credit firms.

Remote working and market turbulence have provided significant stress tests for firms' operational resilience and the forced digital dealings with clients have done more for 'WealthTech' than any of the much-hyped robo-adviser launches. The FCA's recent paper was less an 'evaluation of the advice market'[1] and more an 'evangelism of digital'. The FCA's focus on 'Op Res' was well-timed (almost prescient) and the ever-increasing focus on data protection and cyber risk, including the FCA's warning about client transfers[2], make these topics worthy of comment from our regulatory and data protection & cyber security consulting colleagues.

Dare we say 2020 was a relatively quiet year away from the min-bond and defined benefit pension transfer advice 'crises'? Once SMCR was implemented by all in December 2019, there were no major regulatory change projects and no burdensome thematic reviews in our sector, albeit plenty of business resilience questionnaires and the like.

Firms have continued to experience MiFID II 'teething problems' with an increasing risk of regulatory action. We have all been waiting: waiting for Brexit (but few dedicated wealth managers do much across borders without already having some form of physical presence); wondering whether key court cases will support the FCA's views on key issues about its perimeter and the scope of firms' responsibilities and, if not, whether the FCA will care; and, wishing we could go back to the office.

To help while away the long winter nights, we have included here a 'long read' on the *Avacade* and *Carey Pensions* cases as, together, they warrant a (rare) deep dive into case law. By contrast, to reflect the likely lesser significance, we have included only a brief note on 'the deal' and dealing with EEA clients' post-Brexit.

Whilst CMCs, despite the ever closer attention of their new regulator, continue to make mischief (sometimes in apparent conflict with roles previously performed on the other side of the fence), systemic liability issues have been playing out in the Courts and the FSCS more than at the FOS during recent months. SIPP providers have felt the brunt of these actions but Woodford, authorised corporate directors (ACDs), any regulated firm involved in the distribution of mini-bonds and defined benefit pension (DB) transfer advisers are now in the firing line and we expect them to struggle with these issues for another few years. Much of the current talk about unsuitable advice and mis-selling risk centres around DB transfers and the associated PI insurance challenges – getting cover for advice provided and any business that plans to continue providing it.

The FCA's Enforcement division seems to have delivered on its promise to focus on smaller firms of late. There are reportedly 30 DB transfer advice firms, and numerous individuals, under investigation. The fallout from Woodford has led to investigations amongst ACDs, and anyone within the perimeter and caught up in the mini-bonds saga can expect a 'knock at the door'. We are also seeing more focus on networks and their Principal firms; particularly where their ARs have been caught up in any mini-bonds or DB transfer problems. Judging by the proliferation of skilled persons Requirement Notices coming out of Stratford of late, we can expect an even busier year ahead supporting firms through 'close supervision' and enforcement.

We seem to be in a 'period of grace' in respect of SMCR compliance, with an extension granted for the first annual certification reviews, but the post-implementation phase warrants commentary from our Regulatory Consulting colleagues. In anticipation of contentious issues to follow, we are delighted that Imogen Makin has penned a piece on the hot topic of 'non-financial misconduct' and how the personal and professional divisions are blurred in the eyes of the conduct regulators – so much so that it was a key theme of the new FCA CEO's first speech. Whatever one's views on the politics and jurisprudence of financial regulators policing non-financial (mis-)conduct, the FCA has made its views, and expectations, very clear.

As ever, disruption leads to change and renewal but the FCA's near obsession with 'phoenixing', despite some element of corporate 're-birth' being an inevitable part of corporate life and death, makes restructurings, insolvencies and new authorisations an increasingly scrutinised and complex area. We have asked one of our Corporate M&A partners who deals day-to-day with these issues to summarise what he has seen in terms of 'restructuring' issues arising from DB transfer problems.

It has been a tough year for the regulator too. As well as coping - like everyone else - with Covid-19, it has gone through a major leadership and structural change and come under huge political pressure to perform better in its statutory objective of consumer protection. The latest and most significant example being the damming reports into its failures in respect of LCF and

[1] https://www.fca.org.uk/publication/corporate/evaluation-of-the-impact-of-the-rdr-and-famr.pdf

[2] https://www.fca.org.uk/news/statements/fca-warns-firms-be-responsible-when-handling-client-data

Connaught[3]. Whilst sympathising with the FCA's lack of power to take effective action beyond its perimeter, there is an element of 'do as we say, not as we do'. The FCA (with support even from FOS) has expressed willingness to forgive firms' pandemic problems, which may usher in an era of greater regulatory tolerance and understanding – but we wait to see if the FCA's actions match its words.

We are sorry to say we predict a more tumultuous 2021. Reliance on technology and working from home are likely to catch someone out. We expect the FCA to look for SMCR scalps (albeit, based on the banks' experience, that may not happen for a couple more years), so individuals will be in the cross hairs in the coming years and they will, quite rightly, fight back. The FCA's optimistic ambitions for simplified tech-enabled automated advice services will continue to be thwarted by the FCA's difficulties in defining the advice boundary. The traditional advice market will suffer more than ever before from unattainable PI and unaffordable FSCS levies.

Even the good news about no longer charging VAT on MPS may not last if the FCA challenges the distinction being drawn between a 'special investment fund' (for VAT purposes) and an 'alternative investment fund' (under AIFMD). And we can't end without a prod about PROD. Just as the FCA insisted product governance and distribution should have been viewed through the lens of RPPD since 2007, we remind firms to view the retail investment market through the prism of PROD from now on.

We hope you enjoy our review and find it interesting and useful. Please get in touch if you would like to discuss any of the content or if you have suggestions of what to cover in future editions. If there's appetite, we'll gladly do it quarterly.

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[3] https://www.fca.org.uk/news/press-releases/fca-responds-independent-reviews-london-capital-finance-connaught

Brexit

The deal struck on Christmas Eve includes little information and even less detail regarding the Financial Services sector and unfortunately does not include any provisions for reciprocal market access for UK firms to access the EU through positive equivalence determinations. Therefore, wealth management firms remain in much the same position as they were prior to the end of 2020.

We have finally left the European Union. According to the post-Brexit UK-EU Trade and Cooperation Agreement summary, in relation to financial services:

- *"57. The Agreement includes provisions on cross-border trade in financial services and investment that will secure continued market access. The Agreement provides protections that will ensure that our regulatory and supervisory authorities will be able to act to ensure financial stability, market integrity and protect investors and consumers.*
- *58. The Parties have agreed a joint declaration setting out their commitment to these shared objectives and have agreed to enhanced cooperation as well as information sharing and bilateral dialogue in order to establish a durable and stable relationship.*
- *59. The declaration reaffirms the integrity of our respective, autonomous equivalence frameworks. The Parties will discuss how we move forward on specific equivalence determinations. The Parties will codify the framework for regulatory cooperation in a Memorandum of Understanding."*

We think this can be summarised as an agreement to try and agree! For those few wealth managers with a number of EEA clients, Brexit will continue to present significant challenges.

On 31 December, the Transition Period ended and EU law ceased to apply in the UK. As a result:

- the EU passporting regime for financial services is no longer available to UK-based firms;
- the extent to which UK firms can continue to provide cross-border services to customers in the EEA depends on each EU member state's local law and local regulatory expectations; and
- conversely, EEA-based firms must now either have a UK-based operation, or be able to rely on an exemption, an exclusion, or be acting in accordance with one of the UK's temporary regimes, in order to undertake regulated activity in the UK.

Unlike for 'goods', for financial services, the UK has indicated a desire to operate differently and diverge from EU regulatory requirements; accordingly, the 'Most Favoured Nation' status is not available.

So the question becomes, now what? We have spoken to and assisted a number firms with their Brexit planning and it is clear there have been a number of different approaches. Firms with established EU/EEA businesses, in some respects, have a clearer choice: they need to find ways to ensure their operations can continue without serious impediment. The most likely option is some form of set up authorised in the EU.

It is less clear for firms which happen to have some EU resident clients. We have seen some firms ignore that difficulty whereas others have actively rid themselves of any EEA resident clients (and presumably will continue to do so each time a client moves abroad). Some firms will find measures that fall in between the two.

The regulatory risk for firms with a small number of EEA resident clients is less than for firms with a large number. Perhaps, for those smaller firms, it is easy for them to turn a blind eye but the commercial benefits are likely very limited, so why take the risk at all? Of course, firms with a number of EEA resident clients have to consider the opposite, with the FCA questioning their plans, thereby making it hard for them to continue to serve clients in the EEA whilst simultaneously asking if terminating such clients represents good outcomes.

Even where firms want to address the problem, there are a number of very real practical challenges. Some business arrangements involve multiple firms, making it hard even to identify the one that has EEA resident clients.

Even when we have conducted EU wide exercises, the different national rules have meant that there is (usually) no one approach which provides certainty (without terminating any client relationships outside the UK). Firms not only need to consider each EU member state's local law and regulatory expectations but also how they apply to each service line and/or types of investments. 'Reverse solicitation' won't be the answer to everything!

In our view, all of this means taking a sensible approach to regulatory risk. By all means, if firms want to take a firm approach then, apart from having to continue to monitor residency changes, that may be a 'simple' if uncommercial solution. Equally, firms who choose to maintain EEA client relationship will want to closely monitor for updates released in the jurisdictions across the EEA in which they have clients.

It is also important for firms to be honest with themselves. If a firm's activities clearly have a significant nexus in any EU country then it should consider taking local advice. For larger firms, they should consider any countries for which they have amassed a larger number of clients.

Overall, there is still cause for optimism; we are at the start of the negotiating process for financial services, rather than nearing the end. In the immediate term, firms should continue to plan on the basis of a 'no deal' scenario, keeping a watching brief on developments in the negotiations. Although the words are no longer being used, the detail of the terms agreed for financial services could still end up being materially the same as a 'no-deal' outcome. Unfortunately, the outlook for financial services remains no clearer than it has been since the 2016 referendum.

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Culture and non-financial misconduct in the midst of a pandemic: the FCA's stance

Christopher Woolard's message in December 2018 that 'non-financial misconduct is misconduct, plain and simple'[4] continues to ring true. Since that pre Covid-19 message, we have seen the FCA focus increasingly on non-financial misconduct and cultivating firms in which such misconduct is not tolerated.

The FCA has repeatedly made its views clear that non-financial misconduct falls within its remit, and whilst there is no 'one size fits all' approach, improving culture in financial services, including policing all types of misconduct, is a continuing priority for the FCA.

In October, the new CEO of the FCA, Nikhil Rathi, echoed Woolard's sentiment, promising in one of his first significant speeches to promote cultural change and tackle deep-rooted issues within the financial services sector. Further, in November, Jonathan Davidson, the Executive Director of Supervision – Retail and Authorisations, reiterated that culture remains a key area of focus for the FCA.

So what should firms be doing in order to demonstrate that they are taking steps to promote a positive culture and tackle all forms of misconduct?

Whilst everyone's experience of working from home has differed, it is true that for all of us, our working lives have been revolutionised. The FCA has repeatedly asserted that the combination of financial pressure and psychological stress on employees working in a remote environment may result in an increased risk of misconduct and could certainly lead to the decline of a firm's culture. Whilst firms must tackle the immediate financial and operational issues caused by the pandemic, the FCA has emphasised that it is equally important for firms to foster a healthy and inclusive work culture.

The continued remote working environment means that the lines between work and home, and professional, personal and social life have become blurred and firms must work hard to identify and manage emerging risks. For example, bullying and harassment through the use of WhatsApp or video calls, remote client relationships and client confidentiality. To reduce the risk of harm, the FCA expects formal processes and objectives to remain accessible, clear and re-enforced (irrespective of the work location).

