Wealth Management 2021: A year in review

Second Annual Report

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Editors' Note

Welcome to our second annual Wealth Management and Retail Investments review[1]. Over recent years, it feels like the wealth management sector has had relatively little regulatory change to deal with but social and market changes have brought the (now so-called) 'consumer investment sector' under increasingly close supervision by the FCA, which is being ever more assertive, as it promised.

We have compiled our review with articles from a number of specialist practitioners, both from other lawyers and our Regulatory Consulting team. Regulatory lawyers are – or should be – changing into consultants. 2021 felt like a transitional year in many ways, not just transitioning to a world learning to live with Covid but also a transformational year for the FCA, including significant changes in focus and to its own approach and decision making processes. There are significant regulatory changes forthcoming too, including transition to the new prudential regime for investment firms, a new consumer duty for all to get to grips with and niche reforms - but probably more important for those affected - to the financial promotion and appointed representative regimes.

Andrew Jacobs and (recently promoted) Charlie Baillie of Regulatory Consulting have, once again, taken the lead on IFPR and the proposed changes to the FinPom and AR regimes. New joiner, Shabaz Ahmed, kicks off the review for the lawyers with a summary of the proposed Consumer Duty. Imogen Makin, with input from Zainab (Zee) Bhadelia, has provided an update on FCA Enforcement actions and commented on the FCA's new priority focus on non-financial misconduct. Aaron Osborn has included a short version of a previous article written by him and Shabaz on the changes to the FCA's decision making processes.

We still await the transition from case law to practical reality of the increasingly 'well-ventilated' principles established in the Court of Appeal regarding introducing and the arranging activities. As the FCA polices its perimeter to prevent consumer harm, particularly online, its reliance on jurisprudential support will likely increase. Aaron has provided an update on the most relevant Court cases and the implications for firms dealing with unregulated introducers, in particular.

We are grateful to our Insolvency & Restructuring colleagues, Natasha Atkinson and James Moore, for telling us what they can (based on publicly available material) about the Special Administration of Dolfin which was one of the bigger news stories last year. When Beaufort Securities went into Special Administration in 2018, many in the market were surprised by the broad application of the regime for – and definition of - 'investment banks'. Numerous firms asked us then why client monies were being made available to fund the (staggering) fees quoted by the Special Administrators, given the point of CASS is segregation of client assets and money. Natasha and James' summary of the case and the regime will be of interest to anyone holding assets - and the pre-pack sale of the business will be of particular interest to any aficionados of the regime.

And the ongoing transition to digital distribution across the sector is the subject of Robbie Constance's 'final word'. The pandemic has enabled a step change in digital engagement and electronic communications which can only speed the adoption of robo-advice services and solutions. He sets out the problems observed by the FCA as part of its Consumer Investments Strategy and suggests some hybrid solutions to harness the best of the know-how from the higher risk investment and EO trading platform space for the benefit of the mainstream advisory and discretionary consumer investment markets.

There is also plenty we have not covered here: pension pathways, DB transfers and the British Steel redress scheme, the FCA's decision to drop both the next suitability review and the proposed ban on platform exit fees. We could have commented on the Gloster review into the FCA's handling of LC&F and the Parker review of Connaught. Challenges facing FOS and the FSCS – and the government's FCA-face-saving LC&F compensation scheme - also warrant column inches. No doubt future reviews will feature crypto assets prominently. As ever, wealth management is a lively sector of the financial services market in which we are glad to specialise.

[1] Our first Annual Review (of 2020) is available here - https://dwfgroup.com/en/news-and-insights/reports-and-publications/wealth-management-a-year-in-review

Our team and recent experience

The increasing client demand for specialist legal and regulatory advice from our wealth management sub-sector specialists has required expansion: Aaron has been promoted to Senior Associate and we have recruited a Legal Director.

Aaron's promotion recognises his increasing experience and subject matter expertise. Trusted by clients and colleagues alike, he brings attention to detail, rigorous analysis and independent thought that are second to none.

We also hope to announce a Legal Director hire in H1.

We are uniquely well placed to provide views on the wealth management industry based on the depth of experience. We believe we are the only legal team in the UK focussed exclusively on wealth management regulation.

To help demonstrate our credentials and to provide a flavour of the issues we are dealing with day-to-day for wealth managers, we set out below a list of some key instructions we have worked on in the last year:

FCA investigations covering:

- FinProms and s.89 misleading statements (various similar but unconnected investigations)
- 'Mini-bonds', s21 approvals and distribution conduct breaches
- Defined Benefit Pension Transfer reviews, VREQs, s.166s and linked Enforcement investigations
- Operational resilience and platform migration problems
- Allegations of unauthorised CMC activities on taking over a distressed book of business
- Fund management failings (linked to the ACD thematic review)
- Alleged AML and financial crime failings

With our corporate colleagues, we have supported numerous transactions including

  - regulatory structuring, change in control and SMF approvals, and:
  - restructuring advice, particularly for firms (potentially) impacted by DB transfer liabilities and those interesting in buying their businesses.

We have provided regulatory and compliance advice on a range of matters, including:

- IFPR - group consolidation and the interpretation and application of K-factors
- Helping to review and design new investment products and services, such as:
  - Legal opinions for new robo-advice and ODIM propositions for both traditional and wealth managers and trading platforms
  - Advising on the independent advice standard
  - Summarising the minimum requirements for small client MPS DFM solutions
  - Defining 'platform service provider', assisting with re-platforming and re-organising platform AR arrangements
  - Applying for Authorisations, Variations or Cancellations of Permissions, Approvals and resisting 'voluntary' Requirements and s.166 reviews
- Detailed perimeter advice for introducers, signal providers and trading platforms, and social and copy trading business models, and supporting FCA crypto asset registration applications
- Dealing with the fallout from the FCA's thematic review of principals and their ARs, particularly regulatory hosts and shadowing s.166 reviews
- FSCS claims against administrators or liquidators of firms in default
- FOS investment complaints (including SIPPs and DB transfers), systemic liabilities and Judicial Reviews of upholds against a firm held liable for the advice of another

We would like to say a big thank you to our clients and contacts for continuing to put your faith in us and instructing us to assist with your regulatory and legal needs. We hope you find this review a useful update on key areas of focus and change. We would be delighted to discuss any of these issues – or any others - and how they may apply to your business.

Finally, we would like to wish you a happy and prosperous New Year.

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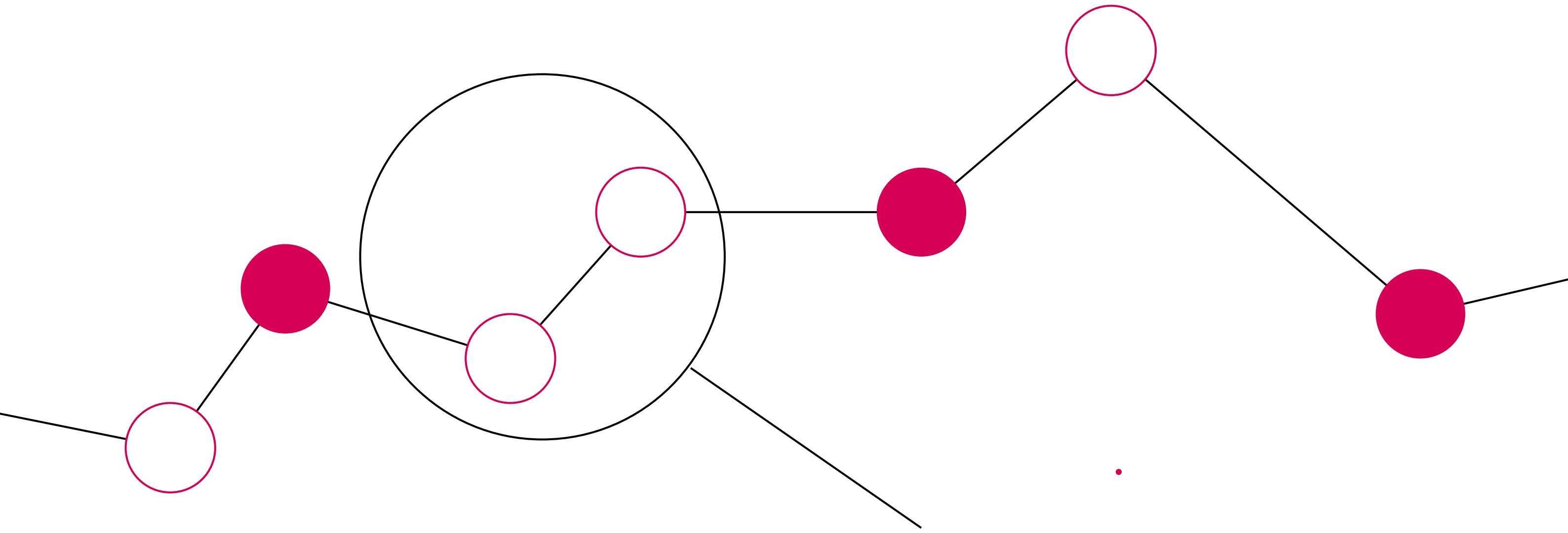


Consumer Duty

In May, the FCA published CP21/13 with plans for a new 'Consumer Duty' "which will set a higher level of consumer protection in retail financial markets for firms to adhere to."

The FCA's Consultation Paper 21/36 entitled "A new Consumer Duty" is the culmination of its work to identify whether consumers are being provided with adequate protection under its existing rules, and whether changes are required to improve consumer outcomes.

The FCA identified that the level of harm to consumers was too high, and better protection was needed in retail financial markets[2]. Accordingly, pursuant to the Financial Services Act 2021, the government required the FCA to conduct a public consultation on whether it should make general rules providing that authorised persons owe a duty of care to consumers.

CP21/36 builds on the initial proposals set out in Consultation Paper 21/13, and sets out the FCA's revised proposals for a new "Consumer Duty", including draft Handbook rules and guidance. In this article, we summarise the rules, consider their application to wealth managers and what firms should be doing ahead of the implementation deadline of 30 April 2023.

The FCA considers that the new Consumer Duty will require a ***"significant shift in both culture and behaviour, so they consistently focus on consumer outcomes, and put consumers in a position where they can make effective decisions"***[3]. It is clear from this statement and the proposals in CP21/36 that the FCA expects firms to revaluate their entire approach to dealing with retail consumers. The FCA uses the term "retail consumers" and "retail customers" interchangeably, as do we.

Consumer Duty Rules and Guidance

Overview and Application of the Consumer Duty

The Consumer Duty is not a singular rule or duty, but comprises of three key elements:

1. A "**Consumer Principle**" reflecting the overall standard of behaviour the FCA expects from firms
2. "**Cross-cutting rules**" setting out three overarching behavioural expectations that apply across all areas of firm conduct
3. "**Four outcomes**", which are a suite of rules and guidance setting more detailed expectations for firm conduct across four areas that represent key elements of the firm-consumer relationship

FCA diagram of the Consumer Duty Structure:

The Consumer Duty will be underpinned by a concept of reasonableness. Firms will be expected to adhere to a standard that could reasonably be expected of a prudent firm carrying on the same activity in relation to the same product, with the necessary understanding of the needs and characteristics of the average customer. Where a firm has additional information about its customer/s, this should also be taken into account.

The Consumer Duty will apply to the regulated activities and ancillary activities of authorised firms connected to the provision of a product or service that is or will be distributed to a retail customer. 'Retail customer' is defined differently depending on the product, aligning with the scope of the FCA Handbook in the respective sectors e.g. in relation to investments, to "retail clients" as defined in COBS; in relation to mortgages, to customers with regulated mortgage contracts as set out in MCOB.

This application will capture all firms throughout the distribution chain that could have an impact on retail customer outcomes, regardless of whether they have a direct relationship with the customer. However, the application is intended to be proportionate to the firm's role in relation to the product or service, nature of the products or service, and the characteristics of customers.

The FCA has confirmed that the Consumer Duty will be forward looking, applying to products (new and existing) that will be sold to customers from the implementation date. However, relevant parts of the Consumer Duty will

[2] See Discussion Paper 18/05 and Policy Statement 19/02

[3] CP21/36 – paragraph 1.12.

also apply on a forward-looking basis to closed products and services that are not being sold or renewed, and firms will be required to undertake an historic review of such products during the implementation period. Significantly, where a firm identifies potential consumer harm, they will be required to take appropriate action.

