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Brexit

Brexit Remains an Immediate FCA Concern for 2019/2020, With Regulatory Evolution a Longer-Term Area of Interest

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The U.K. Financial Conduct Authority (FCA) recently released its 2019-2020 Business Plan (Plan). In the press release announcing the Plan, FCA Chief Executive Andrew Bailey said that "[d]ealing with Brexit will be the most immediate challenge we face. But this plan also commits us to a stretching programme of work across the financial sector." He continued, "In order to ensure we are a regulator that continues to serve the public interest, we need to adapt to the ever-changing environment. This is why the future of regulation is a key priority in this year's . . . Plan."

The Plan focuses on Brexit and seven additional "cross-sector priorities" that will affect some or all of the seven distinct business sectors within its purview, including investment management. This article summarizes the FCA's immediate and cross-sector priorities, as well as the other portions of the Plan most relevant to private fund managers.

For coverage of prior FCA business plans, sector views and mission statements, see "Preparing for Brexit a Key FCA Priority for 2018/2019" (May 31, 2018); "FCA Details Three of Its 2017 Priorities: Competition in the Asset Management Market, Liquidity Management and Custodians" (May 4, 2017); and "FCA 2016-2017 Regulatory and Supervisory Priorities Include Focus on AML, Cybersecurity and Governance" (Apr. 14, 2016).

FCA Key Priorities

As was the case last year, the FCA is currently focused on ensuring an orderly Brexit and engaging with other regulators. In keeping with its prior business plans, the FCA has also set out the following seven "cross-sector" priorities, the first four of which are carried over from last year:

1. firm culture and governance;
2. operational resilience;
3. financial crime and anti-money laundering (AML);
4. treatment of existing customers;
5. impact of innovation and big data on consumers;
6. "intergenerational" challenges in financial services; and

7. the future of regulation.

Immediate Priority – Brexit

Brexit "is the most significant change affecting financial services markets and will be our immediate priority," according to the Plan. The FCA's goals are to "maintain the effective international standards that underpin the U.K. regime, enable market access and reduce the risk of regulatory arbitrage." The FCA is attempting to achieve those goals by:

- supporting the Brexit transition;
- monitoring Brexit's effect on the financial sector and mitigating associated harms to consumers and the broader market;
- developing new bilateral arrangements with other nations; and
- continuing to help shape the global regulatory agenda.

The FCA aims to increase its engagement with other key regulators and become "more globally focused" in order "to ensure international standards reflect FCA views and support our objectives."

See "How Hard Is Brexit Expected to Impact Alternative Fund Managers?" (Dec. 13, 2018); and "FCA Executive Director Outlines Regulator's Brexit Preparations and Expectations for Fund Managers" (Aug. 2, 2018).

Cross-Sector Priorities

Firm Culture and Governance

The FCA seeks generally to promote healthy firm cultures by exploring "the themes of purpose, leadership and management capabilities, remuneration and incentives, and firms' assessment of culture." Its ultimate goal on this front is "to transform culture in financial services firms, so that firms cause less harm to consumers, businesses and the real economy." In the coming year, it plans to work toward that goal by:

- exploring whether healthy firm cultures lead to better outcomes for consumers;
- analyzing whether firms' remuneration practices in general, and bonuses in particular, reinforce healthy cultures or increase risk of harm to consumers;
- implementing the extension of the Senior Managers and Certification Regime (SMCR) across the broader financial services industry; and
- pursuing implementation of the Directory, which will provide information on individuals in key roles who are not covered by the SMCR.

See "FCA Chief Executive Touts Senior Managers Regime and Remuneration Restrictions As Important Incentives to Promote Good Culture at Fund Managers" (Apr. 12, 2018); and "FCA Issues Guidance on Expansion of Senior Managers Regime to Fund Managers and Others" (Feb. 1, 2018).