The FCA has suggested that the following should be considered by all firms to cultivate a positive culture:

– Corporate Purpose;
– Leadership Integrity;
– Identifying emerging risks and opportunities;
– Promoting psychological safety;
– A continued focus on diversity and inclusion;
– Looking after your employees;
– Utilising insights from behavioural science;
– Replacing informal cues that would normally occur in the workplace with group email chains or chat on a firm intranet in order to ensure continued connectivity;
– Commitments to good conduct;
– Learning from fundraising; and
– 'Think, plan, experiment and adapt'.

Given the FCA's rhetoric, it is particularly important for both firms and Senior Managers to be able to demonstrate their consideration of these points in the context of the pandemic and throughout the areas of the business for which they are responsible.

Actions taken by firms to promote a positive culture will inevitably vary, but could include implementing training on diversity and inclusion and re-circulating the firm's policies on bullying and harassment or the use of WhatsApp, for example, thereby emphasising that the firm's stance remains the same even in the remote working environment.

Jonathan Davidson has previously stated that the role of a Senior Manager goes far beyond simply ensuring the operational and financial compliance of a firm and that Senior Managers are responsible for tackling poor culture. Indeed, poor culture is something that Davidson has described as a fundamental root cause of misconduct. He has recently reiterated this view, stating that Senior Managers play a vital role in encouraging a positive culture and are responsible for "being proactive about the behaviour and competence of those they lead"[5]. This is especially the case in the current remote working environment in which employees may feel less connected to their managers, potentially

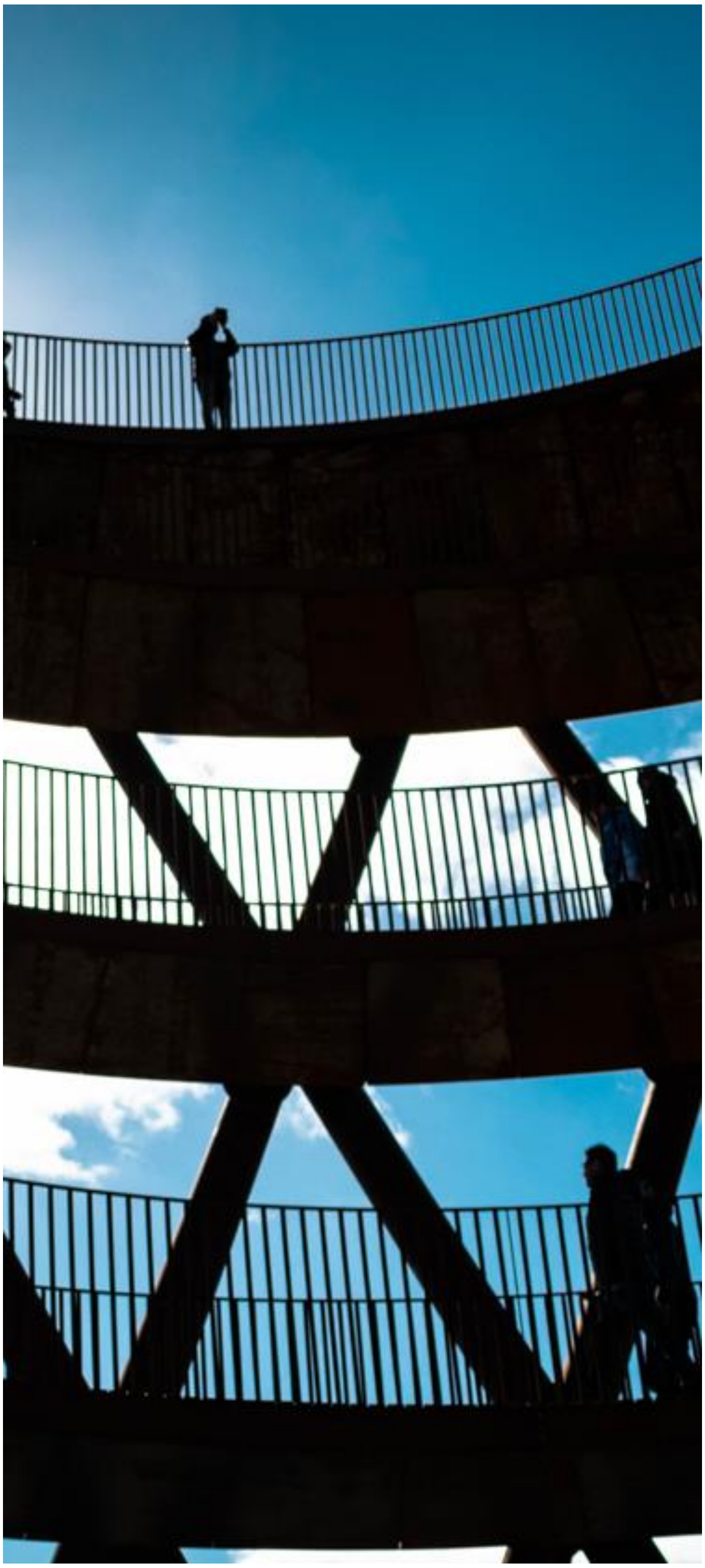
[4] https://www.fca.org.uk/news/speeches/opening-and-speaking-out-diversity-financial-services-and-challenge-to-be-met
[5] Speech by Jonathan Davidson given at the 6th Annual Culture and Conduct Forum on 26 November 2020

less 'surveilled' (whether or not that is, in fact, the case) and in which there is an increased risk of misconduct. Senior Managers should therefore ensure that they are having regular check-ins with their team members both individually and as a group, and that they are reinforcing good behaviours through their own actions.

If positive, motivational and supportive Senior Managers can help to ensure that their team members feel included, valued and listened to, this will likely lead to those individuals being more open with management, thus providing better insights into their team's productivity and behaviours. Engendering a 'speak up' culture should be a priority now more than ever, particularly given that the remote working environment looks set to continue for the foreseeable. All managers, and Senior Managers in particular, should be seen to listen to all viewpoints, promote an inclusive working environment and to discourage any behaviours, such as bullying, which could be considered non-financial misconduct.

The FCA expects Senior Managers to instil behaviours in their teams that comply with the five conduct rules and ensure that employees know what those rules mean for their particular roles. Senior Managers are also expected to regularly assess and certify that colleagues in key roles are "fit and proper". These assessments should include anything that could be seen as non-financial misconduct. The key to being able to demonstrate all of this is, of course, documenting the actions taken and showing pro-activity in addressing any issues identified.

The FCA's focus on culture, driving positive behavioural change and clamping down on non-financial misconduct has not wavered in the context of the pandemic. Firms, and their Senior Managers, must be able to demonstrate that, whilst their focus will inevitably have been on servicing customers, financial and operational resilience, they have not lost sight of the importance of promoting healthy and inclusive work cultures by being pro-active and through clamping down on poor behaviours when necessary.



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Defined Benefit Transfers

The DB transfer suitability review – prompted by the British Steel 'scandal' and concern about clients making bad choices about their 'pension freedoms' – seems to have been going on for an age, especially for those higher risk firms caught in the eye of the storm. Yet, for most, the saga has barely begun and, if the FCA keeps setting the bar so high, many are going to be found wanting.

Although critics say it was late to address obvious problems, the FCA has been on a crusade in the last few years trying to get a handle on its DB pension transfer suitability concerns. 2020 was no different with a ban on contingent charging (in most circumstances), further rule changes and aggressive (if sporadic) supervisory and enforcement action as part of the FCA's DB pension transfer review.

In his report to the Treasury Committee of 26 November[6] about the work of the FCA, new CEO Nikhil Rathi summarised the DB transfer review conducted into 85 firms with higher risk business models, accounting for over 40% of the market. He reported that 28 firms stopped providing DB transfer advice. Detailed feedback has been given to 1,649 firms, of which 402 chose to vary their permissions. He confirmed there are over 30 Enforcement investigations into regulated firms, and we are aware of a number into individual advisers or 'pension transfer specialists' too.

DB Pension Transfer Review

We produced a note in August on the developments in the long running DB pension transfer review, including our suggestions on how to deal with initial FCA requests (see the note here).

The FCA feedback letters and requests followed a similar pattern:

- Set out the FCA's concerns in summary;
- Provided a list of actions or confirmations required, including:
  - confirmation that the firm will remediate the identified unsuitable files;
  - agreeing to collect information for file reviews marked as 'MIG' (Material Information Gap);
  - whether the firm is willing and able to carry out a past business review (PBR) in respect of its wider back-book;
  - confirmation that the firm's PI insurers have been notified, including specifically about the prospect of a PBR;
  - confirmation that the firm has appropriate resources to comply with PI and capital requirements and to provide redress where found due by the PBR;
  - whether the firm is willing to apply (i.e. agree to) a Voluntary Requirement (VREQ) to maintain the assets within the firm, preventing any capital distributions or sale of assets without FCA approval; and
  - what assurance the firm can provide the FCA that its current advice process is compliant, where it wishes to continue to provide DB Pension Transfer advice.
- Enclosed detailed feedback on each file reviewed, in the form of a case report containing case-specific details and the FCA's conclusions, including on the suitability of the transfer and subsequent investment advice.

> **PI insurance:** Firms which advise on DB transfers or which have advised on them in the past, should take great care when applying for professional indemnity insurance. Proposal forms are likely to ask questions about DB advice and great care must be taken with the response. Firms which have not advised on DB transfers but have advised on the subsequent investment of funds released by such transfers may run into difficulties for not disclosing "services with regards to transfers". Under the Insurance Act 2015, firms have a duty to make a fair presentation of the risk. Always seek advice from your insurance broker, but if you have any concerns about past work or consider that a past matter or work type might be caught by a proposal form question, it is generally safer to make a full disclosure than to say nothing.
>
> Once an Insurer offers cover, firms should check proposed exclusions and how they might apply to potential liabilities as well as if the policy meets their capital adequacy and PI Requirement. Many policies now exclude all liability for DB transfers or apply higher excesses. This may not be an issue if DB transfer claims have been successfully notified to a prior year; however, Insurers are unlikely to consider that a

6 https://committees.parliament.uk/publications/3797/documents/38174/default/

notification is valid simply because a firm has advised on DB transfers and the FCA generally disapproves. Each policy wording is different; but usually, firms must be able to demonstrate that third party claims are likely. A regulatory review may not be enough, even if the regulator 'requires' a review or appoints a skilled person to conduct one. Insurers are likely to require the firm's acknowledgement of potential unsuitability before accepting that cover is triggered. They will then likely insist on a customer contact exercise as part of any review to ensure the requisite 'third party claim' is made.

Think carefully about limits. If you have an aggregate limit of indemnity (i.e. a maximum amount of cover available), work out how many FOS maximum awards would use up that cover. If your limit is £500,000, after three maximum awards (assuming the advice was provided pre April 2019), you will have very little cover left.

Finally, care must be taken when purchasing adviser firms. There is no long stop for FOS claims and while the Pensions Review should have mopped up claims relating to advice given before 30 June 1994, the occasional claim still comes out of the woodwork. Less than five years ago, we saw a firm run into difficulty as it had purchased an adviser who had not dealt with the Pensions Review properly and was faced with having to re run the review for a substantial number of investors. In this case, the purchaser's insurance did not cover claims arising from advice given by the acquired firm prior to purchase. While there will be many competing considerations, from an insurance and general liability perspective, it might be simpler to buy the assets of a business, leaving its liabilities behind, rather than buying the whole of a business.

- **Harriet Quiney, Financial Risks PI Litigation partner - on practical issues that firms need to consider in relation to DB transfer advice and their position**

We have advised a number of firms on their responses and have also spoken with a number of other consultants dealing with these requests. It is clear that most firms have (rightly) pushed back strongly, in large part because the quality of FCA's file reviews appears variable. These 'challenges' resulted in the FCA producing a suitability feedback challenge template by which the regulator, rather tellingly, tried to manage and restrict the manner of firms' defences in individual cases reviewed.