The Consumer Principle

The new Consumer Principle decided upon by the FCA is: "A firm must act to deliver good outcomes for retail customers".

This sets out the overall standard of behaviour that the FCA will expect from firms.

The Consumer Principle will be inserted as a new Principle 12 into the FCA's Principles for Businesses, and Principles 6[4] and 7[5] will be dis-applied for a firm's activities to which the Consumer Duty applies. Principle 12 sets a higher standard than Principles 6 and 7, and the FCA considers that it should prompt firms to ask questions such as "'Am I treating my customers as I would expect to be treated?' or 'Are my customers getting the outcomes from my products and services that I would expect?'"

The new Principle 12 is intended to put retail customers' needs at the forefront of firms' minds, and firms must have regard to this whenever performing activities in relation to retail customers. This may require significant change to the policies, procedures, and governance of a firm throughout all layers (even for firms which already focus on ensuring good customer outcomes).

Cross-Cutting Rules

The three cross-cutting rules require firms to:

1. Act in good faith towards retail customers

This is characterised by honesty, fair and open dealing, and consistency with the reasonable expectations of consumers. A number of examples given by the FCA of firms not acting in good faith include:

- **In relation to product service or design** – designing features to exploit behavioural biases to create demand
- **In relation to communications** – promoting products or services in a way that misleads consumers about benefits or risks
- **In relation to consumer support** – setting up systems that a firm knows will frustrate a customer or prevent them enjoying the use of their products. "Sludge practices" – being the introduction of excessive friction to prevent customers from making decisions in their interests, including cancellations – feature heavily in CP21/36. Investment firms will be familiar with this sort of concern being raised in various guises including in operational resilience, COVID and platform exit fees (albeit, the latter can't be that big a concern as the proposed ban has been dropped).

(Further examples can be found in the FCA's draft non-Handbook Guidance in CP21/36).

2. Avoid foreseeable harm to retail customers

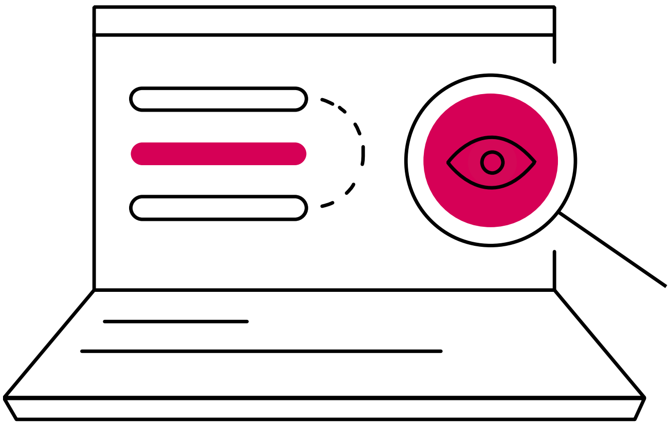
The FCA considers that this includes firms taking both proactive and reactive steps to avoid customers suffering harm from a firm's conduct, products or services. Firms are only required to consider reasonably foreseeable harm in light of what they know or could reasonably be expected to have known.

This rule will apply throughout the customer journey and lifecycle of a product or service. Firms will therefore need to keep products and services under assessment, since new information may come to light over time which means new harms have been identified or becomes reasonably foreseeable.

3. Enable and support retail customers to pursue their financial objectives

This rule requires firms to think about the financial objectives of their customers, and create the right environment where those customers can make informed decisions in their interest. This rule will apply throughout the customer journey and lifecycle of a product or service.

In relation to the foreseeable harm and financial objectives rules, the FCA sets out useful examples of what firms should be doing in relation to product service or design, communications, and consumer support – see paragraphs 4.18 to 4.37 of the FCA's draft non-statutory guidance contained in CP21/36.



[4] Principle 6 – A firm must pay due regard to the interests of its customers and treat them fairly.

[5] Principle 7 – A firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading.

The Four Outcomes

The four outcomes are a suite of rules and guidance setting more detailed expectations for firm conduct across four areas that represent key elements of the firm-consumer relationship, being:

Products and services

The rules and guidance in relation to this outcome relate to the design and distribution of products or services. They include requirements, building on PROD, for firms to:

- Identify a target market (including both manufacturers and distributors)
- Ensure product or service design meets the needs, characteristics and objectives of that target market
- Ensure the distribution strategy is appropriate for the target market
- Obtain and share information along the distribution chain – including between manufacturers and distributors
- Carry out regular reviews to ensure the product or services continues to meet the needs, characteristics and objectives of the target market

Price and value

Firms will be required to consider the price of a product or service to be distributed to a retail customer, and determine whether that constitutes fair value. The FCA is not prescriptive as to how this assessment is undertaken, but states that as a minimum it must include a consideration of:

- the nature of the product or service, including the benefits that will be provided or that consumers may reasonably expect and their quality
- any limitations that are part of the product/service
- the expected total price customers will pay (including any costs to be incurred throughout the distribution chain – this might not be known to manufacturers, but distributors with direct customer contact will need to take this into account specifically)
- any characteristics of vulnerability in the target market for the product or service

Consumer understanding

The FCA wants to ensure that communications enable customers to understand the products and services being marketed to them, including risks and features and implications of any decisions to be made. The consumer understanding outcome builds on the existing "clear, fair and not misleading" rules, and requires firm to:

- support their customers' understanding by ensuring that their communications meet the information needs of retail customers, are likely to be understood by the average customer intended to receive the communication, and equip them to make decisions that are effective, timely and properly informed
- communicate in a way that is clear, fair and not misleading
- tailor communications taking into account the characteristics of intended recipients, including any vulnerability, complexity of products, communication channel, and role of the firm
- ensure information is accurate, relevant and provided on a timely basis
- test, monitor and adapt communications as required to support good understanding and customer outcomes

Consumer support

The FCA notes that customers can only pursue their financial objectives if the firms supports them in using their products and services, and the FCA therefore expects firms to provide support to meet their customers' needs. More specifically, the rules and guidance in support of this outcome require firms to:

- Consider the support customers need and meet those reasonable expectations
- Support customers in light of their needs, such as not designing processes with unreasonable barristers that prevent them from realising the benefits of the product or service or acting in their best interests (including unreasonable additional monetary and non-monetary costs)
- Monitor the support offered, look for evidence of areas falling short of the outcome, and act promptly to remedy these

Monitoring, Governance and SM&CR

A key component of the Consumer Duty is that firms "assess, test, understand and are able to evidence the outcomes their customers are receiving".

The FCA's rules require firms to:

- Monitor and regularly review customer outcomes from products and services to ensure they are aligned with the Consumer Duty
- Identify where, and why, customers or groups of customers are not receiving good outcomes
- Have processes in place to respond to and address any risks or issues identified and to stop them occurring again

Firms will need to consider what data they use to monitor customer outcomes, and also what management information they report on. Firms will not be required to report to the FCA, but should have sufficient information to be able to demonstrate compliance if required. For example, we would consider an obvious starting point is complaints data and ensuring there is sufficient root cause analysis carried out and communicated to senior managers (as appropriate).

A firm's board or equivalent governing body will be required to review and approve, at least annually, an assessment of whether a firm is delivering good outcomes consistent with the Consumer Duty. This assessment should include:

- The results of monitoring
- New and emerging risks to good outcomes
- Evidence of poor outcomes and evaluation of their impact and root causes
- Actions taken to address risks and issues
- How the firm's future business strategy is consistent with acting to deliver good outcomes under the Consumer Duty

The Consumer Duty does not require any single senior manager to be responsible for compliance with all aspects, but instead each senior manager must take responsibility for their relevant area and will be responsible for ensuring compliance on an ongoing basis.

Where the Consumer Duty applies, the FCA are consulting on removing Individual Conduct Rule 4 – "You must pay due regard to the interests of customers and treat them fairly" – and replacing it with "You must act to deliver good outcomes for retail customers". This rule would be supported by the same cross-cutting rules as applicable to the firm.

Specific application to Wealth Managers

The Consumer Duty will apply to all relevant firms in the distribution chain, however its application will depend upon the firm's role in relation to the product or service, nature of the products or service, and the characteristics of customers. Further, the Consumer Duty rules and guidance have specific provisions in relation to manufacturers and distributors, which firms should review (in addition to the existing rules in PROD).

In providing clients with investment products and services, there can be a number a different firms providing different services. For example, you may have a number of different product providers (e.g. funds and/or wrappers such as SIPPs), a platform provider, a discretionary manager and a financial adviser. In some instances, these services may be provided by one firm; whereas, in other instances this may be a number of different firms (particularly product providers). The requirements arising from the Consumer Duty will differ for each firm in the chain. For example, considering financial advisers (which will be distributors), they are unlikely to be involved in the design of a financial product but will presumably have direct customer contact. Therefore, as distributors, there will be more onerous requirements, from a Consumer Duty perspective, when considering the nature and tone of their communications with clients compared to manufacturers, who are likely to have limited or no contact with clients (apart from standard regulatory disclosures).

Equally, there will also be common areas through which firms will need to work. For example, all firms will need to consider the Consumer Duty in the design and delivery of the relevant investment services. This will include considering the needs of the target market, and ensuring the price and value, communication, and customer service outcome rules are met.

As an aside, we can foresee this being particularly challenging for firms that provide execution-only services. This business model has already come under significant pressure from scandals, the FOS and recent Court cases. Typically, execution-only services involve limited information, do not employ advisers and provide lower cost services. In these circumstances, it will likely prove challenging to find ways to ensure they deliver good outcomes as it will require more information from the client and the manufacturer. It will be interesting to see what effect this has on execution-only services and if these will now move to the more professional investor end of the market.

Actions ahead of implementation date

The Consumer Duty will require firms to completely revaluate their approach to dealing with retail customers.

Ahead of the implementation deadline of **30 April 2023**, firms should:

- Map out and review completely the Consumer Duty rules and guidance, and identify any areas of non-compliance and consider remedying/mitigating actions
- Consider data and management information to be used for monitoring and reporting on customer outcomes and compliance with the Consumer Duty
- Consider the firm's governance structure and how the Consumer Duty can be embedded at each level, including at the board and committees, right through to the first line
- Consider the form of reporting to the board, and how it will review and consider compliance with the Consumer Duty

Should you like any assistance with reviewing your firm's policies and procedures in light of the proposed Consumer Duty rules, please do get in touch and we can discuss how we may assist.

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Prudential Changes - IFPR Overview

As always with regulatory capital, the acronyms come thick and fast. This is a whistle-stop tour of the key changes. The changes are substantial, leading to some firms needing to significantly increase capital requirements.

Background and introduction

The Investment Firms Prudential Regime (IFPR) came into force on 1 January 2022. It builds on the FCA's financial resilience framework of FG20/1, and additionally the FCA's two Consultation Papers on IFPR and near-final rules as contained within Policy Statement PS21/6, with another CP and two further Policy Statements and rules published in 2021. The IFPR affects all current BIPRU, IFPRU, matched principal brokers and exempt-CAD firms, amongst others.

The IFPR is the UK variant of the EU's Investment Firms Regulation and Directive (IFR/IFD) which was implemented across EU MiFID investment firms in June. It replaces the Capital Requirements Regulation/Directive (CRR/CRD) for UK investment firms (including CAD-exempt firms). Building on its financial resilience framework FG20/1 (Assessing Adequate Financial Resources), the FCA aims to link its financial adequacy Threshold Conditions directly to the capital and liquidity requirements of the IFPR.

Summary of key changes

Categories of firm

Approximately 3,200 FCA regulated firms are IFPR firms. The MiFID Investment Firm categorisations designated as IFPRU, GENPRU, BIPRU, Exempt CAD, Local and CMPMI firms, matched principal dealers and a specialist commodities derivatives investment firms such as oil market participants and energy market participants are all transitioned across into one of three categories under the IFPR, namely:

- Small and Non-interconnected firms (SNI),
- Non-SNI firms; and
- Certain large (systemically important) firms will continue to be subject to the CRR and not the IFPR (it is estimated this is a cohort of eight UK firms), meeting the on and off balance sheet test of >=£300m, or the trading book is at least £150m with a balance sheet of at least £100m.

Minimum capital requirements

The IFPR introduces a new set of flowcharts to determine the categorisation of firms and the type of regulatory capital to be held, with the new regime following the capital resource instrument definitions of the CRR. However, the IFPR does not allow Tier 3 capital instruments that currently BIPRU and exempt CAD firms were previously allowed to use. The main categories of regulatory capital under IFPR continue to be Common Equity Tier 1 (CET1), Additional Tier 1 Capital (AT1) and Tier 2 capital (T2). Deductions (regarding own funds) are made in full under the IFPR and include intangible assets such as software.