The FCA's approach to determining where redress is required is, in our view, potentially flawed based on what we have seen to date. The FCA has tried to restrict evidence relevant to suitability to the contemporaneous documentation or evidence. Yet the transfer was either suitable or it was not and that is a matter of objective fact to be assessed retrospectively with the benefit of hindsight (taking care not to expect the adviser to have had such foresight). There may be technical regulatory failings by a firm in not obtaining the evidence (or having proper systems and controls to properly record the information on file) but this is very different from determining if a client received unsuitable advice. Firms should push back hard if they face this stance. Firms should also monitor for this mistake in other scenarios.

The FCA is not currently open to much debate about its review findings; it is insisting on pushing ahead with past business reviews (PBRs) – despite saying to the press in May that no one has been 'ordered' to conduct reviews. Insurers (where engaged) are holding the line and insisting that, if in any doubt about individual case suitability, clients are sent 'informed position letters' (IPLs) and invited to opt-in to a full review process. Although prepared to consider challenges to the feedback, early skirmishes suggest the FCA is intent on proving itself right, which, ultimately, bodes very ill for the pension advice sector. Resolution of individual cases will require IPLs – or some other customer contact exercise, questionnaires and interviews - and, if agreement cannot be reached, complaints. The FCA cannot send in skilled persons to resolve these reviews because many of the firms would simply fold when faced with the costs and because a Section 166 appointee does not have authority to determine complaints.

We will have to see what the FOS makes of these cases and whether they are as unforgiving as usual. There has been one recent published decision relating to DB transfer advice and we can expect many more in the coming months and years, albeit many smaller firms will likely have to fold if they lose even a few cases and the complaint files will end up with the FSCS.

If the FCA continues to insist that a majority of reviewed DB pension transfers since 2015 were unsuitable or otherwise non-compliant, the situation of the higher risk firms will be dire - and the implications for the rest of the pension transfer advice market are obvious and ominous.

Corporate 'restructuring': If any significant percentage of the assets under advice come from DB transfers, owners are finding it increasingly more challenging to sell the shares in their firms, which could leave them exposed to larger tax bills (on any future sale) and – one way or another – carrying substantial liabilities, potentially indefinitely. For many buyers, too great an exposure to historic DB transfer business will make a target business too toxic, and the owners of such firms may struggle to sell at all, except in a distressed state as and when liability risks crystallise.

SMCR and the FCA's continued approval of approved persons in Appointed Representatives makes individual accountability an ever greater consideration, particularly now the FCA is so alert to any apparent 'life-boating' or 'phoenixing'. More than ever, sellers – and buyers concerned about their regulatory reputation – need to take care to ensure sufficient value is realised from any sale and sufficient capital provisions are retained in the 'old' firm to meet likely (or even not very likely) DB transfer liabilities. Whilst satisfying the FCA in the short term, senior managers and owners may need to satisfy an insolvency practitioner in the longer term.

Given the amounts involved in typical DB transfers, the FCA's active review of some firms and close scrutiny of the market generally, wide-spread PI problems, and the increased FOS limit, sellers should expect buyers to carry out detailed legal and compliance due diligence on numerous, if not every, DB transfer advice file. As noted elsewhere, block notifications to PI insurers are unlikely to be readily accepted and run-off cover will likely be expensive to begin with and difficult to renew in subsequent years in order to protect sellers against warranties and indemnities given to buyers.

We're seeing ever more firms looking to sell client books as assets because of DB transfer liabilities. Despite buyers being able to buy the goodwill 'clean', sellers struggle to realise full value for such distressed books (and have difficulties in extracting proceeds from the firm without running the risk of FCA blockers or later insolvency implications). The FCA has made it increasingly difficult to transfer the clients without, at least, evidence of client consent. Long gone are the days of a simple 'novation of agency'. Asset purchase agreements increasingly operate like introducer agreements, with staged payment being made based upon the number of clients successfully transferred.

We have seen a number of clients ask about possible pre-emptive sales, treating the FCA's scrutiny of the market generally as another good reason to sell up and retire. For any business owners agonizing about their options, the only comfort is there is no easy option. Hive-ups and intra-group transfers may work from a corporate and tax perspective but can easily trip over technical regulatory requirements (like permissions to provide on-going services) or more vague 'regulatory expectations'. Sellers are increasingly looking for buyers to hive-up target company assets into the buyer entity post-completion in an attempt to minimise any come-back on the seller in later years. The trip wires noted above make it unlikely that buyers will accede to such strategies without back-to-back protection in place from the seller in any event.

An early and honest assessment of the nature and extent of potential liabilities in a DB transfer back-book should give a firm a clear sense of its options and how things may play out. Reliable external assurance and advice – from compliance consultants, lawyers or insolvency practitioners – is necessary to justify any big decisions and very useful in making them. A good DB transfer client book could be highly prized – given the likely higher net worth and sophistication of clients for whom transfers were suitable – but the mis-selling risk makes this area a minefield.

- **Gary MacDonald, Corporate M&A partner - on corporate and restructuring issues arising from the current DB transfer review**

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Wealth Management – operating resiliently?

The global coronavirus pandemic has focused regulators' minds on operational resilience. Even before the start of the pandemic in 2020, operational resilience was still very much towards the top of the PRA and FCA agendas.

Operational resilience is defined by the FCA as "the ability of firms and the financial sector as a whole to prevent, adapt, respond to, recover and learn from operational disruptions". The regulators should rightly feel vindicated for moving operational resilience up the regulatory agenda during 2018 – 2019.

The FCA, the PRA and the Bank of England (BoE) want to increase the resilience of financial institutions to protect customers, the wider financial sector, and UK economy from the impact of severe operational disruptions. To their credit though, considering the scale of the disruption in 2020, most investment management firms have coped – but is simply coping enough for clients?

Regulatory direction

The first key comments on the issue came in the Discussion Paper "Building the UK Financial Sector's Operational Resilience," published in July 2018 by the BoE, the FCA and the PRA. This was the first time that all three regulators had published a joint discussion paper, indicating their shared view of how importantly they regard this topic. Subsequently, the FCA Consultation Paper (CP 19/32), published in December 2019, clarified, to some extent, the regulatory expectations and with remarkable sagacity predicted that firms should be prepared for the worst case, in the event that they were to suffer severe operational disruption in future.

The proposals set out in the FCA's CP will likely not apply as direct FCA rules to most investment managers (although some larger institutions may be directly caught within scope). This is because generally speaking, solo-regulated firms not considered as 'enhanced firms' for the purposes of the SMCR (i.e. 'core firms') will likely only have to follow the requirements as guidance. Furthermore, the implementation date for the new Operational Resilience regime is now not expected to be until 2022, due to Covid-19, with a policy statement likely to be published by the FCA at some point in 2021. However, one would be surprised if the relaxed approach through guidance remains the status quo.

Leading by example

It is likely that all investment managers will still be expected by the FCA to design and implement risk and operational resilience frameworks, including effective contingency planning. Without doing so, Senior Managers at firms will not have the assurance they need to fulfil their responsibilities. The FCA has also made clear that irrespective of a firm's size or complexity, a Senior Manager should be appointed as responsible for ensuring the operational resilience of the firm. Whoever is appointed must have a sufficient level of seniority and oversight to effectively undertake the role. Equally though, senior management more broadly must be committed to ensuring the firm has in place the appropriate arrangements.

As with everything the tone from the top in achieving the right culture will be critical, as will the engagement of senior management and their role in providing effective challenges to the steps taken to comply with the new rules.

The requirements

The core requirements set out by the regulators to date can be summarised as follows:

- **Important business services:** Firms must identify their 'important business services'. Note that the regulators define a business service as "a service that a firm provides to an external end user or participant", but do not intend to provide a detailed definition of what an 'important business service' is. Therefore, the regulators have suggested that to define their 'important business services', firms need to consider how any disruption to their business services could impact matters beyond solely the firm's own interests i.e. where there could be customer detriment as a result of disruption. Firms should review their important business areas once a year and / or whenever there is a material change to the business or the operating environment. The Investment Association has gathered some feedback from its members on their important business services and in terms of numbers, almost all had opted for a number less than ten.
- **Disruption tolerances:** There is also a requirement to set tolerance levels for disruptions to each 'important business service'. Tolerance levels should be supported by a consistent methodology to define a firm's tolerance for each 'important business services'. The FCA proposed that firms should set their impact tolerances from the first point at which disruption to an important business service would cause intolerable levels of harm to clients / consumers or market integrity. Firms should ensure they have the ability to remain within their impact tolerances during realistic but severe scenarios. This requires understanding the risks and vulnerabilities relevant to each

important business service and in effect, setting risk appetites for them.

- **Mapping:** Firms must then map their 'important business services'. Firms will be expected to identify and document the resources (people, processes, technology, facilities and information) necessary to deliver each important business service, to ensure it can remain within the impact tolerance the firm has set. Firms are also expected to consider their outsourcing and third party service providers when undertaking mapping exercises. The FCA expect an operationally resilient firm to have a comprehensive understanding and detailed mapping document of the resources that support their business services.
- **Scenario testing:** Firms must stress test to assess their ability to manage services within the impact tolerances set across different types of scenario. Results of this exercise can then be used to re-calibrate the firm's risk appetites and impact tolerances. Whilst Covid-19 has provided a useful real-life stress test, it is important to note that there are additional types of disruptions for which firms should be prepared for e.g. cyber-attacks, which are becoming ever more likely.
- **Communication:** The importance of communication with internal and external parties has been highlighted by the regulators. Good communication externally during a disruption should be underpinned by planning to ensure customers receive the necessary warnings and advice from the firm as quickly as possible. Firms should also have in place plans for internal communications that set out the key decision makers and reporting lines during a disruption.
- **Ongoing governance:** Firms should develop a mature second line monitoring programme for operational resilience to provide Senior Managers with the necessary assurance of the efficacy of the firm's systems and controls. Any monitoring programme must test that the firm has a documented self-assessment in place of their compliance with the FCA's operational resilience requirements that has been signed off by senior management. Good governance is critical in setting effective standards for operational resilience. It is through an appropriate governance framework and the engagement of senior management, enabled by effective MI and analysis of the impacts on business operations caused by disruptions such as the pandemic, that firms can fully assess operational resilience in a meaningful way and, therefore, be in an informed position to make the decisions necessary to be better prepared for any future crisis.

Data protection: Firms should also consider how they are achieving operational resilience from a data protection perspective. A key part of protecting customers is to ensure that technical and organisational measures are in place to protect their personal data. Firms must also be transparent with customers about the purposes for which their personal data will be used. These purposes should be fair and within the customer's reasonable expectations. In addition, firms must rely on, and record, an appropriate lawful basis under data protection law for each processing purpose.

The FCA recently highlighted these data protection considerations in the context of transfers of client data. These transfers are likely to be more common given the current economic climate, which according to the FCA, may cause some firms to leave the market or merge with other firms.

The FCA reminds firms (particularly those that intend to transfer or receive client personal data) to demonstrate how they have considered the fair and transparent treatment of customers (i.e. Principles 6 and 7) and how their actions comply with data protection laws.

From a wider data protection operational resilience perspective, firms should ensure that appropriate risk management procedures are in place, particularly around the use of new systems and technology that may have been introduced to store, process and transfer client personal data.

It is important that these systems and technology can facilitate compliance with data protection laws. This includes being able to respond to the exercise of data subject rights (e.g. the rights of access and deletion of personal data where applicable), complying with data retention periods and ensuring the right level of security measures have been implemented to safeguard personal data against personal data breaches.

- **Tughan Thuraisingam, Data Protection & Cyber Security specialist**

Moving forward

Not many firms would have envisaged or prepared for a disruption quite like Covid-19. However, it has presented firms with an opportunity to learn vast amounts about their operational resilience. The regulators continue to emphasise that firms will need to keep their focus on operational resilience as we hopefully return to some kind of 'new normal'. All investment management firms should now begin to put in place robust contingency plans for potential disruptions. Firms should track and document how and why decisions were taken as far as possible and implement lessons learned to emerge from recent events with operationally more resilient businesses.

One key consideration not to overlook is the impact of the new deal reached at the end of the transitional period and how it will affect firms' Operational Resilience as of 1 January.

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FCA Enforcement – key trends and themes

The enforcement data published with the FCA's Annual Report 19/20 makes grim reading; longer, more expensive cases and not even a hint at relaxing the approach to enforcement as a 'diagnostic tool'.

The key points from the Annual Report are: the average length of civil and regulatory cases has increased significantly from 17.5 months in 18/19 to 23.9 months in 19/20; the average cost of enforcement cases has also risen from £103,400 to £229,000; no criminal cases were closed during the reporting period (itself indicative that the length of criminal cases tends to be far longer); and the FCA's focus in enforcement action was in the same five areas as the previous year: unauthorised business (142 cases); retail conduct (134 cases); insider dealing (88 cases); financial crime (71 cases); and pensions advice (61 cases).

Enforcement outcomes[7]

The types of outcome resulting from enforcement action have largely remained the same; in 19/20, 81.1% of outcomes were variation/cancellation of permissions or withdrawal of approvals when compared to 82.6% in 18/19, 4.2% were criminal outcomes in both 19/20 and 18/19 and 6.9% were fines in 19/20 when compared with 5.6% in 18/19. The remaining outcomes were civil, public censure and prohibitions.

Whilst the total amount of fines imposed has decreased slightly from £227.3m in 18/19 to £224.4m in 19/20, this should not be taken as a sign that the regulator's appetite for enforcement is waning; the number of open cases has only decreased by 1 from 647 on 1 April 19 to 646 on 31 March 20. In addition, the single largest fine was £102.2m for anti-money laundering (AML) breaches, a significant increase on that of the previous year (£76m) and further evidence of the FCA's commitment to combatting financial crime.

Relevant examples

Recent fines tell us more about the FCA's policy agenda than the current issues within the sector. Charles Schwab was fined[8] for apparently basic client money segregation failings and breaches of CASS and Principle 10. No UK wealth manager is in any doubt these days about the importance of CASS compliance.

The timing and press release about the fine imposed on LJ Financial Planning[9] made much of the pension transfer advice unsuitability but, on closer inspection, the issues related to a period (March 2010 and December 2012) long before pension freedoms so this had nothing to do with the current DB transfer review. The level of fine suggests much was being made out of old news about a firm that had gone a long way to put right historic errors. So whilst this will certainly be a sign of things to come in respect of the numerous current enforcement actions relating to DB transfer mis-selling, it probably goes only to show that those things won't come for a while yet.

Predictions for 2021

Although the FCA's Business Plan for 2020/2021 was somewhat shorter than usual due to Covid-19, it is clear from that, and FCA publications throughout the pandemic, that the regulator's appetite for enforcement remains as insatiable as ever.

The FCA's focus this year is likely to be similar to the last; retail conduct, pensions advice, financial crime and fraud are set to be top of the regulator's enforcement agenda combined with firms', and their Senior Managers', actions during the pandemic.

Given the retail conduct and pensions advice focus, it is likely that the number of enforcement cases involving wealth management firms will increase over the next year. We are also likely to see increased focus on smaller firms and those who consistently fail to meet the FCA's standards; in those cases the FCA has stated that it will move more swiftly to enforcement action. The wealth management sector would do well to heed the FCA's warning; "we will remain vigilant to potential misconduct" and "where we find poor practice, we will clamp down with all relevant force".

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[7] https://www.fca.org.uk/data/enforcement-data-annual-report-2019-20
[8] https://www.fca.org.uk/news/press-releases/fca-fines-charles-schwab-uk-over-safeguarding-and-compliance-failures
[9] https://www.fca.org.uk/news/press-releases/fca-fines-lj-financial-planning-ltd

The Appointed Representative regime: Principals lacking principles?

The FCA has continually raised concerns about the effectiveness of the Appointed Representative / Principal model over many years. Starting with the IFA networks, FCA reviews have found shortcomings and some significant weaknesses in the control and oversight of ARs by many Principal firms. The latest communique from the regulator was in the wide-ranging call for input on the 'Consumer Investments Market'[10] in September 2020, including on how the AR regime is working in practice.

The issue

There have been numerous concerns raised by the FCA since 2016 regarding the efficacy of the systems and controls in place at the Principal firms of Appointed Representatives (ARs). The regulator has published a number of FCA 'alerts', 'Dear CEO' letters, and findings from its supervisory work relating to the issue. Despite the repeated warnings and guidance from the FCA, it has continued to identify serious weaknesses in the systems and controls at Principals. The FCA's concerns have grown as the number of ARs has proliferated, particularly in the investment management sector. The FCA's focus has shifted from IFA networks to regulatory hosting platforms. 2020 saw the collision of the Principal / AR thematic review with the 'mini-bond scandal' and associated investment mis-management.

The regime

The AR regime is designed to enable firms that are not directly authorised in their own right the ability to undertake certain limited regulated activities ('advising on investments' and 'arranging deals in investments') as an agent of an authorised firm. Section 39(1) FSMA provides a specific exemption for ARs from the 'general prohibition' i.e. it is a criminal offence to carry on a regulated activity in the UK unless a firm is either authorised or exempt. An AR is therefore a firm who undertakes regulated activities and acts as an agent under the umbrella of the FSMA Part 4A Permission of another directly authorised firm - this firm is known as the AR's 'Principal'.

It should not be forgotten that a Principal is an authorised firm that agrees to take on the regulatory responsibility (and therefore the regulatory risk) for the regulated activities carried on by another (exempt) firm, the AR.

Principals are entirely responsible for ensuring that their ARs comply with FCA rules. Concomitantly, in addition to their own regulatory obligations, Principals are wholly responsible for any regulatory failings or breaches of their ARs. SMCR does not apply to ARs, therefore it is the Principals' Senior Managers who are responsible and accountable for the actions of the firm's ARs (as well as the approved persons carrying out controlled functions within the AR).

There are many benefits to becoming an AR. Primarily, ARs benefit from lower initial and running costs and lower barriers to entry to the UK financial services market, when compared to seeking direct FCA authorisation. The FCA authorisation process can be lengthy, sometimes taking up to a year. However, an AR can be vetted and approved by the Principal in just a few weeks. Regulator approval is not technically required (as FSMA and SUP 12 require mere notification) but the FCA has, of late, instigated a *de facto* approval process, with many firms facing delays and some having to 'undertake' or agree VREQs not to take on any more ARs, particularly to carry on retail business.

Additionally, an AR is much less expensive in terms of application costs and capital requirements, and is much cheaper in terms of ongoing costs, when compared to being directly authorised (so-called "DA"). This is because there are no mandated capital requirements for ARs. It is the Principal that primarily incurs the costs of regulation, and ARs pay a bundled fee to use the Principal's authorisation.

The benefit for the Principal is the ability to leverage infrastructure and add in multiple ARs to a certain scale, without additional costs. The infrastructure required to have five ARs is broadly the same as having 10 and having 25 ARs can be achieved on pretty much the same infrastructure as having 50 and so on. This is the appeal and means that Principals can have a stable cost-base with a geared, guaranteed revenue stream through ARs, making it an attractive business model.

FCA supervision

The most recent disclosures from the regulator regarding Principals and ARs were the findings from the FCA's multi-firm review into the supervision by Principals of their ARs in the

[10] https://www.fca.org.uk/publications/calls-input/consumer-investments

investment management sector, and the associated 'Dear CEO' letter, in May 2019. In these publications, the FCA reported on its findings from its review of 338 Principals in the investment management sector. In 15 cases, the FCA conducted site visits and reviewed the arrangements within those firms in more detail. The FCA identified significant failings at Principal firms during the review, with the majority of firms having under-developed risk management frameworks and governance / oversight controls in place in relation to their ARs. Each Principal within scope of the review had between one and 80 ARs. Overall, in the sector, the FCA noted in the review that investment management firms have appointed over 1,000 ARs. Specifically, the FCA called out shortcomings regarding:

– **On-boarding:** many firms didn't fully understand their ARs' business models and therefore the risks they pose. Many Principals did not appear to understand the conflicts of interest inherent in their AR business model, or put in place controls to mitigate them, suggesting the initial due diligence undertaken on ARs is often not sufficiently robust.

– **Ongoing monitoring:** another common theme was Principals not having sufficient controls or resources in place to monitor their ARs effectively. The regulator found scant evidence of client file testing and compliance monitoring generally. Where monitoring was evident, it was not bespoke to the business model of the AR and the Principal often relied on high-level attestations from the AR. None of the Principals in scope regularly reviewed their ARs' websites, with a number containing non-compliant financial promotions and inaccurate information about the AR's regulatory status.

– **Capital and liquidity:** as Principals are responsible for their ARs (including any liabilities arising), they should assess any risks arising from their ARs' activities and consider what additional financial resources are appropriate to meet their obligations. The FCA identified that some Principals were likely not holding sufficient financial resources for both liquidity and capital to reflect the risk represented by an AR's business model, therefore putting the Principal at risk of breaching Threshold Conditions and Principles 3 and 4.

The FCA's thematic review of Principals and their ARs in the insurance sector in 2016 also found that, in many of these areas, a large number of firms were not meeting the FCA's minimum expectations – so there appears to have been little improvement in other sectors based upon published findings, which is something that the FCA always looks upon dimly. This lack of progress alongside the increasing number of ARs is a strong indicator that the FCA will look to revise the regulatory framework in this area in 2021 and potentially use the on-shoring of regulations to achieve its aim.

FCA supervisory work in 2020

Despite Covid-19, the FCA has continued to undertake supervisory work in relation to Principals and ARs during 2020, including through the use of Skilled Person's reviews.

During 2020 the FCA has identified familiar weaknesses regarding the systems and controls of Principals. The regulator has been active with both s166 review supervisory work and supervisory review and evaluation process (SREP) work.

The focus of SREP reviews is usually a firm's Internal Capital Adequacy Assessment Process (ICAAP), and work in this space is unsurprising given some of the concerns previously flagged through FCA findings regarding the potential for breaches of capital adequacy requirements and the appropriateness of capital resources in terms of the risks to Principals presented by ARs' business models. The FCA has previously had concerns that Principals may not be holding adequate financial resources, both liquidity and capital.

We are aware that in some cases the FCA has issued Individual Capital Guidance (ICG) to firms following SREP reviews of

ICAAPs, with concerns centring on the accuracy of Pillar 1 capital requirements, a 'Threshold Condition'. ICG is usually issued by the FCA to firms where the regulator has concerns that a firm is not holding sufficient regulatory capital. In most instances, this means the firm will have to hold significantly more regulatory capital. Additionally, the FCA identified concerns regarding the lack of an effective risk assessment of ARs within Principals, with Principals failing to differentiate the level of risk posed by their individual ARs.

What does a robust control framework for Principals look like?

Principals should take note of the FCA's renewed interest in this area. The four key areas for Principal firms to consider in relation to their ARs are: due diligence (and on-boarding); written agreements; regulatory capital; and ongoing monitoring.

Alongside these areas, in the investment management sector in particular, Principals should always ensure that as part of their Compliance Monitoring Plan (CMP), they are reviewing:

– the FinProms in use by ARs, introducer relationships (particularly with any unregulated introducers) and their understanding of their own business model and products;
– the suitability of advice given to clients by their ARs; and
– the training and development needs of their ARs.