The previous Pillar 1 capital requirements under the CRR/IFPRU and BIPRU are replaced by the Own Funds Requirement (OFR). The OFR is the higher of the Permanent Minimum Requirement (PMR) and Fixed Overhead Requirement (FOR) for SNI firms, and the higher of the PMR, FOR and K-Factor Own Funds Requirement (KFR) for non-SNI firms.

Transitional Provisions (TPs) are in place for five years from the implementation date, so that firms can adjust to the potentially higher capital requirements of the IFPR. However, the TPs are only for the minimum requirements (PMR, FOR and KFR) and do not affect the risk-based levels of capital a firm needs.

As most will be aware by now, the PMR to be held is set to increase as a result of the IFPR (please note that Article 3 exempt firms are outside the scope of the changes, unless they have opted in to MiFID). They become:

- **£750,000** where MiFID activities include one or more of the following:

- Dealing on own account (this includes matched principal dealers, as the exemption is removed under IFPR)
- Underwriting and/or placing on a firm commitment basis

- **£75,000** where MiFID activities are only among the following:
  - Reception and transmission of orders
  - Execution of orders on behalf of clients
  - Portfolio management
  - Investment advice
  - and the firm does not have permission to hold client money or assets
- **£150,000** for all other FCA investment firms

The FOR should be viewed as the FCA's proxy for wind-down and should be based upon 3 months' relevant expenses of the last year's audited accounts.

K-Factors are introduced for non SNI-firms. The K-Factors quantification for capital purposes is the sum of the three categories: Risk to Market (RtM), Risk to Customer (RtC) and Risk to Firm (RtF).

Under each primary heading of the three main risks, other K-Factors are applicable, dependent on the type of firm and its activities including; K-NPR (net position risk), K-CMG (clearing margin given), K-AUM (assets under management), K-ASA (client assets safeguarded and administered), K-CMH (client money held), K-COH (client orders handled), K-TCD (trading counterparty default), K-DTF (daily trading flow), K-CON (concentration risk) and K-TCD (dealing on own account).

The capital ratios are maintained from the CRR, however, under the IFPR, the FCA makes an objective link between capital requirements and its Threshold Condition of having adequate financial resources. Firms will have to ensure that they meet the Overall Financial Adequacy Rule (OFAR): "A firm must hold adequate own funds and liquid assets to ensure it can remain viable throughout the economic cycle, with the ability to address any potential harm from its ongoing activities, and to allow its business to wind-down in an orderly way".

Liquidity requirements follow the same principles as capital requirements under the IFPR, i.e. the focus is on ongoing viability and wind-down planning within the OFAR.

Firms will have to hold a minimum level of liquid assets to meet the IFPR's Liquid Assets Threshold Requirement (LATR). The LATR is the sum of the Basic Liquid Assets Requirement (BLAR) and Additional Liquid Asset Requirement (ALAR) – as derived from the internal assessment carried out in the risk-based Internal Capital Adequacy and Risk Assessment (ICARA) process.

Group consolidation

Under the IFPR, virtually all entities that might be involved in the provision of a financial service are caught by Group Consolidation Requirement (GCR), losing the ability to report on a non-consolidated basis. This includes all investment firms, financial institutions, tied agents and ancillary services undertaking (where the entity provides services that enable the investment firm to carry out a regulated activity). SNI groups will have to hold the higher of consolidated PMR or consolidated FOR. Non-SNI groups will have to hold the higher of a consolidated PMR, consolidated FOR or consolidated K-Factors.

Regulatory reporting should be submitted on a sole entity basis, but the group also has to submit group regulatory reporting. Even if the UK parent is unregulated, it will have direct responsibility under the IFPR to report at group level to the FCA.

The Group Capital Test (GCT) is an alternative under the IFPR to the Group Consolidation Requirement. The GCT is similar to the derogation from prudential consolidation that currently applies to groups of investment firms covered by Article 15 of the CRR. To qualify for GCT, the group structure must be sufficiently simple to justify applying a GCT, and there is no significant risk of harm to others (clients or markets) from the group that would otherwise require that the group should be supervised on a consolidated basis.

Central to a firm's risk management framework is ICARA, which replaces the current ICAAP. The focus of the firm's risk management framework and ICARA is more on harms as opposed to simply risks to the firm, considering and monitoring harm posed to consumers, clients and markets, as well as to the firm itself.

Firms that currently prepare an ILAA or ILSA will no longer have to do so under the IFPR. Liquidity assessments are captured and documented within the ICARA.

The FCA also expects all IFPR firms to carry out recovery planning, which includes both quantitative and qualitative indicators that provide an early identification that the firm is running into capital and/or liquidity/funding difficulties.

MIFIDPRU

IFPR introduced a new prudential sourcebook (MIFIDPRU) within the FCA Handbook. MIFIDPRU will cover all the rules applicable to UK MiFID investment firms. The proposed MIFIDPRU rules are found within CP20/24 and CP21/7 and the details of required Public Disclosures can be found in the CP21/26. The final IFPR rules are set out in the legal instruments – FCA 2021/38 and FCA 2021/39. The third policy statement

PS21/17 is addressed across legal instruments FCA 2021/49, FCA 2021/50 and FCA 2021/51.

Through the IFPR, the FCA makes an objective link between capital requirements under IFPR and its adequate financial resources Threshold Condition, which will affect regulatory reporting. While five of the existing CRR reporting schedules have been maintained by the FCA under MIFIDPRU, such as the Balance Sheet and Income Statement, four additional reporting schedules have been introduced including the Liquid Asserts Requirement, Metrics reporting, Concentration Risk and Group Capital Test.

The IFPR MIFIDPRU Remuneration Code requirements supersede those previously in place. There are no proportionality levels under the IFPR compared to previous practices, so there are changes for previously limited licence/limited activity firms, although the IFPR Remuneration Code rules are similar to the previous IFPRU Remuneration Code with three categories: Basic, Standard or Extended remuneration requirements.

Governance considerations & future regulatory engagement

The largest non-SNI firms will have to have risk, remuneration and nomination committees, with at least 50% being non-executive members of the management body. As a small number of firms that are not currently significant IFPRU firms but are enhanced firms under the SM&CR, will need to establish committees under IFPR.

Further changes are introduced as part of the approach to regulatory engagement. As part of the Supervisory Review and Evaluation Process (SREP) FCA include new metrics including an Early Warning Indicator (Capital), Threshold Requirements (Capital & Liquidity) and Wind-down Trigger (Capital and Liquidity).

Regardless of IFPR categorisation, all firms are expected to have robust governance arrangements that include a clear organisational structure with defined, transparent and consistent lines of responsibility; effective processes to identify, manage, monitor and report the risks they are or might be exposed to, or pose or might pose to others; and adequate internal control mechanisms, including sound administration and accounting procedures.

As well as the risk management rules through the ICARA, the MIFIDPRU rules and Remuneration Code, there are resulting updates to SYSC that firms should also be conscious of identifying.

Conclusion

There are many facets introduced under the new regime that will require the careful management of the regulatory change impacts. Not least the ICARA: The ICARA should not be treated as a once a year process with senior management sign-off, rather senior management should drive and be involved fully in the ICARA process.

The FCA has stated that it expects that firms will recognise, monitor, control and mitigate the risks to which they are exposed, and the potential for harm their activities pose to consumers and markets. FCA will hold senior management and governing bodies responsible for this, tying-in with the SM&CR.

What you need to consider

Boards and Senior Management should take time to understand the final IFPR rules and to see if FG21/5: General guidance on the application of ex-post risk adjustment to variable remuneration applies to your firm.

The IFPR is layered and is likely to impact firms on a number of client and operational fronts - professional input is key to getting this right, preferably with your lawyers and regulatory consultants working together on interpretation, application and implementation.

Please contact us for advice, impact analysis, gap analysis, assistance with capital and liquidity planning and any ongoing implementation support.

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Changes to FCA Decision Making

The FCA's stated aims are to increase the efficiency of decision making whilst also increasing accountability for decisions.

Key Changes

Prior to 26 November 2021 the majority of FCA decisions to issue statutory notices were taken by the Regulatory Decisions Committee (RDC). The RDC, although not fully independent, includes various individuals from a number of professions with only the chair being employed by the FCA. It acts as a procedural safeguard in decision making by providing a level of independence from the FCA in the decision making process.

The FCA has transferred four categories of decision from the RDC to FCA staff under the executive procedures. The changes took effect immediately on 26 November 2021. Statutory notice decisions taken under executive procedures will be taken by a senior staff committee or by individual FCA staff members.

Decisions by individual FCA staff members will be made by an executive director of the FCA Board or a delegate (who is at least of associate level):

- on the recommendation of an FCA staff member of at least the level of associate; and
- with the benefit of legal advice from an FCA staff member of at least the level of associate.

Under executive procedures parties will only be able to make written representations to the executive, unless there are exceptional circumstances where oral representations will also be allowed. This is in contrast to the historic position whereby firms could make both written and oral submissions to the RDC.

One safeguard added by the FCA in relation to any decision made by FCA staff under executive procedures to give a supervisory notice exercising own-initiative powers which involves a fundamental variation or requirement (discussed below) is that this will be taken by an FCA staff of at least Director level (including an acting director).

The four categories of decision which will now be made by FCA staff are:

1. The decision to remove a firm's permissions where a firm does not meet regulatory requirements in straightforward cases

The RDC will no longer make decisions in relation to 'straightforward' cancellation cases. Questions were raised over what constitutes a 'straightforward' case and the FCA has advised that these are:

"cases where the relevant facts and considerations are not complex. Such cases may involve, for example, firms who have failed to submit the relevant regulatory returns, or firms that are failing to meet our Threshold Conditions."

2. Making a final decision regarding a firm's application for authorization or an individual's application for approval that is contested

The RDC's role will be replaced by the Authorisation team within the FCA executive.

3. Using own-initiative intervention powers to impose a fundamental requirement or variation on a firm

Decisions relating to non-fundamental variations or requirements were already made under executive procedures. However, FCA staff under executive procedure will now also take these decisions in relation to fundamental variation or requirement. DEPP 2.5.8G defines a fundamental requirement or variation as

• removing a type of activity or investment from the firm's permission
• refusing an application to include a type of activity or investment
• imposing or varying an assets requirement or refusing an application to vary or cancel such a requirement.

4. The decision to start civil and/or criminal proceedings

This decision making power has been taken away from the RDC chair/deputy chair. In practice, this change will make it easier for the FCA to commence civil and criminal proceedings.

The continued role of the RDC

Any cases which were being considered by the RDC prior to 26 November 2021 will not be impacted, and the RDC will still consider these cases under its stated procedures. The RDC will continue to make decisions in enforcement cases.

For a more detailed overview of the changes, we published an article in November, which can be seen here.

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Changes to the AR Regime

In recent years, the FCA has been increasing its scrutiny of the Appointed Representatives (AR) regime as it has identified that the harm to consumers is too high.

As part of its ongoing work, the FCA launched a consultation proposing stronger requirements on oversight of appointed representatives, set out in CP 21/34: Improving the Appointed Representatives regime.

Summary of key changes

The FCA's proposed changes to the AR regime aim to reduce potential harm to consumers and the wider market caused by inadequate due diligence checks performed by the principal firm before an AR is appointed or insufficient ongoing oversight and control of AR's business activities for which the principal firm accepted responsibility.

The consultation follows on from the Treasury Select Committee's report on lessons learnt from the collapse of Greensill Capital Securities Ltd[6] - resulting in a circa £1 billion direct cost to investors. The report recommended that the FCA and Treasury consider reforms to the AR regime, with the aim of limiting its scope and reducing opportunities for abuse of the system.

Based on the analysis of internal data conducted by the FCA, principal firms generate 50 to 400% more complaints and supervisory cases than non-principals across all sectors where this model operates. As part of the backdrop to this CP, the FCA previously undertook thematic work across the insurance and investment management sectors where it identified a number of endemic concerns in how the current AR regime is operated.