Implementing a robust AR control framework

Principals should focus on minimising the level of regulatory risk they are exposed to in relation to their ARs, as far as possible. Some core elements firms should aim to incorporate into a robust AR control framework include:

– **AR due diligence:** before on-boarding an AR, Principals should undertake a detailed assessment of the unique regulatory risks that each AR may pose. Principal firms should consider issues including the fitness and propriety of an AR's directors and other key staff, the suitability of the firm's business model, and the level of ongoing oversight that is likely to be required to effectively monitor the AR.
– **AR control framework review:** Principals should review regularly through second line monitoring the effectiveness of their controls and oversight framework relating to ARs, in line with FCA's evolving expectations.
– **ICAAP review:** Principals should regularly review their ICAAP to ensure that all of the risk types that arise as a result of their AR relationship(s) are being appropriately considered, and assess whether the firm is holding sufficient regulatory capital to cover those risks.
– **Compliance monitoring:** Principal firms should design and implement a risk-based CMP that enables the effective monitoring of the risks posed by ARs. Where necessary, Principals should also undertake targeted thematic monitoring reviews of higher risk ARs, where management information indicates there may be increasing levels of risk, or new risks developing (e.g. suitability).

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Overhaul of the UK Financial Promotions regime

The 'FinProm' regime in the UK shares a number of similarities to the historic Data Protection framework, prior to the introduction of the GDPR in 2018. New and innovative ways of marketing new and innovative products and services present risks in today's world that aging regulation was not able to foresee.

We've reached a point where the roles of those approving FinProm controls are insufficiently defined and non-prescriptive approval rules have led to a wide interpretation when it comes to responsibilities in the FinProm publication process and the standards to be met. In essence, the murkiness in the rules around FinProms from inception have become blind spots, and the regime is arguably no longer adequate for how communications are being made in today's world.

The Financial Promotions Order (FPO) provides much needed clarity to FCA rules in a number of areas, however, the overlay with PERG and considerations such as 'in the course of business', 'solicitation', 'invitations' and 'inducements' means that many shades of grey exist in current regulation. It is now felt by competent authorities that the FinProm regime is falling short in terms of delivering the consumer protections for which it is designed.

Currently, under FSMA, non-authorised firms wishing to promote products and services that may be within the regulatory perimeter, have been able to rely upon authorised firms to approve such communications. However, lack of efficacy in a number of circumstances, such as promotions relating to mini-bonds, has prompted the Treasury to launch a consultation calling for additional 'gateway' protections to be introduced, as it is felt that "The regime needs additional safeguards to ensure that approval by an authorised person is a genuinely effective means of ensuring that consumers are protected from deficient or potentially harmful financial promotions."

This came seven months after the FCA introduced a temporary ban in January last year following serious concerns that 'speculative illiquid securities' were being promoted to retail investors who neither understood the risks involved, nor could afford the potential financial losses.

In responding to a Freedom of Information request, the FCA said that, between 1 January 2019 and 1 August 2020, it had contacted 55 authorised firms to ask them to amend or withdraw promotions that they had approved, because it had concerns that the promotions may have been "unclear, unfair or misleading". The point remains that there is probably insufficient clarity on the areas mentioned above that the FCA still has to be the arbiter of what is 'fair, clear and not misleading', after promotions have gone live and the damage to consumers may have been crystallised.

The FCA said that it had not taken any enforcement action against firms or individuals for approving the communication of misleading or inaccurate financial promotions for the period, but it had a "number of ongoing investigations, where the suspected misconduct relates in some way to the communication of financial promotions". Things have moved on.

Highlighting the level of concern on this topic, the HMT Consultation entitled 'Regulatory Framework for Approval of Financial Promotions' ran from 28 July to 25 October 2020 and cited some of the following areas as concerns:

- lack of a specific suitability assessment for authorised firms approving financial promotions;
- lack of relevant approver firm expertise;
- lack of approver firm due diligence; and
- challenges in exercising appropriate regulatory oversight.

The implications of failings in these areas were noted as being:

- investor losses;
- re-direction of investment away from appropriate products; and
- loss of consumer confidence.

The consultation set out the proposed amendment to FSMA, so that the general ability of authorised firms to approve financial promotions of unauthorised firms is removed.

Two 'gateway' options were proposed:

- **Option 1:** restrict approval of the financial promotions of unauthorised firms through the imposition of requirements by the FCA: Section 21(2) (b) of FSMA would be amended. The amendment would mean that unauthorised persons were only able to communicate their own financial promotions, if these had been approved by a firm that had obtained consent from the FCA to provide such approval.
- **Option 2:** specify the approval of financial promotions communicated by unauthorised persons as a 'regulated activity' under FSMA.

Before we know the outcome of the HMT consultation, FCA followed up last month with a permanent ban on the mass marketing of speculative illiquid securities, including speculative mini-bonds, to retail investors. Given the issues identified in this area, it is not surprising that the FCA has not waited for the outcome of the HMT consultation before seeking more permanent measures in this sector of the market, but it is anyone's guess as to the future of the overall FinProm regime.

The conclusion may be that there is only one outcome when considering that the FCA has to continue to balance its statutory objectives of consumer protection, integrity of the UK financial system and promoting competition. The unprecedented events of last year have impinged upon the FCA's ability to adhere to statutory deadlines, accordingly, when looking at the proposals pragmatically, it may be that the only pro-business option is to make this a regulated activity, rather than seeking to provide approval on a case-by-case basis.

One way or another, our hopes are that the resulting regime will mean that only those firms with the correct knowledge and understanding of relevant activities will be the ones who take responsibility for the approval of Financial Promotions. If done right, this could achieve two further apexes in terms of regulation; the first being that the regime is better able to self-regulate - with authorised firms providing more relevant checks and balances to unauthorised firms (as their own authorisation and livelihood is intrinsically linked to 'doing the right thing'). Second, that the new regime is future-resilient, with those involved in the development and distribution of new and innovative products and services also defining the prevailing standards as the financial services sector continues to evolve.

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The Senior Managers & Certification Regime

While the initial roll out of the SMCR took place four years ago for systemically important dual-regulated firms, the SMCR was extended to a further 47,000 solo-regulated firms in December 2019, replacing the Approved Persons Regime (APER). Having just passed the 12-month anniversary of the implementation, we reflect on each of the areas of the three strands to the regime.

At this point, in ordinary circumstances, we would expect that there would be a substantial body of feedback from the FCA regarding findings from supervisory work relating to the roll-out of the regime across different sub-sectors. However, given Covid-19 inhibiting the amount of thematic monitoring the FCA has been able to perform, direct regulatory feedback has not been abundant, so we share below feedback from our clients and from events in which we have participated throughout the year.

The Senior Managers Regime

Generally, firms have not had major issues with this aspect of the regime; having had a number of regulatory clarifications in the FCA guide for solo firms, assigning and implementing Senior Management Functions and Prescribed Responsibilities has taken place with minimal challenge. A survey conducted by DWF early into the extension of the regime told us that 48% of respondent firms found the most debated aspect of the SMCR launch to be narrowing down who in the organisations should hold ultimate responsibility, or where applicable, overall responsibility.

In terms of monitoring and follow-up, firms are still finding their feet when it comes to being able to demonstrate evidentially that Senior Managers are sufficiently meeting expectations in respect of the 'reasonable steps' and the Senior Management Conduct Rules (specifically COCON 2.2.3 / SC3), relating to the oversight of delegated responsibility.

The key learning in this regard appears (as so often) to be clear record keeping and detailed note taking when participating in Committees and Forums – having one's view recorded for posterity is important. Additionally, having greater formality around one-to-one meetings with line reports is becoming increasingly important, so that there is a record of discussions considering competence, capability and capacity of team members and that this is objectively reviewed, with any necessary support measures highlighted on an ongoing basis.

The Certification Regime

This aspect of the regime has again not greatly fazed many firms in terms of its implementation. Initially, some firms were unsure about whom to include in the Certification regime but, again, evolving FCA guidance assisted and firms tended to take a conservative approach with whom they included in the regime.

From the firms surveyed, given the familiarity with this component under the APER, Fitness and Propriety assessments (F&P) have generally not created challenges for firms. However, firms are still finding their way when it comes to assigning responsibilities appropriately within the business to ensure that certification assessments are undertaken effectively, with different firms taking differing approaches to where the assessments sit between the business and HR. However, as we approach the anniversary for firms to have completed the first re-assessment of F&P, challenges are arising in respect of assessments encompassing more than the binary consideration of financial or criminal conduct.

Our work through DWF Responsibility has highlighted that as the Certification regime begins to embed, the next iteration of F&P assessments is very much focussing on the myriad issues surrounding non-financial misconduct and how they must be monitored, investigated and considered when making a determination about assessing F&P.

The Conduct Rules

The Conduct Rules for Senior Managers and Certification Staff came into force in December 2019, but for staff subject to the regime, not in one of the first two categories, the December 2020 deadlines were pushed out by four months, allowing firms until 31 March 2021 to conclude the implementation of the Conduct Rules fully across their businesses.

Indications from our survey were that firms were well placed to meet expectations for the Conduct Rules population but, anecdotally, that the additional time permitted by the FCA would definitely be valuable in terms of ensuring that firms have mechanised processes in place for confirming ongoing compliance with Conduct Rules.

As with most feedback received from the Individual Accountability event that we held in conjunction with the legal publication, 'The Lawyer', those that we spoke to confirm that their organisational experiences of implementing Conduct Rules mirrored experiences in respect of implementing the regime as a whole. Firms were good at delivering the training and executing the project to perform the initial assessment, but that having the indicators and processes working organically as part of 'business as usual' was proving to be more of a challenge.

This mirrors the one publication that we did see from the FCA in respect of SMCR. In a paper entitled 'Messages from the Engine Room', published in September 2020[11], the FCA provoked feedback from Wholesale Banking Supervision, having posed five questions to firms. The FCA pulled out some key themes arising, such as:

– Carefully considered remuneration schemes can lead to some excellent practices; and
– Employees are often unclear on the purpose, principles and values of their organisation, confusing individual mantras of dynamic leaders as being what the firm itself actually stands for;
– that Firms should shift focus slightly and not just concentrate on the tone from the top, but instead be alive to the 'tone from within'; and, lastly
– to the point about whether firms viewed the SMCR as a project, more than business as usual, the finding from the FCA is that firms very much now need to focus on embedding the SMCR.

The paper itself is well worth reading and we would recommend that all regulated firms use the questions as a barometer for their own business, regardless of the sector in which they operate.

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[11] https://www.fca.org.uk/publication/market-studies/5-conduct-questions-industry-feedback-2019-20.pdf

2020 case law update – *Carey* and *Avacade*

It is revealing that so much interest has been shown in key recent Court cases. *Berkeley Burke* (a legal challenge to a FOS decision) fell at the last hurdle but 2020 saw two key legal judgments in and around the FCA's perimeter – *Avacade* and *Carey Pensions*. The FCA has made its position clear on both and, regardless of the outcome of the forthcoming appeals, the FCA has shown willing to disagree with the Courts.

In a rare 'long read' on case law, we discuss below two cases which we consider may have great significance for the wider wealth management sector. Both of these cases deal with the FCA's regulatory perimeter. The most interesting point is how they approach the 'arranging' activities as per Article 25 of the Regulated Activities Order 2001 (the RAO). There are also some points of interest for execution-only SIPP providers and, by extension, possibly other 'EO' businesses, such as the comments in *Carey* on the client best interest rule.

Both cases have similar facts whereby retail investors have lost significant sums of money from an investment promoted to them by unregulated introducers. The investments were purchased in an execution-only SIPP.

Whilst it may seem that there is little for regulated firms to take from this, in our experience, a number of firms deal with unregulated introducers. We have seen this as a particular issue for networks or firms with large numbers of de-centralised branches as, without strong supervisory controls, it is easy for Appointed Representatives (ARs) or those branches to be used to facilitate these type of arrangements. (We touch on this more in our article on Principals and their responsibility for their ARs).

The *Carey* case helps to provide some comfort to SIPP providers as well. It will be interesting to monitor FOS decisions going forward by reference to this case. We must also be conscious this is different to the *Berkeley Burke* case as that involved a fraudulent investment. It also appears that the FCA is still pushing ahead, based on its 'Dear CEO letter' dated 2 December 2020[12].

Adams v Carey Pensions / Options SIPP UK

The pertinent facts in this case are:

- The Claimant was a self-employed haulage contractor who had a FriendsLife personal pension with a value of approximately £52,000. It was accepted that the claimant was of limited means (albeit the specifics were not determined).
- The Defendant operated and administered execution-only SIPPs.
- The Defendant had a business relationship with CLP. CLP referred clients to the Defendant. Whilst the Defendant did not pay for the introductions, they were aware that CLP earned commission from the underlying investment provider of 2-5%. They also knew that investors in the Store First scheme would be directed to the Defendant to invest their pension funds via a SIPP provided by the Defendant.
- This was a significant arrangement for the Defendant who had 580 clients in the Store First scheme amounting to approximately £29m. Most of these clients were introduced by CLP and this equated to approximately 10% of the assets held by the Defendant.
- The Defendant had a due diligence (DD) process for unregulated introducers. It's important to note that a failure of DD was not pleaded but submissions were made at trial.
- The contractual arrangements made clear that CLP was introducer and the Defendant was providing execution only services and had the ability to reject introductions.
- The FCA visited the Defendant and provided feedback in a letter which, in His Honour Judge Dight's view, "demonstrates that the FCA were fully aware that unregulated brokers, recommending underlying investments, were introducing investors to the defendant so that a SIPP could be set up on an execution-only basis. Had the FCA formed the view that this was in breach of the duties, obligations and authorisation of the defendant I am sure that they would have said so".
- The Defendant's terms and declarations were clear in that they were not advising the Claimant.
- An important point to note is that this appears to be a direct property holding and so is not a specified investment for FSMA purposes.
- Finally, the FCA was permitted a limited role at trial to provide submissions to assist on questions of law. It was not permitted

[12] https://www.fca.org.uk/publication/correspondence/sipp-operator-portfolio-letter.pdf

to submit factual or expert opinion evidence or make submissions as to the factual evidence.

Regulatory Considerations

Section 27 FSMA Claim

The primary claim was that CLP was carrying on a regulated activity despite not being authorised. This meant s.27 FSMA should apply, making the SIPP agreement unenforceable and the Claimant should, therefore, be entitled to recover his investment loss. The Defendant claimed there was no such breach of the FCA perimeter by CLP and, even if there was, HHJ Dight should apply the discretion allowed under s.28 FSMA to find that the agreement is still enforceable.

This claim required the Claimant to prove that CLP was carrying out a regulated activity in breach of the general prohibition which led into the discussion on Articles 25 and 53 of the RAO.

This is why firms need to be aware of their arrangements with unregulated introducers and ensure there is a sufficient on-boarding and DD process and ongoing monitoring in place to address and minimise this concern (and others).

Article 25 (1) and Article 26 RAO

One requirement for Article 25 (1) and Article 26 is the need for a causal link between the act(s) of arranging and the transaction itself. The question then becomes, what standard is this causal link?

It was argued by the Claimant, which HHJ Dight notes the FCA appears to have also suggested, that "the court should conclude that the appropriate causal link would be established if the well-known common law "but for" test were satisfied". However, HHJ Dight disagreed. He stated: "The relevant words of Article 26 are "bring about". That phrase, in ordinary English, suggests that the arrangements have to be a positive or effective cause, not merely a set of circumstances which may be no more than the context of the transaction which eventuates".

HHJ Dight went on to conclude that: "<u>I accept the defendant's submissions that for the arrangements to bring about the transaction there must be a direct and substantial causal connection between the arrangements and the ultimate transaction</u> and that simply giving advice on the underlying investment and effecting an introduction are not sufficient because those acts do not necessarily result in anything further happening and the further steps which were necessary to establish a SIPP were not within the introducer's power to effect or direct" [emphasis added].

We also note that HHJ Dight went through the acts which allegedly amounted to arranging and stated: "The completion of the application form may be said to be getting closer but it is still essentially administrative in nature, it did not require the specialist knowledge found to be key in other cases, the questions were not difficult to answer and it was intended, in any event, to be completed by a lay person on line". For these purposes, this comment would suggest that administrative acts would generally fall outside of Article 25 (1) activities. That said, we would still recommend requiring unregulated introducers to not be involved in completing applications forms and the like.

Finally, HHJ Dight concluded: "It cannot be said that the acts of CLP were causative of the transaction, other than in the "but for" sense. In my judgment, the acts of CLP did not "bring about" the transaction and therefore the SIPP was not entered into as a "consequence of" CLP making arrangements within the meaning of Article 25(1)". This highlights that the casual link required under Article 25 (1) is significant.

Article 25 (2) RAO

Historically, there has been an area of debate around introducing and whether it is captured by Article 25 (2). The FCA are bullish on this point and say (at PERG 2.7.7) that arrangements "to enable or assist investors to deal with or through a particular firm (such as the arrangements made by introducers)" are caught. There is some nuance on this point and a potential distinction between an active and passive introduction.

However, previous case law has found contrary to this. The FCA (at PERG 2.7.7 BD), specifically addresses *Watersheds Limited v David Da Costa and Paul Gentlemen*: "The judgement suggests that the activity of introducing does not itself constitute a regulated activity for the purposes of article 25(2) of the Regulated Activities Order". The FCA concludes this case should be considered in light of its own facts (i.e. it is of limited precedent value) and, in any event, the judge did not have sight of a key argument, summarised in the question: 'why have exemptions for introductions if they are not generally caught?'.

In that PERG section, the FCA concludes it "remains of the view that article 25(2) of the Regulated Activities Order includes certain types of arrangements for making introductions whilst recognising that the judgement in the *Watersheds* case introduces an element of doubt". Indeed, the FCA must have made a similar submission in this case as HHJ Dight referenced as much.

Whilst noting the case on Article 25(2) was not properly pleaded, HHJ Dight said: "In any event in my judgment any purported reliance on Article 25(2) does not assist the Claimant … "arrangements" should be construed in the same way as in Article 25(1) and a mere introduction would not suffice and the steps taken "with a view" to a transaction would have to be capable of satisfying a notional causation test. Thirdly, as a matter of fact, the steps taken by CLP are not capable of satisfying any such test".

HHJ Dight went on to say: "insofar as it may be alleged that the arrangements were the arrangements between CLP and the defendant in 2011 and 2012, which became regulated by the

Terms of Business, not only is that not pleaded but in my judgment it is not capable of falling within a proper interpretation of Article 25(2) because it has no reference to the claimant". If this is the correct legal position, this appears to allow more, potentially quite a lot more, arrangements to occur outside of the regulatory perimeter.

As the FCA's view has been disregarded by HHJ Dight, subject to any Court of Appeal commentary at the forthcoming appeal hearing, it will be interesting to see if the FCA updates its guidance on this point as it seems its views are less sustainable, at least as currently set out in PERG 2.7.7.

This decision does not mean it is open season for unregulated introducers and the firms that engage with them. The status of 'mere introductions' is still not certain. Firms will also still need to be very careful about any further arrangements they enter into. The more the introducer involves itself with administrative or arranging steps post introduction, the more likely it is that the introducer will stray into the regulated arena.

Indeed, we expect this area of regulation to remain contentious. The Work and Pensions Select Committee has a current inquiry into protecting pension savers. As part of this, there has been discussion as to whether introducers should be regulated (which in and of itself seems to suggest the Committee thinks they are not currently, which again runs contrary to the FCA's position).

Article 53 RAO

HHJ Dight stated that the FCA considers that someone advising on the merits of using a particular investment company "is contemplated by PERG 5.8.14 as being an implied recommendation of a particular investment and therefore within RAO 53 because the effect of it is to steer the client towards a particular investment".

HHJ Dight held: "Even if "recommending" a specific SIPP, which in my judgment falls short of advising on the merits of a particular investment for the purposes of the Article, fell within Article 53 nevertheless in this case the evidence does not support a contention that the claimant was recommended a specific SIPP by CLP, let alone the particular SIPP that he entered into". It is not entirely clear what this is saying but we think HHJ Dight is drawing a distinction between "recommending" a SIPP in general as a product type compared with advising upon a particular SIPP. Quite what the difference is and when a recommendation becomes advising is not clear from the judgment.

Notably, however, HHJ Dight concludes that the evidence at its highest is that any recommendation was "of the defendant and not of any of their specific products. I do not accept the submission that steering an investor in the direction of a specific SIPP provider amounts to a recommendation of a specific SIPP or "advising" in the sense contemplated by Article 53". This latter point seems to directly dismiss the FCA's submission (set out above).

We agree on this point. Whilst it may be possible to imagine a contrived scenario designed to find a way around the rules, it is hard to see how a recommendation of a product provider could or should generally amount to advising on a particular investment, as contemplated by the RAO.

It is also interesting whether this would have any impact in instances where the FCA asserts in PERG 8 and PERG 8 Annex 1 that certain scenarios amount to an implied personal recommendation. Whether a Court has to tackle this point and what its stance would be is something to look out for.

Section 28 FSMA

Despite finding that CLP was not carrying on a regulated activity, HHJ Dight went on to conduct the required balancing exercise in s.28 FSMA in order to decide whether it would be just and equitable to allow the agreement to be enforced even if s.27 FSMA had applied. HHJ Dight held that he would enforce the contract and that "There is no reason in the circumstances why [the Claimant] should not take responsibility for his own decision". This was because a) the Defendant had put a system in place to constrain the role of CLP and was entitled to assume it was working; b) the Defendant would not have been aware of the alleged breach; and c) the Claimant knew and was prepared to accept the risks. It is not hard to imagine points a) and b) being considered differently by the FCA in an enforcement context.

This application of s.28 should provide some comfort to investment firms as, no matter the policies and procedures, process and safeguards one creates, there can never be any guarantees that nothing will go wrong.

The Client Best Interest Rule

It was claimed that the Defendant had breached the rule at COBS 2.1.1. It is interesting to note HHJ Dight's summary of the FCA's view of the duties that apply to SIPP operators generally under Rule 2.1.1: "They say that there is a duty to ensure that the proposed underlying investment is not part of a fraud or scam. Further, the FCA disagrees with the defendant and submits that Rule 2.1.1 "does include a duty not to accept into a SIPP an investment of a kind that is inappropriate for any SIPP investment, or for any SIPP investment by a retail customer who is not known to have received independent regulated advice about the investment." They say to act otherwise would be not to act in the client's best interests in accordance with the Rule".

HHJ Dight states that to identify the duty imposed by Rule 2.1.1 you must identify the relevant factual context. In this instance he highlighted the key fact is the agreement between the parties which defined their roles and functions in the transactions. HHJ Dight also considers the FCA's consumer protection objective as relevant. The FCA must also have regard to, amongst other things "the general principle that consumers should take responsibility for their decisions".

HHJ Dight says the starting point is the contract between the Claimant and Defendant. HHJ Dight highlights he was not made aware of any provision in the regulatory regime resulting in the COBS duties taking precedence over the contractual terms. The obligations imposed by COBS 2.1.1 have to be read in light of the agreed upon relationship between the parties. The judge concluded "A duty to act honestly, fairly and professionally in the best interests of the client, who is to take responsibility for his own decisions, cannot be construed in my judgment as meaning that the terms of the contract should be overlooked, that the client is not to be treated as able to reach and take responsibility for his own decisions and that his instructions are not to be followed".

We consider this is a sensible proposition and one which the FOS would do well to take as its starting point rather than the ever increasing assumption that where the client suffers a loss then there must have been a failing by the regulated firm. We are also concerned with this general rule being used to try and blur the lines between the responsibilities owed by firms providing different service levels. A conclusion which explicitly or implicitly requires an execution only firm, whether SIPP or platform for example, should have provided a client advice is not sustainable and is not what is required in the relevant (and substantial) UK and EU legislation. It is also unsatisfactory that the FCA relies on general rules and principles in scenarios where it seems to have a set of internal rules, requirements and expectations. We also cannot see how the FCA hopes to simplify the 'advice boundary' without respecting the lines drawn in the contract and in law.