The two main areas subject to possible change following consultation are:

1. The FCA requiring additional information on ARs and notification requirements for principal firms. This is intended to help the FCA identify potential risks within principals and ARs and allow the FCA to better assess whether the principal has the systems and controls as well as expertise necessary to effectively oversee its ARs.
2. Clarifying and strengthening the responsibilities and expectations of principal firms as set out in the FCA rules and providing additional guidance for principals on their responsibilities and the FCA's expectations in how they act and oversee their ARs.

In addition, the FCA is seeking views on the risk in relation to regulatory hosting arrangements and business models in circumstances where ARs are larger in comparison to the principal firms. It is also considering whether a new prudential standard should be introduced or strengthened to help protect consumers and firms potentially exposed to business models involving ARs, as well as scoping general ideas on how potential harm could be reduced i.e. limits on arrangements by ARs.

The outcomes the FCA is looking to achieve by overhauling the AR regime are:

- Principal firms having an **improved oversight and management** of their ARs through a better understanding of their responsibilities over ARs.
- **Better quality information** available to consumers on principal firms and ARs allowing consumers to make good decisions when choosing products and services in line with the new Consumer Duty proposals.
- The FCA will be **better equipped to challenge** principal firms and firms looking to appoint an AR achieved by collecting data on principals as well as ARs via more detailed regulatory reporting requiring principal firms to provide the FCA with additional information on ARs.

The FCA estimates around 10% of all ARs will exit the market permanently as a result of a more robust AR regime with some ARs seeking direct FCA authorisation, or direct employment by the principal firms in an attempt to remain outside of the new proposals.

Draft changes to the FCA Handbook are contained in Appendix 1 of the CP.

The FCA is seeking responses to this consultation by **3 March 2022.**

Conclusion

The current AR regime was not intended to operate in the way in which some business models are currently

[6] https://publications.parliament.uk/pa/cm5802/cmselect/cmtreasy/151/15102.htm

operating – this was a very clear message within the CP. The FCA says the purpose of the regime was primarily to allow self-employed representatives to engage in regulated activities without having to be authorised. However, a far wider range of business models has developed, e.g. regulatory hosting and [i]networks. This is not to suggest that there is anything wrong with the regulatory hosting business model, but the evolution of this model requires a re-think of the way in which it is regulated. The planned update to the AR regime does set out the direction of travel that the FCA plans to follow in terms of implementing specific requirements for this particular business model.

The options being considered also sign-post the fact that the rules arising from this CP will only represent the first-step towards increased requirements for regulatory hosting businesses– assuming that the business model is not prohibited in the long term. There is a real risk that changes to the AR regime will have an impact on those market participants who use the regime to establish a regulated business with a lower cost base or as a pre-cursor to applying to become directly authorised. The FCA seems to acknowledge that the AR regime provides a genuine service to those types of firm and has stated that this is not something it is seeking to curtail. When considered in the round, the CP sign-posts that the AR regime for regulatory hosting will be more challenging than those business models where a principal has 3 or 4 ARs, where barriers to entry are not likely to be overly prohibitive, if the changes are rolled-out as currently proposed.

ARs of general insurers and investment firms represent a potentially significant risk to consumers depending on the nature of their activities, and there are still a range of genuine drivers for increasing the requirements for ARs. The CP does set out some factors considered in terms of the risk for harm which will be more adequately addressed under the new proposals by the FCA and consumers having greater clarity about the services offered by ARs. The fact is that ARs that are already operating professional businesses have nothing to be concerned about in terms of the proposals. There will inevitably be greater record-keeping requirements, but a number of the controls being consulted upon largely represent good business practices being employed by the majority of ARs.

There have been some suggestions that the changes to the regime are as a result of the regime being abused. However, it should be borne in mind that in all aspects of regulation, there will always be a few who seek to side-step regulation or find the easiest route to market; in the absence of rules or regulatory certainty, practices will always emerge that were not conceived when the regime was first launched – some may call that innovation, others call it abuse. But ultimately, it has always been the responsibility of the principal to determine the expected conduct of the AR's and accordingly, wherever the regime lands for different types of AR and AR model, principals will definitely be the focus of greater control and increased standards of conduct under the new regime.

How we can help

We have extensive first-hand experience of working with a number of networks, incubators and principal firms given the FCA's preceding thematic work in the sector. This work has included producing a Skilled Person's report (s166), so we are knowledgeable about the FCA's expectations and can assist principals and ARs in transitioning their regulatory activities and commercial model ahead of the announced timeline for the implementation of the rules. Given the systemic change to the AR regime, we recommend that firms start their preparations as early as possible in 2022.

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Enforcement Report

The FCA published its Enforcement performance Annual Report for 2020/2021 in July 2021, providing an update on what the regulator has achieved over the last year, key statistics on enforcement data and an overview of its priorities for the year ahead.

Published alongside the (forward-looking) Business Plan, the Enforcement Report shows what the FCA's investigators have been doing. The 2021 data showed a 15% decrease in total fines from £224.4 million in 2019/2020 to £189.8 million in 2020/2021

- a decrease in the single largest fine imposed from £102.2 million in 2019/2020 to £64 million
- a slight increase in the average length of all enforcement cases (including those resolved by agreement, referred to the RDC or Upper Tribunal, and those where the FCA decided to take no further action) to 24.7 months (from 23.9 months)
- a reduction in the number of cases opened in the last year; only 134 cases were opened compared to 184 cases the year before.

The Annual Report is based on data to the year ended 31 March 2021 (so covers a majority of 2020). We suspect the modest decrease in action and fines reflects the impact of COVID-19, which has, in general, lengthened the time it takes for firms to provide information to the FCA and also lengthened the time it takes the FCA to review and assess the information provided. It is noticeable that in December (some months after the report), three significant fines were imposed on firms, the two largest related to anti-money laundering failings:

- NatWest plc - £264,772,619.
- HSBC - £63,946,800
- BlueCrest Capital Management (UK) LLP - £40,806,700[7]

As demonstrated by the most recent fines, the regulator's appetite for enforcement continues unabated. The FCA's 2020/2021 Business Plan reinforces the FCA's commitment to enforcement; the regulator stated that it is ***"improving how we detect, triage, disrupt and take enforcement action to help reduce fraud and harm"*** and clarified its intention to ***"take assertive enforcement action where there is serious misconduct".***

The FCA has changed its decision making process which, whilst not directly affecting Enforcement, also forms part of the regulator plans to be more assertive and interventionist.

In further bad news for firms, the average cost of cases resolved by agreement has increased from £341,600 to £365,700. This is likely due to the complexity of cases and/or the volume of information that has to be reviewed to resolve them. We have witnessed an increasing trend for the FCA to issue extremely broad information requirements, far broader than it has historically, meaning that they are more costly for firms to respond to, and for the FCA to review, alike.

[7] This has been referred to the Upper Tribunal which will determine the appropriate action, if any, for the FCA to take

Looking ahead, the FCA has indicated that it will be focusing on the following areas:

Retail conduct: the FCA wants to establish how harmful 'sludge practices' are. These "exploit consumers' behaviour to make it harder for them to make decisions in their best interests", for example, where insurers make it difficult for consumers to cancel an insurance product online. It has also stated in the Business Plan that it will increase its supervisory focus on whether asset managers present the ESG properties of funds in terms that are fair, clear and not misleading.

Financial crime: this is one of the FCA's cross-sector priorities in the Business Plan. The FCA has issued multiple statements throughout the pandemic warning firms to be vigilant against new and emerging financial crime risks. Firms that have not taken these statements on board, or who discovered gaps in their systems and controls that were not swiftly rectified, may well find themselves the subject of enforcement action.

Diversity & Inclusion: this is another one of the FCA's cross-sector priorities as per the Business Plan. There are already diversity requirements in place for some firms, including banks, building societies, investment firms, insurers and central securities depositories. UK banks, building societies and investment firms, for example, must meet certain requirements on the diversity of their Board. We expect the FCA to start taking action where it finds that these requirements are not being met.

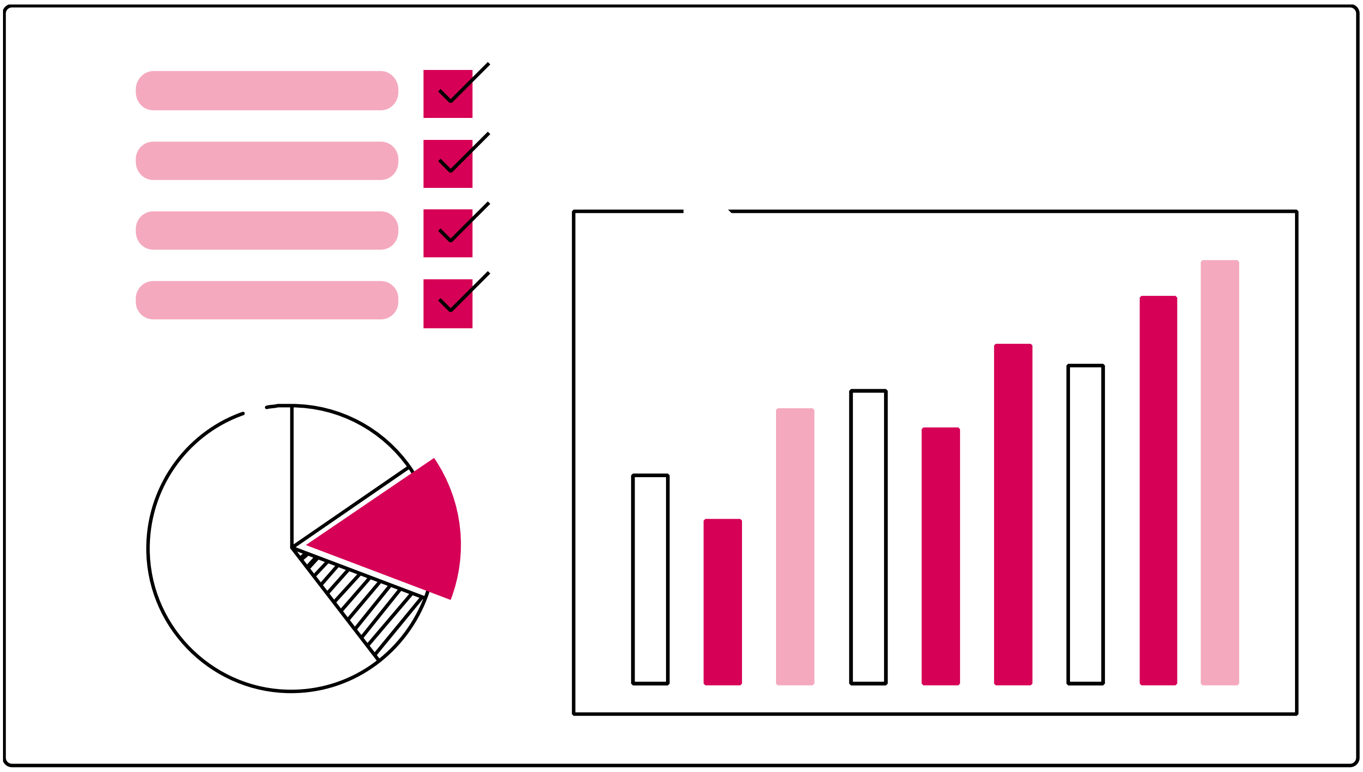
We highlight below some of the key relevant enforcement cases from 2021, during which there was a notable focus on financial crime and pensions advice:

First prosecution In March, the FCA instigated its first prosecution for AML failings under the Money Laundering Regulations 2007 (MLRs), related to a bank's on-going and enhanced monitoring failings transactions of a particular client, despite concerns being raised by staff on multiple occasions. In particular, the bank failed to:

- conduct periodic client reviews, which resulted in a client's transactions not being scrutinised
- have adequate monitoring arrangements in place to demonstrate risk-sensitive on-going monitoring

Further, the bank failed to have adequate transaction monitoring arrangements in place, nor did it have a differentiated automated transaction monitoring process in place for higher risk customers. The bank pleaded guilty and was fined £264,772,619 reflecting a discount of a third due to the guilty plea (the original fine being £397,156,944). The sentencing judge noted that whilst the bank was "*in no way complicit with the money laundering which took place*", it was "*functionally vital*" for the money to be effectively laundered.

The FCA has long been threatening a prosecution under the MLRs and now it has been successful. It is no secret that the regulator has had multiple live 'dual-track' (regulatory and criminal) investigations regarding financial crime for several years and this prosecution should serve as a reminder to all institutions subject to the MLRs; the regulator will not hesitate to prosecute. Whilst prosecutions are still expected to be the exception rather than the norm, recent regulatory fines for AML failures have been large (see below for another recent example), and should also serve as a warning to institutions that regulatory action for such failures is not rare and can be costly. It is, therefore, worthwhile spending money on ensuring that anti-financial crime systems and controls are reviewed regularly, are adequate and meet the requisite regulatory and legal standards.