Due Diligence

A failure of DD was not pleaded and so it was always going to be a difficult point for the Claimant to succeed on when raised at trial. The Defendant explained that it had "conducted a number of due diligence exercises in relation to the Store First Investments in order to establish that the investment was a legitimate investment and one that was capable of being held in a SIPP pursuant to HMRC guidelines". This included obtaining third party reports about the suitability of the Store First investment being held in a SIPP. The legal documentation and literature as well as template leases and sub-leases relating to the investment were all reviewed. Checks were also conducted on the directors and shareholders. Company reports and accounts were obtained.

The claimant submitted that the Defendant's checks should have revealed a number of high risks relating to CLP which meant that they were not an acceptable introducer for the Defendant to deal with. Even though HHJ Dight stated he did not have to determine the question of DD, he concluded "that the defendant undertook proper due diligence and behaved appropriately in the best interests of their clients in that respect".

This provides a) an idea as to what in this case was held to be sufficient due diligence and b) that Courts understand and respect the difference between execution only duties and advisory activities. The latter point is something we consider the FOS should place more weight on when determining what is fair and reasonable.

Status of Guidance / Thematic Reviews etc.

This case neatly highlights the difference between the Court and the FOS and FCA. The FOS, in our experience, treats informal guidance and thematic review findings as gospel, whereas, in this case, HHJ Dight found that "The Thematic Review cannot properly be described as a set of rules or even guidance and in my judgment cannot give rise to a claim for failing to follow the suggestions which it makes. Nor in my judgment is it a proper aid to statutory construction of the COBS Rules which must be construed in accordance with the usual principles of construction". The latter part is significant as if it cannot aid COBS construction this must, by default, apply to and limit the client's best interest rule in court claims. From a legal perspective, the FCA's high-level Principles for Businesses cannot ground a civil claim so the lack of reference to the PRINs is not of significance. This does pose the question as to why the FCA does not create additional rules and guidance in COBS relating to SIPP business. A similar point can probably be made in relation to DB transfers (at least, until recently).

Another favourite of the FCA and FOS is to say that guidance provided after the event is relevant when considering actions carried out prior to the guidance being issued on the basis the guidance was just explaining what the firms' duties - and expectations of the FCA - are and have always been. In this case, HHJ Dight found that later 'guidance' can have no direct bearing on the matters. It will be interesting to see how the FOS responds when challenged on this point of legal principle and precedent, albeit the FOS is not bound by legal principle.

Conclusion on *Carey*

The judge was careful to link his decision to the specific facts. He was also clearly (and rightly) persuaded by the fact that the client understood the risk. In our experience, many complainants, particularly when dealing with the FOS, are less forthcoming and, no matter what they were actually told will, rightly or wrongly, say they did not fully understand the risk.

There were also a number of potentially relevant points of wider interest that were not pleaded, which gives the impression that the findings are not necessarily that strong. That makes the appeal all the more important.

That said, at least from the legal standpoint, this case offers some hope of turning the tide against a seemingly ever increasing attack on execution only operators. We still find it baffling that the FCA, for example, relies on a thematic review from 2009 rather than setting out rules on SIPP operators. This would make this area of investment business a lot more predictable and legally certain (to a point) but there is still a surprising reluctance to do so.

Avacade

The facts in this case are long and complex (described over 27 pages in the judgment[13]) and changed over time but, for these purposes, we note the following facts:

– An unregulated business was contacting individuals directly with a view to them commissioning a "free pension report"
– If the individual elected to proceed, they were sent a LoA together with a signature pack. This was often obtained via a courier who would apparently wait for signature and return the signed documents to the introducer
– There were various steps at this stage, often involving two further calls with the client, obtaining information from the pension funds and producing a pension report which set out investment options
– There was then a call following the pension report with Avacade to discuss this. If deciding to transfer into a SIPP, a courier would again obtain the required signatures (with it being "common ground that the practice was for the courier to wait for the documents to be signed immediately by the consumer and returned")
– If a client elected to receive advice it would happen at this point. The advice was typically limited in nature
– Finally, there was an 'Investment Call' "to discuss the investments which might be made with the funds transferred into the client's SIPP".

For completeness, we note that there were a number of defendants and a couple of different entities. For the purposes of this article, we generally do not (and do not need to) differentiate between the defendants.

A key, if not only, purpose of this arrangement was to funnel individuals into picking investment products from which the introducer would earn commission.

The FCA brought a restitution claim under s.382 FSMA. This allows a Court to order a person, who has contravened a relevant requirement, or been knowingly concerned in such a contravention, which has caused profits to accrue to him or caused one or more persons to suffer a loss or be adversely affected owing to the contravention, to pay such sum as appears to the Court to be just taking into account factors set out in s.382.

The Court found in favour of the FCA in this instance. This Defendants have been given permission to appeal to the Court of Appeal (CoA).

We draw out below what we consider the key points to be. Whilst we query a couple of the conclusions reached and points made by the judge when considering it in a wider regulatory sense, based on the judge's summary of the facts, it does not appear to

[13] https://www.bailii.org/cgi-bin/format.cgi?doc=/ew/cases/EWHC/Ch/2020/1673.html&query=

be a difficult case in which to conclude that the perimeter was breached (in some way). It will be very interesting to see how the CoA deals with the appeal.

At the risk of being made to look silly, our prediction for the appeal is that whilst it may: a) slightly narrow the application of Article 25 (2); and, b) widen the application of Article 33; it will substantively uphold the verdict of the judge. What we hope the CoA does not do is decide on the facts that this is an easy case, thereby avoiding dealing with the legal points in detail.

Article 25 RAO

Unsurprisingly, the judge held that Article 25 (2) is intended to have a wider application than Article 25 (1) (which, he found, must be causative of the transaction). Specifically, he states that "Art 25(2) is broader, and seems apt to capture arrangements which, although they do not or would not necessarily "bring about" the transaction, in the direct sense of causing it to occur, are nonetheless performed "with a view to" encouraging or assisting it to happen…The phrase "with a view to" describes a more inchoate form of activity, which is not necessarily causative of the transaction in the sense that it brings it about, but which nonetheless helps it to happen"…he confirms this where he says "Once again, not all of such steps would necessarily have been causative of a transaction actually being concluded, but in my judgment that is not the test under Art 25(2) (cf Art 25(1)). The point is that they did all have the effect of contributing to, or encouraging, the conclusion of a transaction".

The judge has framed this in such a way as to create a low bar which would capture a wide range of arrangements. The judge also stated that he is not persuaded that Article 25 (2) should be confined to instances where the arrangements involve providing assistance to both parties.

It will be interesting if this is a low enough bar so that effecting introductions, in and of itself, is sufficient. The judge did not deal with this point (and did not need to on the facts) but if answering the question, 'does an introduction "help [a transaction] happen"?' it is a difficult to say 'no'. This would seemingly be at odds with the *Carey* case as, if you remove the introducer in the *Carey* case (CLP), it is hard to imagine Mr Adams having subscribed for a SIPP at all. Perhaps the differing investments in the two cases make that comparison ill-founded but it is worth noting that HHJ Dight in *Carey* stated (obiter) that he did not consider a mere introduction sufficient for Article 25 (2) purposes.

Article 27 RAO

The judge gave the arguments put forward by the Defendants short shrift on the facts and expressly agreed with the FCA's guidance at PERG 2.8.6A which provides a limited exclusion for parties which provide the means of communications (obvious examples include internet service providers (ISPs) and telecommunications networks).

There is still scope that this exclusion could be wider than simply ISPs and telecommunication networks (and the like) as the current FCA guidance indicates the exclusion is lost where the person making the arrangements goes beyond providing the means of communication and adds value to what is provided. However, without clearer judicial commentary, it is advisable to stick closely to the FCA's view of the meaning of this exception which is focussed on some form of technical means to communicate.

It would also not surprise us to see the argument that a mere introduction, in its most basic form, could be caught by this as what value does the introducer add if it simply puts two people into contact? We consider it unlikely that the FCA would agree with this view.

Article 29 RAO

The judge, in the circumstances, refused to separate out arrangements with a view to the SIPP and arrangements with a view to the underlying investment. This was for two reasons: a) the SIPP transfer was only an intermediate step and not the end of the arrangements/transaction; and, b) "in any event, the evidence indicates that even in the early stages of the process, there was discussion of topics which ultimately would feed into the later decision about investments…The two, inter-related objectives (transfer into a SIPP and the making of investments) were commingled in the same arrangements even in the early parts of the overall process".

This meant the commission received by Avacade arose out of the arrangements in question. In any event, there were also examples of the SIPP provider, Berkeley Burke, paying Avacade a fee which would have not fallen to be caught by the Article 29 exemption.

Article 33 RAO

The judge also made it clear that, in his view, the exclusion operates in a narrow way whereby introducing a client to, for example, an IFA would not be sufficient for Article 33 if the overriding arrangements were not for the purpose of earning commission from the introduction itself:

"The fact remains that it was devised and put in place not in order to effect introductions to IFAs, as a means in itself of generating income (which it seems to me is the real focus of Art.33). Instead it was put in place with a view to achieving a very different result altogether as its desired outcome and end-point"

This is a narrow view – there is a strong logical argument to say that provided an IFA gives true independent advice (by this, we do not necessarily mean independent advice defined in COBS 6.2B but more that the client is advised as to their circumstances and provided advice on the suitability of their potential options etc.) that the safeguards intended by Article 33 are satisfied even if the unregulated introducer earned commission for other purposes. This would not mean the unregulated introducer can act *carte blanche* as it still has to ensure each individual activity it carries out (as well as when looking at them as a whole) does not amount to a regulated activity. It may be that factually it becomes very difficult to create an unregulated business model when trying to satisfy Article 25, 53 and FinProm rules but that is a fundamentally different point as to how the Article 33 exception operates.

The judge goes on to say more fully at paragraph 289: "First, and leaving aside for the moment any question about the quality or scope of the advice to be provided, I am not persuaded that the arrangements I am concerned with, when looked at objectively, were put in place "with a view to" independent advice being provided. AA's business was not making money out of referring consumers to IFAs for advice, in return for payment of a fee. Their business was making money in the form of commissions, out of consumers deciding to transfer their existing pensions into SIPPs and then buying an AA-related investment – the Paraiba bond. If one asks, "what was the purpose of the arrangements, looked at as a whole?", I think it clear that their purpose was the furtherance of that objective. To take an example, when AA prepared a Pension Report, it was not "with a view to" introducing the relevant consumer to BlackStar for independent advice; it was "with a view to" the consumer making a SIPP transfer and investing in Paraiba".

Whether you agree with how narrow the advice line was drawn, it seems safe to say, in this case, that the advice being sought was sufficiently narrow that it would not be possible to label the advice as "independent". This is because the advice focussed purely on that one investment and, even then, did not appear to be that thorough (based on the judge's conclusions at paragraph 274).

This appears to be one of the key grounds on which the CoA have allowed an appeal to be heard so it will be very interesting and important to see what it says on this point.

Article 53 RAO

From an advisory perspective, the judgment probably does not provide anything new or surprising. It highlights what was said by HHJ Havelock-Allan QC in *Rubenstein v HSBC [2011] EWHC 2304 (QB)*, specifically:

"81…In both instances information is provided, and in both instances the client has a choice as to what he decides to do with that information. The key to the giving of advice is that the information is either accompanied by a comment or value judgment on the relevance of that information to the client's investment decision, or is itself the product of a process of selection involving a value judgment so that the information will tend to influence the decision of the recipient. In both these scenarios the information acquires the character of a recommendation."

Whilst both parties relied on this statement, the judge concluded that, in relation to Avacade, the processes went beyond just the provision of information. It involved the "identification, by reference to a number of predetermined themes, of the customer's objectives". The judge went further in explaining the process and then concluded saying: "The conclusion of the whole process… was the identification in the Investment Call of various investment options and a proposed split of the transferred fund between different investment products by reference to the "investment calculator".

Having analysed the process involved in relation to Avacade, the judge stated that it "involved the expression of opinions or recommendations at the very least at two stages: first, at the conclusion of the Report Call, where consumers would have been left with the impression in light of the build-up that the opinion of the Avacade agent was that the option of transferring into a SIPP was the best course to take; and second, at the conclusion of the Investment Call, in particular in light of the "investment calculator" and the suggested division of investments by the agent, which in my view carried with it the implication – in light of everything that had gone before – that "we think this is the best thing for you to do"

The judge goes on to say: "It seems to me that the process, at the very least at these two points, involved just the kind of comment or value judgment on the relevance of the information supplied which HHJ Havelock-Allen had in mind in *Rubenstein v HSBC*".

In relation to AA (a defendant entity), the judge talked about the consumers being exposed to a funnelling process which was intended to draw the consumer into thinking a SIPP was the best of the available options to take.

The question arose as to what effect contracts and/or disclaimers had when determining whether Article 53 RAO advice had been given. Unsurprisingly, the judge considered the substance of the proposition and not just what the contracts between the parties said would happen. Whilst the contract and disclaimers are relevant, they are not determinative. The judge highlighted that activities falling within Article 53 RAO can happen in "unexpected places". The judge also highlighted that: "there is every reason to suppose that Art 53 is there to ensure not only that someone seeking to act as an investment adviser is properly authorised, but also to ensure that where a salesman expresses views which in substance are really advice about the merits of buying or selling particular investments, steps can be taken by the Regulator".

The judge concludes this by asking himself whether what happened can "fairly be described as having the quality and character of advice on the merits of buying or selling securities". The judge answered this in the affirmative.

Appeal

Some of the defendants applied for permission to appeal to the CoA citing 28 grounds. The CoA has granted permission on 4 grounds, these are:

Grounds 1 – 3 Construction of Art 25(2) – "making arrangements" – need for causation

It was stated that these grounds have a real prospect of success and there is a compelling reason why they should be heard. They concern the proper construction of Art 25(2) in context and differing approaches in the *SimplySure* and *Watersheds* cases.

It was also considered that *Ground 9 – construction of Art 33(c) –* has a real prospect of success in relation to the construction of Art 33(c) and a compelling reason why this matter should be heard

Comments from the CoA on these points could be very significant and we wait with interest to see what happens.

Conclusion

This judgment seemingly sets a low threshold when determining whether an activity falls within Article 25 (2). The judge uses the phrase that the activities he identified had "the effect of contributing to, or encouraging, the conclusion of a transaction". Many activities could be said to amount to this.

Perhaps that is the point of the activity and this is a perfectly acceptable outcome but when you tie this to the view that the judge took on the limited nature of the exclusions, and particularly that of Article 33, it does leave a lot of seemingly legitimate arrangements under a cloud of suspicion. Don't forget, a breach of the perimeter without authorisation or exemption is technically a criminal offence so getting this wrong could prove very costly. It will be very interesting to see what the CoA has to say on this as one of the key Grounds of appeal relates to the nature and extent of causation under Article 25 (2).

Whilst not relevant to any takeaway lessons for firms, this is another case of apparent regulatory failure; as it is not clear what the FCA was doing between raising initial concerns in late 2011 and finally acting in June 2014 to investigate, albeit not informing Avacade of this until January 2015?

Comparing the two cases

It appears hard to reconcile quite what the two judgments mean for Article 25 (2).

On the one hand, there is seemingly one school of judicial authority which suggests that mere introductions are not arrangements under Article 25 (2). This appears to be on the basis that they are not sufficiently causative of a transaction actually occurring. This is not to be confused with the causative requirements under Article 25 (1) as arrangements in that instance must bring about the transaction, rather than being a step which leads to the transaction.

On the other hand, the commentary in *Avacade* sets the bar sufficiently low that it would be difficult to conclude that an introduction is not sufficient. There is then the difficulty with the FCA's guidance at PERG 5.6.4 G. This sets out that the FCA consider that introductions are generally caught by Article 25 (2).

The summary of the FCA's view by HHJ Dight in *Carey* shows this to be the FCA's view. Perhaps a line can be drawn between when there is a specific transaction in contemplation rather than more general introductions but the FCA's guidance does not clearly allow for this. The FCA's guidance does seemingly draw a distinction between passive and active introductions.

For these reasons, it will be very helpful for the CoA to consider and adjudicate the *Avacade* case.

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Key areas of expertise

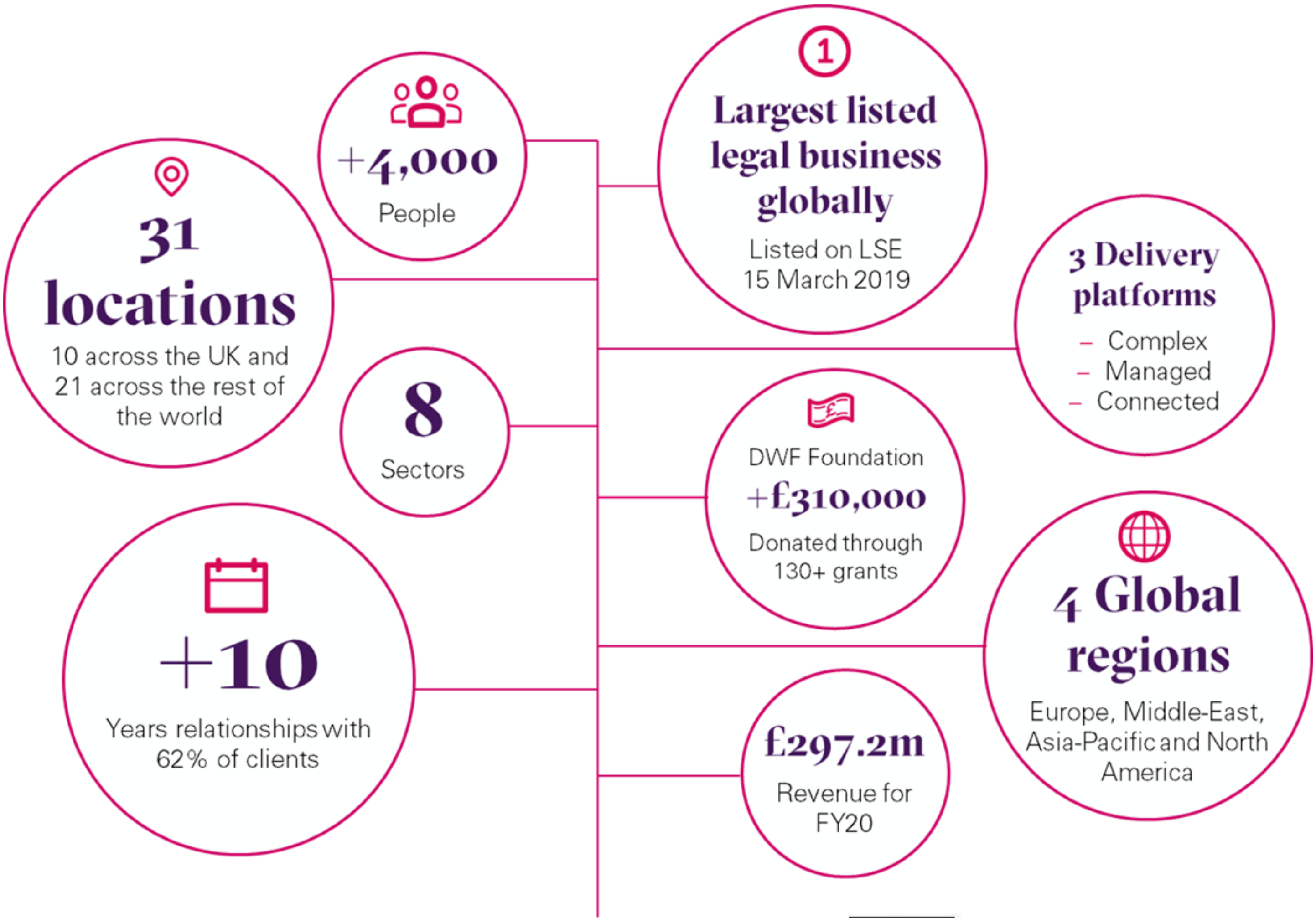
Our FSR consultants specialise in:

- Regulatory & Compliance Advisory: product governance, regulatory structures, regulatory change and risk management, MiFID II, anti-financial crime including MAR, AML/MLR and bribery, SM&CR, FinProms, COBS, PROD, SUP, SYSC, DISP and the rest of the FCA Handbook;
- Distribution Models: new propositions and distribution arrangements, client and intermediary agreements, adviser / DFM partnering (e.g. JVs, vertical integration, trading styles, 'agent as client' and 'reliance on others' or outsourcing), inducement rules, conflict of interests and adviser charging;
- Conduct Risk: former FCA skilled persons advise on conduct risk frameworks, compliance and mitigation for firms and their approved or certificated persons and senior managers, including the Principles for Businesses, Threshold Conditions, clients' best interests, TCF, suitability and conflicts;
- Governance Reviews: review of governance arrangements, policies and procedures, Board effectiveness and the implementation of SMCR;
- Financial Ombudsman Service & Systemic Risks: dealing with mis-selling, root cause analysis, remediation programmes, notifications to the FCA under SUP 15 or PRIN 11, individual or systemic FOS complaints under DISP, Court claims and Judicial Review of the FOS. Acting jointly for PI insurers or supporting uninsured firms through wind down, administration and the FSCS;
- Investigations & (Shadow) Skilled Person Reports: internal investigations, privileged legal advice on findings and skilled persons' 'review and recommend' reports on remedial actions;
- Pensions: advising on regulatory requirements for pension transfers and SIPP due diligence, dealing with Berkeley Burke related complaints, DB transfers thematic reviews and FCA enforcement, systemic liability issues (such as 'insistent clients', introducers and outsourced PTS);
- Enforcement or 'Close Supervision' by the FCA: Advising on interactions with the FCA, from responding to informal or formal information requests, dealing with VREQs or OIVOPs, to defending firms or individuals from Enforcement action, including before the RDC or Tribunal;
- Past Business Reviews & Redress Schemes: Whether mandated by the FCA or carried out voluntarily in line with conduct risk appetites or to comply with FCA rules, customer contact letters and 'review and redress' schemes, in conjunction with PI insurers; and
- Authorisation & Exemptions: We advise firms and Appointed Representatives on obtaining or varying Part IV permissions or exemptions, often with the firm's retained compliance consultant.

> *DWF takes the time to get to know its clients and to understand their needs, and has a refreshing approach that highlights its knowledge and expertise in the best possible way*
>
> **Legal 500**

About DWF

Transforming legal services through our people for our clients.



DWF is a global legal business with a different mindset: we disrupt to progress

We're taking the business to the next level, building on our three principal strategic objectives: understanding our clients; engaging our people; and doing things differently. Our purpose is to transform legal services through our people for our clients. That's why we are transforming our own business, with world-class technological innovation, outstanding sector specialists and advanced working practices that translate into an entirely new business model.

We have received recognition by The Financial Times which named DWF the 7th most innovative law firm in Europe and we were recognised for our ground breaking IPO, where we became the first legal business to list on the main market of the London Stock Exchange.

Beyond borders, sectors and expectations

DWF is a global legal business, connecting expert services with innovative thinkers across diverse sectors. Like us, our clients recognise that the world is changing fast and the old rules no longer apply.

That's why we're always finding agile ways to tackle new challenges together. But we don't simply claim to be different. We prove it through every detail of our work, across every level. We go beyond conventions and expectations.

Join us on the journey.