Sunrise Brokers LLP, an interdealer broker, was fined £642,000 for deficient AML systems and controls to identify and mitigate the risk of being used to facilitate fraudulent trading and money laundering.

Omar Hussein, former director and senior financial adviser at Consumer Wealth Ltd, was fined £116,000 for providing reckless and unsuitable pension switching advice that was often unnecessary and not in the clients' best interests. He advised 620 clients to switch into SIPPs with high-risk investments comprised of unregulated mini-bonds relating to overseas investments in car parks, renewable energy and holiday resorts which were illiquid and highly likely to be unsuitable for the low net worth, financially inexperienced investors who formed the firm's target market. The FCA also prohibited him from working in financial services. The FSCS has paid compensation to 437 of Consumer Wealth's former clients. So-called speculative illiquid securities will feature prominently in Enforcement cases in the coming months and years.

The FCA's thematic review of **DB pension transfer mis-selling** and the British Steel 'scandal' have resulted in there being 50 open Enforcement investigations as at Christmas. In addition to the announcement about the FCA's consultation on a British Steel redress scheme, an FCA spokesperson reportedly said "In the past three years we have completed 24 investigations relating to unsuitable pensions advice, taking either supervisory or enforcement action in approximately half of those cases". DB transfers will remain a key issue in Enforcement cases for some time to come.

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Non-Financial Misconduct - the new focus for the FCA

In the wake of the Weinstein scandal and the #MeToo movement that followed, the FCA intensified its focus on all forms of non-financial misconduct which now forms part of its determined commitments to the D&I and wider ESG agendas.

FCA laying the groundwork

In September 2018, the FCA's then Executive Director of Supervision – Investment, Wholesale and Specialists Division, Megan Butler, wrote a letter to the Women and Equalities Committee following the Committee's Report on Sexual Harassment in the Workplace. Butler's message was that the FCA views **"*sexual harassment as misconduct*"** and that **"*tolerance of this sort of misconduct would be a clear example of a driver of poor culture*"**, culture being key given that it is seen by the FCA as a root cause of conduct failings.

Christopher Woolard, then Executive Director of Strategy and Competition, also gave a speech in December 2018, stating that "*non-financial misconduct is misconduct, plain and simple*". Just over a year later, on 6 January 2020, the FCA published a Dear CEO Letter addressed to wholesale general insurance firms highlighting the FCA's views that non-financial misconduct is "*a key cause of harm*". The letter also forewarned that failure on the part of senior managers to take reasonable steps to address non-financial misconduct could lead to a determination by the FCA that a senior manager is not fit and proper.[8]

Enforcement action for non-financial misconduct

So, have the FCA's strong words translated into action? In short, yes. The FCA has taken an increasingly robust stance against individuals engaging in non-financial misconduct, demonstrated by the enforcement actions against Russell David Jameson, Mark Horsey, Frank Cochran[9] and more recently, Jon Frensham, which we consider in more detail below[10]. They all acted as financial advisers or were directors and/or shareholders of authorised financial advisory firms and were convicted of serious (but non-financial) indictable offences while working in financial services.[11,12]

A common theme emerges in all four Final Notices issued to these individuals: the FCA determined that none of them were fit and proper as they lacked the necessary integrity and reputation to work in the regulated financial services sector. The cases received specific mention in the FCA's Enforcement performance Annual Report, with the FCA saying: "Mr Horsey's case formed part of a broader collection of 'non-financial misconduct' cases in which we prohibited financial advisers whose criminal convictions, albeit arising from their affairs outside of their regulated activities, nonetheless demonstrated a severe lack of integrity causing them to fall short of our Fit and Proper criteria. We consider that financial advisers who demonstrate a propensity to abuse their position of power pose an inherent significant risk to the consumers they advise."[13]

The FCA guidance on the fitness and propriety of individuals (FIT 1.3.1G) states that the FCA will have regard to a number of factors when assessing the fitness and propriety of a person to perform a particular controlled function and one of the most important considerations will be the person's honesty, integrity and reputation (FIT 1.3.1BG).

FIT 2.1 G also contains specific guidance on how criminal convictions will be considered. Whilst conviction for a criminal offence will not automatically

[8] https://www.fca.org.uk/publication/correspondence/dear-ceo-letter-non-financial-misconduct-wholesale-general-insurance-firms.pdf
[9] https://www.fca.org.uk/news/press-releases/fca-bans-three-individuals-working-financial-services-industry-non-financial-misconduct
[10] FCA bans Jon Frensham from working in financial services | FCA
[11] https://www.fca.org.uk/news/press-releases/fca-bans-three-individuals-working-financial-services-industry-non-financial-misconduct
[12] https://www.fca.org.uk/news/press-releases/fca-bans-jon-frensham-working-financial-services
[13] https://www.fca.org.uk/data/enforcement-data-annual-report-2020-21

mean an individual is not fit and proper (see FIT 2.1.1 G), in these four Final Notices, the FCA indicated that it had imposed a prohibition order after considering a number of factors, including:

1. the seriousness of the offence and surrounding circumstances
2. relevance of the offence to the individual's role
3. the individual's explanation and passage of time
4. evidence of rehabilitation
5. severity of the risk posed to consumers and confidence in the financial system

The four cases involved convictions for serious offences, including voyeurism, sexual assault, putting a person in fear of violence contrary to section 4(1) of the Protection from Harassment Act 1997, and attempting to meet a child following sexual grooming, contrary to section 1(1) of the Criminal Attempts Act 1981; thereby,

making it easy to understand why the FCA came to the conclusion that these individuals were not fit and proper.

Whether the FCA would come to the same conclusion in relation to less serious offences remains to be seen, however, historic cases suggest that if the offence involves dishonesty, it would; in 2014 the FCA issued a prohibition order against Jonathan Burrows who admitted to train fare evasion, the regulator's reasoning being that **"*individuals who are approved to work within the financial services industry should conduct themselves with honesty and integrity in both their professional and personal capacities*"**[14]. Mr Burrows' conduct fell short of that standard.

2021 Upper Tribunal Appeal

Mr Frensham's case was referred to the Upper Tribunal; the first non-financial misconduct case considered by the Tribunal, thereby making it a significant legal precedent. He was an IFA, and the sole director at Frensham Wealth Limited, who had been convicted of attempting to meet a child following sexual grooming (whilst on bail for another similar offence).[15] The FCA issued a decision notice prohibiting Mr Frensham for working in financial services and cited the fact that Mr Frensham's offence: i) was committed whilst breaching bail conditions for another offence; and ii) involved an abuse of a position of trust and a **"*deliberate and criminal disregard for appropriate standards of behaviour*"** as the reason that he was not 'fit and proper' and lacked integrity.

The Tribunal found that Mr Frensham was not 'fit and proper' because he had failed to disclose to the FCA the fact of (1) his arrest in relation to a separate matter and (2) his arrest in respect of the offence that led to his conviction. He had also failed to inform the FCA that the Chartered Insurance Institute had refused to renew his Statement of Professional Standing and decided to expel him from its membership.[16]

The Tribunal concluded that it was **"*not satisfied that a decision to make a prohibition order against Mr Frensham based solely on the fact of his conviction could have been reasonably arrived at by the Authority*."**

However, it accepted that when the offence was considered in tandem with the circumstances under which it came to be committed and Mr Frensham's failure to be open and cooperative with the Authority following his initial arrest meant that the decision to make a prohibition order "*was reasonably open to the Authority*". Ultimately, the Upper Tribunal held that although the FCA's rationale for imposing the prohibition order was flawed, it did not consider that the flaws were serious enough to warrant directing the FCA to reconsider its decision.[17]

The case reinforces the FCA's guidance in FIT that conviction for a criminal offence does not necessarily lead to a determination that an individual is not 'fit and proper'; additional circumstances surrounding the conviction will be taken into account when undertaking that assessment.

FCA's take on corporate culture and the year ahead

Following the decision by the Upper Tribunal, Sheldon Mills, the Executive Director of Consumers and Competition at the FCA, made a speech in September

[14] https://www.fca.org.uk/publication/final-notices/jonathan-paul-burrows.pdf
[15] https://www.fca.org.uk/news/press-releases/fca-bans-jon-frensham-working-financial-services
[16] https://www.fca.org.uk/publication/final-notices/jon-frensham-formerly-known-jonathan-james-hunt-2021.pdf, paragraph 33

[17] https://assets.publishing.service.gov.uk/media/612e14dfe90e07054107585e/Frensham_v_FCA.pdf, paragraphs 174 and 215 (respectively)

emphasising the FCA's focus on firms maintaining a healthy culture, which is instrumental to consumer protection and to well-functioning markets and makes firms less susceptible to misconduct.[18]

The FCA's focus on non-financial misconduct and its holistic view of culture, and the behaviours that follow, is set to remain a feature of both supervision and enforcement in 2022. The Tribunal's narrow interpretation of the Frensham case and FIT criteria will no doubt become a key battleground as individuals seek to defend themselves in future cases involving criminal (and non-criminal) non-financial misconduct.

For now, the message to those working in regulated firms is clear: their actions both in- and out-side the workplace are under the spotlight and considered to be within the FCA's enforcement jurisdiction.

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[18] https://www.fca.org.uk/news/speeches/regulatory-perspective-measuring-assessing-culture-diversity-inclusion

FinProms – FCA Focus Continued

Financial promotions are very much in the FCA's cross-hairs currently - or rather the exploitation of financial promotions by bad actors. Financial promotions have been called out by the FCA as an area of concern in numerous recent publications.

FinProms commanded significant attention within:

- FCA Business Plan 2021/2022
- Consumer Investments Strategy
- Implementing the recommendations from Independent Reviews
- Perimeter Report 2020 / 2021

As the regulator stated in its 2020/201 'Perimeter Report', "One of our key consumer priorities is enabling consumers to make effective financial decisions. This includes ensuring that rules on financial promotions are fit for purpose…".

In the same report, the FCA expressed concern about the 'significant vulnerability' presented by the exemptions in the financial promotion regime for 'high net worth' and 'sophisticated' investors.

The FCA appears to have got its wish with HM Treasury's consultation paper, published in December, making a number of suggestions to amend these exemptions.

HMT is consulting on five proposals for amending the financial promotions exemptions for certified high net worth, sophisticated, and self-certified sophisticated investors. We have set out below the various proposals under consideration:

Proposal	Detail
Increasing the financial thresholds for high net worth individuals	The government is of the view that the thresholds should be increased in line with inflation. Under this approach, the net income threshold to be considered high net worth would be uprated to £150,000 and the net asset threshold to £385,000.
Amending the criteria for self-certified sophistication	The government does not believe that the criteria around making one investment in an unlisted company in the last two years is appropriate in relation to self-certification any more, and are requesting proposals for an alternative test. The government is also proposing amending the existing director test of two years as director of a company with annual turnover of at last £1m. The proposal is to update the threshold in line with inflation to a value of £1.4m.
Placing a greater degree of responsibility on firms to ensure individuals meet the criteria to be deemed high net worth or sophisticated	In light of evidence that some investors are being classified as high net worth or sophisticated when they do not meet the conditions, the government believes that there should be a greater responsibility placed on firms to check that the criteria are met. The government proposes that under this proposal the emphasis of the 'reasonable belief' be shifted so firms communicating the financial promotion must have a reasonable belief that an individual meets the criteria, not simply that they have signed a relevant statement. It would be for the firm to determine how it comes to this conclusion, and to

	document this information accordingly. The investor would still be required to sign the investor statement.
Updating the high net worth individual and self-certified sophisticated investor statements	The government proposes making three substantive changes to investor statements: Updating format: the government think more can be done to make the information about the conditions that need to be met more prominent Simplifying language: the government want language in the statement to be simplified wherever possible Better investor engagement: the proposal is for the investor to have to select which specific criteria they meet, in addition to signing the statement.
Names of the exemptions	The name of the high net worth exemption is proposed to change to 'high net worth individual'.

Additionally, in its Consumer Investments Strategy, published in 2021, the FCA announced that it will take action to prevent dishonest firms and individuals from exploiting financial promotions exemptions.

FPO exemptions

The FCA has data showing that unauthorised persons are relying increasingly on these two financial promotion exemptions which allow authorised and unauthorised firms to advertise high risk investments directly to investors without having to comply with standard FCA financial promotions rules, sometimes resulting in significant harm to consumers. Recent FCA statistics show that at least 1.6 million consumers have investments in unlisted companies.

Dealing with these concerns is not straightforward however. The regulator cannot change the exemptions as they are contained within a piece of secondary legislation, the Financial Promotions Order (FPO), 2005, and so are a matter for Parliament only. But, of course, the FCA can always seek an injunction under s.382 FSMA in cases of breach.

There is also the risk that tightening financial promotions rules could have unintended consequences. It is possible that unauthorised firms could end up using the exemptions more, rather than obtaining the necessary approval for financial promotions by an authorised firm.

The FCA perimeter report notes that the exemptions were last reviewed in 2005 and expresses concern that they are no longer fit for purpose. The regulator is primarily concerned that unauthorised persons are increasingly relying on the exemptions in the FPO for high net worth and sophisticated investors to market high-risk investments. The FCA wants significant changes made to the exemptions, particularly regarding the relevant quantitative thresholds and the process around self-certification. The thresholds in the high net worth exemption have remained the same for approaching 20 years.

It is these arguments which the Treasury has seemingly taken on board in its latest consultation and proposed changes.

It is abundantly clear that the regulator is not comfortable with the exemptions but needs the Government to address the issues, which the Treasury is now seeking to do.

Approving financial promotions

As part of the focus on the regulatory 'gateway' the FCA specifically highlighted the changes around the approval of financial promotions for unauthorised firms in the Business Plan. The FCA highlighted that in July 2020, the Treasury consulted on changes to the regulatory framework for firms approving financial promotions. It proposed a new regulatory gateway, which an authorised firm must first pass through before approving financial promotions for unauthorised persons. HMT announced it would bring forward legislation to introduce this new gateway in 2021.

In its 'Consultation Response' Paper published in June 2021 HMT confirmed that the new gateway would be implemented through the restriction of the ability to approve financial promotions via the imposition of FCA requirements (rather than the other option mooted of creating a new FSMA regulated activity of 'approving financial promotions'). Specifically, the gateway will take the form of a prohibition that will prevent all new and existing firms from approving financial promotions for unauthorised persons (through a Requirement on firms' permissions).

Furthermore, the FCA also flagged its concerns regarding online platforms, such as search engines and social media platforms, given they play an increasingly significant role in putting consumers at risk of harm through adverts for financial products. These range from scams and promotions of high-risk investments to false or misleading adverts.

In response to this and wider concerns regarding financial promotions the FCA is making changes to the financial promotions regime. The regulator has put in place new procedures to fast-track responses to breaches. The FCA intends to be more proactive in monitoring firms while focusing on those firms that repeatedly breach rules, investigating where breaches indicate more serious issues. For example, the FCA now publishes quarterly data on financial promotions: in the first quarter of 2021 alone, 105 promotions were amended or withdrawn as a result of the FCA's interventions.

As the FCA has stated:

> *"Our experience in applying the protocol is that firms generally respond quickly and positively to our early interventions requiring them to make changes to, or to withdraw, financial promotions which may not meet our core requirement that they be clear, fair and not misleading."*

The FCA has also established the Joint Supervision and Enforcement Team to develop and deliver the supervisory strategy for non-standard investments such as mini-bonds. The team has taken forward or referred for further assessment over 800 non-standard investment financial promotions cases since early 2020. What's more, the FCA is currently developing a new strategy for financial promotions' supervision that has a more interventionist, data-led and proactive approach. This new strategy will be delivered by a new Financial Promotions and Investment Scams Department.

Online / Social Media

The law applying to online financial promotions changed at the end of the Brexit transition period. A broad exemption from the UK's financial promotion regime for e-commerce financial promotions (those constituting the provision of an information society service) made from an EEA State other than the UK was removed. As a result, online platforms now need to comply with the UK's financial promotion regime when they are disseminating adverts for financial services and products. As part of its supervisory work, the FCA has directly engaged with and is taking part in ongoing discussions on the issue with Google, Microsoft and Facebook/Instagram. With Facebook/Instagram and TikTok, the FCA can now directly request that user accounts which are creating content in breach of UK legislation and their policies be suspended.

Conclusion

It is positive to see the FCA taking steps to deal with developing issues arising out of the increased use of technology. Generally, the FCA should receive credit for acting on its word and tightening its control on the regulatory perimeter and gateway.

It should also act as a warning for firms which act in the various areas on which the FCA are clamping down. It is easy to see how, in light of the FCA's new decision making powers, the FCA may take more significant actions in a shorter timeframe should it feel the need to.

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Case Law

In last year's review, I wrote a detailed eight page article about *Avacade* and *Carey Pensions* (and then an update on *Carey* for those who wanted more[19]). Whilst I'm sure everyone enjoyed the detail, I thought this year a shorter article would suffice. Both of these cases ended up at the Court of Appeal (COA) and both were bad news for the authorised firms involved. You will see from this article there is one overwhelming point: unregulated introducers beware, as well as those authorised firms that deal with them. I also briefly discuss the importance of the FCA's case against Mr Steel and provide a brief update on the FOS.

Avacade and Carey

In my view there is still uncertainty about how Article 25 (1) and (2) operate. Some of the key excerpts from those two CoA decisions are:

Carey judgment relating to Article 25 (1)

- "For arrangements to "bring about" a transaction for the purposes Article 26, they must play a role of significance. Whether or not arrangements "bring about" a transaction is not to be judged simply on a "but for" basis, but neither is a "direct" connection inevitably required"
- The following steps were held sufficient to result in Article 25 (1) arranging to have taken place: "procuring the letter of authority, the undertaking of money-laundering investigations, the completion of the application form 'which had been delegated to CLP [the unregulated introducer]'". It is not entirely clear if the CoA was talking about each step or the steps when taken together but this does show that the threshold for Article 25 (1) 'arranging' is low
- "It does not matter that [the introducer's] acts "did not necessarily result in any transaction between [the investor client] and [Carey]" or that "the process was out of [the introducer's] hands to control in any event". Nor is it determinative whether steps can be termed "administrative". [The introducer's] "procuring the letter of authority" role in relation to anti-money laundering requirements and (especially) completion of the Carey application form were much more closely related to the relevant transactions than, say, the advertisement which originally prompted [the investor] to contact [the introducer]. It is to be remembered that [the introducer] filled in sections of the application form dealing with "Personal Details", "Occupation & Eligibility", "Transfers", "Investments" and "Nomination Of Beneficiaries". In my view, what [the introducer] did was thus significantly instrumental in the material transfers"

Avacade judgment relating to Article 25 (2)

- "The second [difference between Articles 25(1) and 25(2)] is that for article 25(1) the buying or selling may be conducted by anyone, whereas for article 25(2) it must involve a person who participates in the arrangements"
- "There is no need to introduce any test of causation into 25(2) by reference to the language of the inapplicable article 26 because by using the words "with a view to", article 25(2) makes clear that it is concerned with the purpose of the arrangements. An intended purpose, an end in view, must be that a relevant transaction take place, but the arrangements do not need to bring it about by way of an actual or notional test of causation. These are wide words which suggest that all that is necessary is that a relevant transaction is part of the purpose of making the arrangements. A person may have a relevant transaction as an end in view where the arrangements do no more than create or facilitate a situation which provides the opportunity for it to take place. That may be an intended result notwithstanding that the arranger is powerless to ensure that it takes place or even influence the decision which leads to it taking place. You cannot make the proverbial horse drink, but taking it to water involves making arrangements with a view to it drinking".

[19] https://dwfgroup.com/en/news-and-insights/insights/2021/4/analysing-the-court-of-appeals-decision-in-carey-pensions

Commentary

Having advised a number of clients who are unregulated or deal with unregulated introducers, it remains very difficult to provide certainty around what is permissible. The easy and safe advice is that very little is not now potentially an Article 25 activity. Perhaps that is the way it was intended and, indeed, for those unregulated individuals or entities which deal directly with the client that is probably right.

However, there are circumstances where service providers assist regulated firms behind the scenes, which based on the case law and wording of Article 25 and/or current PERG guidance, are potentially caught. The only saving grace is we have not yet seen, nor do we necessarily expect to see, regulatory action in those circumstances. Whether this is because the FCA is content with the line drawn or simply too busy dealing with the egregious wrongdoers we are not sure. It will also be interesting to see if more claimants - perhaps through CMCs (or, more accurately, lawyers acting for CMCs and their clients) - seek to bring s.27 FSMA claims against the authorised firms involved on the basis of investments made with or through unregulated entities acting in breach of the general prohibition. This may end up being the avenue through which a business model closer to the regulatory perimeter is adjudicated upon rather than via any regulatory action. We are aware that Carey is seeking permission to appeal to the Supreme Court.

24Hr Trading Academy

We are working with a number of trading platforms in the CFD and related markets and this case is a good reminder of the FCA's application of the principles of *Carey* and *Avacade* in that space. The FCA sought (on a summary basis) to obtain injunctions and restitution from the respondents (Mr Maricar and the company) who were allegedly breaching the perimeter.

The FCA alleged that Mr Maricar was breaching Article 25 ((1) and (2)) (arranging); Article 53 (advising) and sending Financial Promotions in contravention of s.21 FSMA. This was on the basis that trading signals, which were described as details of transactions in contracts for differences, spread betting contracts, and options relating to foreign exchange, were being provided to investors. He would brag about the success of his signals. Additionally, the company received commission for introducing individuals to trading platforms.

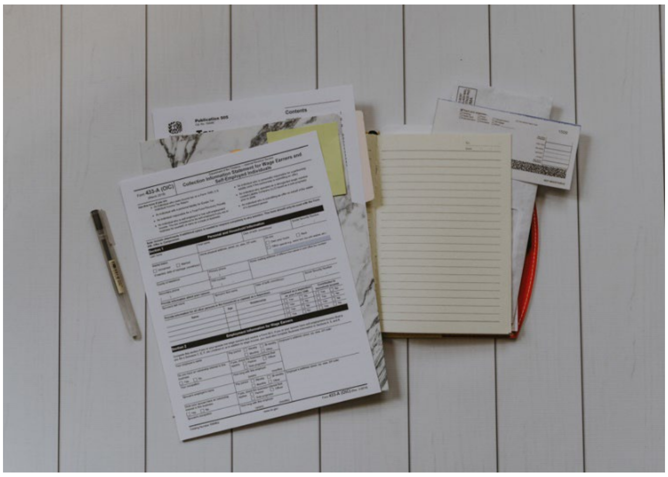
On a summary basis, the judge concluded that the company had breached Article 25 (2), Article 53 and FSMA. Additionally, it was held that Mr Maricar was knowingly concerned in said breaches. A restitution order was made against Mr Marciar and an injunction against the Company.

Maricar sought permission to appeal this decision, which was rejected by the CoA. In August, the FAC bankrupted him.

Commentary

Evidently, this is an area where the FCA is cracking down and we expect to see further action like this in due course as the popularity of regulatorily risky business models increases. This also confirms the theme of this article that unregulated introducers, and regulated firms that deal with them, should beware.

What will be interesting is whether the FCA will look to branch out and tackle firms closer to the perimeter than they are currently. In our view, which was shared by the Court, this was an obvious case of someone breaching the perimeter. Other cases will be much trickier.



FCA v Steel

The FCA is seeking a restitution order against Mr Paul Steel for up to £7m. It obtained interim freezing orders against Mr Steel and his partner, Ms Jacqueline Foster, who it is alleged may be holding or controlling assets owned by Mr Steel.

We believe this is the first time that the FCA has sought a restitution order under s.382 FSMA against a regulated individual. There are various examples of the FCA taking this action against unregulated individuals who have breached the General Prohibition (s.19 FSMA) or the Financial Promotion Prohibition (s.21 FSMA). This is where we would normally expect the FCA to target such action but we note there is no obvious bar in s.382 to prevent the FCA doing what it is attempting to do in this case (in effect, to pierce the corporate veil).

We are not privy to the specifics of this case but from what we have seen and been told, the allegations made by the FCA appear to be fairly standard e.g. Mr Steel provided unsuitable DB transfer advice (i.e. mere negligence). Perhaps there is something more to this case but, if not, this would seem to be a significant step for the FCA to take. If successful, it would allow the FCA to go behind the corporate veil and hold an individual financially liable despite the existence of a limited company.

This could have far reaching implications if the Courts empower the FCA to do this. There is no obvious reason why this would be limited to shareholders instead of, for example, directors / senior managers.

It may become apparent why the FCA has taken what we consider to be exceptional measures. It is also alleged that Mr Steel breached FCA requirements resulting in the removal of assets from his firm. This may be a reference to an asset retention. If so, this would start to make the FCA's actions more understandable (in our view).

The latest publically available update is that a trial will be listed for the first available date after 21 November 2022. It appears we are all in for a long wait to see the outcome of this but we will be sure to keep you updated.

Financial Ombudsman

There is not too much to report from the FOS. Any substantive investment complaint seems to be taking a long time to resolve (months, if not a year or two). The main area of interest relates to execution only business. We have previously seen an (unsuccessful) attempt to extend the *Berkeley Burke* principle to AIM-listed companies. It will be interesting to see if the *Carey* case has a big impact.

Depending upon the facts of any complaint, we consider both *Berkeley Burke*- and *Carey*-type complaints still involve a number of uncertainties as to how the FOS will likely determine them. For example:

In relation to *Berkeley Burke*-type complaints, it cannot (we hope and assume) be the case that any non-standard execution only investment is automatically compensable should the client lose money in their SIPP. Therefore, the question becomes: where is the line drawn?

In relation to *Carey*-type complaints, in some instances, it may be obvious that the regulated firm has, in effect, facilitated an unregulated introducer in guiding the investor to the investment choice. However, there are a number of scenarios involving unregulated introducers where it is evidently not this straight forward, for example, where the regulated firm is not aware there is an unregulated introducer in the background.

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Special Administration – 'Investment Banks'

In July, DWF's Insolvency & Restructuring team acted on the notable restructuring of the London-based wealth management firm Dolfin Financial (UK) Ltd, putting the company into Special Administration and advising the Special Administrators with regards to a subsequent pre-pack business and asset sale.

The Special Administration regime is a relatively rare insolvency process, given the restricted circumstances in which it can be used to secure a structured wind-down of an FCA regulated business holding client assets. What was particularly unusual in this case was that the business was sold by way of a pre-pack which is almost unheard of in Special Administrations of investment banks due to the need to reconcile client assets post appointment.

As was widely publicised at the time, Dolfin was placed into Special Administration following the withdrawal of certain permissions by the FCA following concerns over the firm's activities with regards to Tier 1 Visa Investment Schemes. With the consent of the FCA, the Special Administrators completed on an asset sale to Britannia Global Markets Limited which included an agreement for the purchaser to on-board the bulk of the firm's clients and their assets. Dolfin was holding approximately £1.28Bn of client assets and £120m of client monies at the date of Special Administration on 30th June 2021 so it was extremely difficult to reconcile client assets as part of a pre-pack sale. In the case of Dolfin, some clients will have been affected by the fallout of the Special Administration caused by FCA concerns over certain investments within the business, even when they themselves had invested in somewhat less controversial/risky investments.

Investment Banks

There are a number of special administration regimes which cover various sectors of the economy considered essential to the running of the country or which have a public interest that require additional measures on an insolvency event. Such sectors include energy, education, health, travel and finance. The special administration regime for investment banks is just one of these regimes that was introduced in 2011 following the financial crisis and issues which arose from the largest insolvency of the time, Lehman Brothers, where the Insolvency Act 1986 was simply not drafted to handle the insolvency of a bank or other investment firm holding client assets.

The Special Administration regime is available to insolvent companies which fall within the definition of "investment bank", as defined by section 232 of The Banking Act 2009.

FCA Guidance for Insolvency Practitioners

One of the three key objectives of a Special Administration of an Investment Bank is to ensure timely engagement with market infrastructure bodies and certain authorities, including the FCA, Bank of England and the Treasury. It is therefore important that any insolvency practitioner acting as a special administrator of an investment bank ensures compliance with the FCA's rules and guidance and relevant legislation which aim to achieve better outcomes for consumers and market participants following a firm failure.

In May 2021, the FCA issued guidance to IPs on the failure of regulated investment firms. It provides much needed clarity for IPs in this arena and the FCA's view of how an IP should ensure firms meet their ongoing regulatory obligations following appointment. The guidance covers a wide range of complex issues faced by IPs that are largely specific to special administrations, such as the relevant experience, knowledge of CASS, FSMA and their interaction with the Special Administration Regime (SARs) and expertise expected by the FCA; guidance on how to approach a wind down plan and engagement with the FCA and FSCS; treatment of shortfalls in client assets and approach to compensatory options; use of bar dates to assess client claims; and concerns over transfer of client data to CMCs etc. Whilst the FCA guidance has no binding authority, it has yet to be seen whether a deemed breach of the guidance could be considered to be a breach of Objective 2 of the SARs, namely to ensure timely engagement with market infrastructure bodies and authorities, which includes the FCA. As such, aside from being a helpful guide, the FCA's guidance should also be considered as part of the special administrators' primary objectives.
The occurrence of investment bank Special Administrations should remain rare due to the nature of

such entities being heavily regulated in the first instance, which also includes the requirement for regulatory capital to try and soften the impact of an insolvency or ride through turbulent times in the market. However, when faced with a Special Administration any IP would be well placed to be properly advised upon how to approach the FCA Guidance. The FCA's position is clearly stated: "*While we cannot stop firms failing, we aim to help minimise disorderly failures that cause serious harm to both consumers and markets. This involves working with insolvency practitioners (IPs) appointed over regulated firms to reduce such harm where possible*".

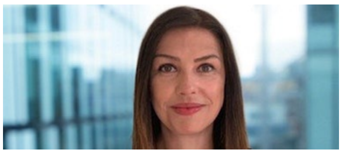
Transfer of client assets via a pre-pack sale

Immediately following their appointment and as required by the SAR, the Special Administrators of Dolfin produced an extensive Reconciliation of all Client Assets and Client Monies under the control and management of the firm. Prior to the appointment of the Special Administrators, and as part of the Company's wind-down planning, negotiations were advanced with Britannia for the sale of certain assets of Dolfin (which included the benefit of certain client contracts). The sale was concluded shortly after the appointment of the Special Administration, notably using the effective pre-pack restructuring tool in the context of a Special Administration in order to return client assets to clients. Interestingly, SIP16 does not apply to Special Administrations but it remains to be seen whether this is a legislative oversight or intentional given the rarity of special administrations and the limited opportunity there is to abuse the process given the statutory involvement afforded to the FCA.
The other safeguard for clients, as opposed to most normal insolvencies, is that the FSCS does provide a compensation scheme capped at £85,000 per person per firm (subject to certain qualifying criteria) so that each client can claim compensation where they have suffered a loss as a result of their dealings with an FCA regulated practice.

Summary

The Dolfin Special Administration is unique as it was the first Special Administration following the issue of the FCA guidance to IPs on Special Administrations, and it is one of the very few examples of a pre-pack sale in a Special Administration.

Contacts



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Final word… Digital distribution disrupted and delayed

"The overall long-term trend for wealth management growth remains incredibly strong as new wealth is created and the overall number of wealthy individuals increases. How these clients are served and advised will be a fascinating area to watch, as the increased use of digital channels drives innovation in service models". So said Michael Morley, who has stepped down as CEO of Deutsche Bank's wealth management business for the UK, in a recent article on banks returning to wealth management[20].

The robo advice market (in what the FCA calls 'mainstream investments') has rather stalled, with the FCA reporting that only 1.3% of adults have used on-line robo-advice. A few B2B offerings have gained traction but the big bank launches haven't broken through into their huge customer bases and the start-ups have (by and large) failed to get off the starting line in terms of new customer acquisition. The banks have tended to develop simple advice propositions to guide clients into suitable funds from their own product range. The start-ups have tended to offer discretionary model portfolio service but treat them like products, and continue to struggle with the notion of 'self-select DFM', even though a digitally delivered discretionary service could be the best of all mass market solutions.

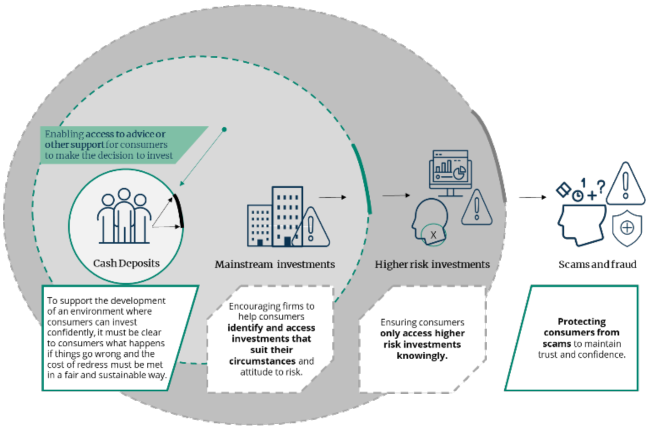
At the same time, regulators are struggling with a booming digital investment market but the boom is 'higher risk investments'[21] that are more likely to lead to bust than a robust, robo-advised, retail investment market. The low interest rate / low yield market conditions are tempting consumers to seek out returns in ever more non-mainstream ways, through increasingly immediate and direct digital channels. Digital distribution is proving most successful in higher risk investments distributed by newer market entrants, like CFD trading platforms, social and copy trading, and crypto assets - and the outright scams and frauds beyond the fringes.

We're all convinced digital plays a big part in the future of wealth management. The big question remains: how?

Consumer contradictions

The FCA published its consumer investment strategy in September, aiming to give consumers the confidence to invest, with support from a high-quality, affordable advice market. The FCA anticipates this will lead to fewer people being scammed or persuaded to invest in products not suitable to their risk profile.

The FCA's Consumer Investment Strategy:



By 2025, the FCA wants to:

- Reduce by 20% the number of consumers who could benefit from investments but are missing out. There are over 15m consumers with more than £10,000 of investible assets, of which 37% hold their assets entirely in cash, and a further 18% hold more than 75% in cash
- Halve the numbers investing in higher risk products that are not aligned to their needs. 6% of consumers increased their holdings of higher risk investments during the pandemic. 45% of non-advised investors failing to recognise that 'losing some money' was a risk of investing
- Reduce the money consumers lose to investment scams perpetrated or facilitated by regulated firms. Consumers lost nearly £570m to investment fraud in 2020/21 – this has tripled since 2018
- Stabilise the £833m compensation bill for the FSC

Measures the FCA will take to achieve its strategy include:

[20] Raconteur, Wealth & Asset Management special, 19/12/21 -"*New returns: banks move back into wealth management*", by Simon Brooke
[21] Defined as: mini-bonds (also known as high interest returning bonds) and other non-readily realisable securities; unregulated collective investment schemes (UCIS); some structured products, derivatives and Contracts for Difference (CFDs); Venture Capital Trusts (VCTs); exchange tokens or cryptocurrencies (eg Bitcoin); investment-based crowdfunding; and, peer-to-peer lending

- Considering regulatory changes to help firms provide more assistance to consumers who want to invest in relatively straightforward products. It plans to consult on its proposals in Q1 2022 and implement them at the start of 2023
- Launching a new £11m investment harm campaign to help consumers make better-informed decisions
- Addressing misuse of the appointed representatives regime
- Strengthening the financial promotions regime

In March, the FCA had issued a warning about younger investors taking on big financial risks in high-risk investments like cryptocurrencies and foreign exchange. Over 4 in 10 did not view 'losing some money' as one of the risks of investing, even though as with most investments their whole capital is at risk and in some cases, investors can lose more than they initially invested (e.g. CFDs). This newer group of self-investors are more reliant on contemporary media (e.g. YouTube, social media) for tips and news. This trend appears to be prompted by the accessibility offered by new investment apps.

In October, when launching its new InvestSmart campaign, the FCA reported on its survey that found three quarters of younger (18-40) high-risk investors feel competitive when investing in high-risk products; over two thirds (68%) likening it to gambling. Just 1 in 5 respondents (21%) were considering holding their most recent investment for more than a year, and less than 1 in 10 (8%) for more than 5 years. Hype on social media and in the news is driving new investors to take up high-risk investments. 58% of respondents agreed that constantly hearing about a certain investment on the news, on social media and from other people encouraged them to purchase specific investments.

While those who have invested believe themselves to be more knowledgeable about financial matters than the general public, the new research found that majority of those who purchased forex or crypto (57% and 69% respectively) incorrectly believed these to be regulated by the FCA.

Regulatory risks

The FCA's Consumer Investments Data Review reported on the regulator's King Cnut-like efforts to hold back the tidal wave of digital dangers – in the year to March 2021, the FCA: stopped 48 new firms (1 in 5 applications) from entering the market where it identified potential for consumer harm; opened over 1,700 supervisory cases involving scams or higher risk investments; and published over 1,300 consumer alerts about unauthorised firms and individuals.

Much of the FCA's annual Perimeter Report for 2021 was a reaction to LCF and the risks of mass-marketing of high-risk investments to retail consumers and speculative illiquid securities but it majored too on the marketing of CFDs and other high-risk investment products and online harms, saying: "Online platforms, such as search engines and social media platforms, are playing an increasingly significant role in disseminating promotions of financial products and services."

Mark Stewart spoke on 18 May at an Investigations & Enforcement Summit about "the rise in scams and the threat to a legitimate financial services industry", noting in particular the rise in unregulated adverts: "This year to date we have issued 632 specific warnings, which means we are running at more than 100% of last year's figures". Steward addressed the FCA's difficulty in policing its perimeter, saying: "While the FCA does have statutory power over the use of false or misleading statements in relation to securities, those offences will not bite where the investment product is outside the financial promotions perimeter. The perimeter, or perimeters (there is more than one), is an intricate boundary that can produce different results in terms of regulatory power, consumer protection and outcome, depending on some equally technical distinctions. Despite these circumstances, the FCA remains very active and engaged in tackling the scourge of investment fraud in this country." The LCF scandal has shown just how intricate the boundary can be and the different results in terms of consumer protection and outcome. The internet, social media platforms and web-based trading and investment platforms from other jurisdictions make for a minefield of boundaries and perimeters which appear to leave the FCA fighting a losing battle with insufficient powers (or appetite to use them in place of criminal law enforcement agencies).

The FCA's Consumer Investment Strategy paper acknowledges that its "powers to act against unauthorised firms conducting unregulated activities are extremely limited". In a recent example, it was left to the ASA to rule against misleading advertising by a cryptocurrency trading platform and its ads which included text stating "Invest in the world's top crypto's with one click" and "Discover [the firm's] unique BitcoinWorldwide offering, a ready-made portfolio, holding the world's leading cryptoassets". The firm explained that the term "one click" referred to the efficiency of having a ready-made diversified cryptoasset portfolio, in contrast to the time it took to create a bespoke portfolio, and so did not make a comment on the simplicity of the cryptocurrency. The ASA noted that no FCA financial promotion rules applied (and therefore none could be breached) but found the statements over-simplified the offering and therefore in breach of the CAP Code in relation to social responsibility and financial products. The lack of risk warnings breached the Code's 'misleading' and 'qualification' requirements.

The technology to enable a 'one click' investment into a portfolio of diversified assets is impressive and could be harnessed for mainstream investments. However, some of the best tech – and best innovation – is focussed on the higher risk investment market. This is, in part, because, as the FCA described it in its strategy paper: "The general view was that current legislation and rules relating to financial advice and guidance restrict firms' ability to offer more personalised help to consumers. Although many firms wanted to do more to guide consumers to investment products which were right for them, they had concerns about inadvertently crossing the boundary between guidance and advice".

In the mainstream market, the FCA wants to encourage ease of investing. It is "exploring how we can make regulatory changes to make it easier for firms to provide more help to consumers who want to invest in relatively straightforward products". But for the higher risk investments, the FCA is considering inserting frictions into the consumer journey to slow down investment decisions by, perhaps, imposing stronger pre-purchase consumer assessments or making higher risk investments accessible only via advice.

The current consultation on LTAFs will be instructive as to the direction of travel as the FCA balances these apparently conflicting pressures. It is planning new rules to create a Long-Term Asset Fund (LTAF) regime, designed specifically to help investment in longer term, riskier assets including venture capital, private equity, private debt, real estate and infrastructure. The FCA will be consulting this year on the potential for widening the distribution of the LTAF to certain retail investors. The LTAF structure was one of its wholesale market priorities from its Business Plan 2021-22 and marks its commitment to being more innovative, assertive and adaptive.

In addition to its short term strategies, including implementation of the Consumer Duty in Q1 next year, the FCA has set out longer term strategic action plans. The FCA "wants to make changes so that firms are subject to proportionate requirements when they support new consumers to invest in products that suit their simple investment goals", with consultation to follow early this year ready for implementation at the start of 2023.

Proposition problems

The basic problem for firms is that the more they do for their clients, the more responsibility they take. The obsessive focus on advice is, in my view, misplaced - at least in respect of investment solutions as opposed to financial planning (for which there is no substitute). Loading up consumers with complex product information and potentially meaningless regulatory disclosures for them to then (apparently) take an informed investment decision but without ever really shifting responsibility from the adviser onto the investor, creates a slow and costly system that doesn't fully achieve the objectives of informed clients taking investments decisions for themselves.

Personalised advice is hard to digitise as it has to combine the twin challenges of customer engagement and sophisticated interpretation of client-specific data to allocate ('recommend') suitable products. Even if a customer engages, they are unlikely to take much interest in the details of the investments proposed and will inevitably take the recommendation 'on trust'. If the customers don't engage, their advisers have to chase them around to fill their files with sufficient client-specific data to 'demonstrate suitability'.

At the opposite end of the risk spectrum, consumers can lose their shirts very quickly through online trading or, if really unlucky, scams. The digital customer journeys and investment propositions can be cutting edge. Some of the technical capabilities are hugely impressive and ought to be applied in the mainstream retail investment market.

The plethora of trading platforms and online investment apps are bringing the weird and wonderful into the market with innovation from across sectors and around the world that leaves the comparatively pedestrian paced robo-advisory offerings lagging behind, weighed down by regulation and risk aversion. Through lack of familiarity with the UK market and its regulatory regime or because the FCA hasn't the resource to consider, supervise or tackle them all, higher-risk investment businesses have, until recently, been left to thrive (so long as they stick to the right sort of clients and the right sort of investments). But with the increased focus on consumer detriment in high risk investments and the risk of scams, the FCA has been far more active of late in dealing with international trading platforms and apps, signal providers (particularly those, like 24hr Trading, which stray into unauthorised advising) and social and copy trading propositions that push various boundaries.

The key risk is the ease of on-boarding, account opening and investing, often with a few key strokes on a key board, clicks of a mouse or swipes on a smart phone app. But just as investors can thereby get themselves into trouble very quickly, they could be steered towards suitable mainstream investment solutions if the regulator facilitated and the market encouraged the 'right' propositions.

Execution only is the default business model for those wishing to avoid responsibility for the suitability of investments for individual clients. Whilst 'selling' through FinProms and enabling clients to invest with ease through slick broking and custody services, these firms don't give their clients the full benefit of their investment expertise. Some have – like many of what the FCA called ODIMs (online discretionary investment managers) – turned to 'self-select DFM', whereby investors all but choose a model portfolio for themselves and then the DFM discharges (as best it can, assuming it understands them) its ongoing obligations to ensure its client data is up-to-date and not manifestly wrong, such that it can rely on the client to satisfy themselves that the portfolio remains suitable (so long as the DFM continues to manage it to mandate). It is not entirely clear how firms can be satisfied that self-select DFM complies with all the relevant regulatory requirements.

The old stockbroking model of 'advisory managed' no longer works well under MiFID II restrictions. But the hybrid between broking, ad hoc advice and discretionary management is potentially the way to go, taking the best bits from each service line. However, the law (in the form of contractual terms and legal duties) and regulation don't support such a 'pick 'n' mix' approach.

I've long maintained that discretionary could be the best solution for the mass market. However, perhaps because of the legacy of stockbroking and the assumption that bespoke DFM was only for higher net worths, it is mis-understood, particularly by the regulations (if not also the regulator). RDR and MiFID regulation doesn't deal well with commoditised model portfolio management in the UK. The implications of MPS being a MiFID service as opposed to retail investment products are varied and complex. The treatment of most MPS as 'special investment funds' for VAT purposes has only served to further complicate matters.

Overlaying misunderstandings about the legal and regulatory status of model portfolios, the regulator struggles to understand 'direct DFM' and how clients can be on-boarded into a suitable model portfolio service without separate advice in compliance with COBS 9/A. Robos like Nutmeg – that were belatedly identified as ODIMs by the FCA – have had to take advisory permissions and develop their initial client take on procedures to include an advice stage. Many have very simplistic initial advice processes to identify suitable risk-rated portfolios but some still allow 'self-select DFM'. The idea of an execution only MPS might seem like an effective distribution channel for DFM services but it is arguably a legal and regulatory impossibility.

Firms could provide guidance on which MPS to select – so long as the DFM then ensures suitable decisions to trade within the portfolio – but the FCA is still unable to provide meaningful and actionable clarity about the 'advice / guidance boundary'. With time and good consultant support, firms can certainly devise a workable business model on paper but putting it into practice and adapting to the vagaries of real clients in the real world is another thing altogether.

In addition to the FCA's forthcoming consultation on regulatory reform, I was pleased to see one of the market leaders in non-advised services, Hargreaves Lansdown, lending its considerable weight to the debate. It was reported in a recent FT article[22], that: "Hargreaves' head of government affairs and public policy, said: "The advice/guidance boundary gets in the way of our ability to engage our clients using targeted messaging and guiding them to better outcomes." HL reportedly wants to use in-house information drawn from customer investment patterns, saying "The power of data hasn't yet been fully harnessed here — more could be done to support consumer understanding." The article says HL said it wanted the FCA to take a more flexible approach to policing the border between advice and guidance, so it could do more to personalise the information it sends to clients. The FCA reportedly said it was open to new ideas: "We recognise that firms need to navigate the boundary between advice and guidance . . . We are open to innovation in the advice market and have supported a number of firms that wish to test new ideas before coming to market."

The article goes on, quoting: "the platform's content team leader, who stressed that Hargreaves did not want to become an investment nanny state. "We are not taking away people's right to choose. They can opt out or ignore it". Therein lies one of the problems, if its advice and the client acts on it, the firm is potentially responsible.

Much of this interminable debate ends up back at a simple consideration as to whether the firms involved are 'good or bad actors' and whether the consumers get 'good or bad outcomes'. Whilst that may be a sensible policy objective targeting a satisfactory outcome, it's no way to regulate or create sufficient legal and regulatory certainty for new business lines to develop. We often find ourselves in the unsatisfactory position of advising clients that their proposition falls into a considerable legal grey area but we think it is unlikely to be challenged by the FCA as long as the 'wrong people don't lose money in the wrong investments'. It may be pragmatic and sound advice – and it may even be the FCA's policy intent – but it's no basis for legal certainty and predictability when business planning or developing a proposition.

Following through my 'discretionary is best' idea, I advocate regulatory and market reform to properly recognise the status of model portfolios and their under-appreciated potential properly to serve the mainstream investment market. My proposals for the consumer investments strategy – on which I welcome challenge and debate – is for:

- Regulatory understanding of and guidance on 'direct/self-select DFM'
- Proper regulation of model portfolios to regularise their use as small client and robo-advice (ODIM) MiFID service solutions
- Adopt the best customer journeys and ongoing client engagement practices from the EO trading apps, using social trading features to educate and maintain engagement with the next generations and hybrid robo-advice tools for existing clients
- Develop personalised investment strategies using expertise and innovation from wholesale market

[22] https://www.ft.com/content/ecdd023b-5362-40ce-a910-2faec768b2de

research and technology providers and the best traders amongst signal providers and copy traders

- Mainstream discretionary management services to ensure access to a full range of low costs investments, continual monitoring and risk management in accordance with the individualised mandate

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How we can help

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We work with all types of clients across the wealth management sector including:

- Wealth managers, DFMs, IFAs, networks, national advisers, consolidators and platforms
- Wealth management and distribution divisions at banks, life insurers, asset managers and SIPP providers
- Robo-advisers, Online Discretionary Investment Managers (ODIMs) and FinTech start-ups
- Unregulated businesses outside the FCA's perimeter, seeking authorisation or relying on exemptions
- Regulated individuals, approved or certificated persons and senior managers, often with the benefit of D&O insurance
- International clients setting up a regulated entity in the UK or firms conducting investment business overseas (including post-Brexit)

Key areas of expertise

Our FSR consultants specialise in:

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- 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, and 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
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