Operational Resilience

The FCA's overarching goal is to "maintain continuity of services whatever the cause of disruption," be it a technology outage, cyber attack or other cause. It will continue to develop its understanding of cyber threats and potential responses and to publicize its expectations. In particular, the FCA will:

- develop policy proposals, in cooperation with the Bank of England, based on the results of its July 2018 operational resilience discussion paper;
- set expectations for how firms manage risks posed by third-party service providers, emphasizing that "critical services may be outsourced but responsibility cannot." See "How Fund Managers Can Develop an Effective Third-Party Management Program" (Sep. 21, 2017);
- review its expectations on how firms manage system upgrades, data transfers and other technological changes;
- continue to use "ethical hacking" to test the cyber defenses of "high impact" regulated firms;
- continue to explore firms' weaknesses in identifying their own key assets and in detecting and responding to cyber attacks;
- explore ways to communicate with smaller firms about resilience; and
- work with other U.K. authorities in responding to major cyber and other incidents and continue to assess how firms respond to incidents.

See "FCA Evaluates Firms' Cyber Resilience" (Mar. 21, 2019); "FCA Head of Technology Outlines Regulator's Cybersecurity Expectations and Three Key Lessons for Fund Managers" (Feb. 22, 2018); and our two-part series on the key elements of a hedge fund business continuity and disaster recovery plan: Part One (Feb. 17, 2010); and Part Two (Feb. 25, 2010).

Financial Crime and AML

Through intelligence gathering, data analysis, intelligence sharing with other government agencies, technology and identification of sector-specific risks, the FCA seeks to "make the U.K.'s financial markets a difficult target for criminals." Its specific areas of focus include:

- improving its AML capabilities through intelligence gathering, analytics and, possibly, becoming "more intrusive in assessing the effectiveness of firms' own systems and controls." See "FCA Fines Deutsche Bank £163 Million for Lax AML Controls, Warns Other Firms to Review AML Procedures" (Feb. 9, 2017);
- deepening its understanding of fraud and financial crime;
- supporting the U.K. government's economic crime agenda and participating in various cross-government initiatives;
- considering whether to require more firms to report on financial crimes;
- improving professional standards established by law and accountancy bodies through its Office for Professional Body Anti-Money Laundering Supervision; and
- identifying pension and payments sector scams, raising awareness of such scams and developing technological approaches to combat those scams.

The FCA will continue to monitor regulated firms' progress in improving AML controls, analyze financial crime data to monitor changes in risk and assess whether professional bodies "have effectively implemented a robust AML/[counter-terrorism financing] strategy and governance framework."

See also "Lessons Private Fund Managers Can Learn From U.S. Bancorp's Settlement of AML Violations" (Apr. 26, 2018); and our two-part series on the U.S. Department of the Treasury Financial Crimes Enforcement Network's AML rule: "Establishing an AML Program" (Nov. 5, 2015); and "Operating an AML Program" (Nov. 12, 2015).

Innovation, Data and Data Ethics

Innovations in financial technology (FinTech), regulatory technology (RegTech) and data collection may not always benefit consumers. The FCA aims "to ensure that innovation, coupled with advances in technology and data use, works in consumers' interests." In this area, the agency will:

- review the effectiveness of the U.K.'s "Open Banking" initiative, and seek input on increased data sharing by financial firms through "Open Finance";
- explore how artificial intelligence and automated decision making may affect products and services, along with the implications of those technologies for consumers and the financial markets;
- publish feedback on recent consultation on the risks associated with crypto assets, and consider extension of its "regulatory perimeter" to encompass additional activities associated with those assets. See "Best Practices for Funds That Invest in Digital Assets" (Feb. 21, 2019);
- continue to work with the Global Financial Innovation Network, which focuses on innovation and best practices in FinTech, and participate in certain cross-border trials pertaining to market access; and
- continue its work on RegTech, including:
    - improving data exchange between industry and regulators, and analyzing the potential costs and benefits of digital regulatory reporting. See "FCA Solicits Industry Input on Machine-Executable Regulatory Reporting" (Mar. 15, 2018);
    - devising technological solutions for AML and financial crime compliance; and
    - using technology to help vulnerable consumers.

See "FINRA RegTech Conference Reviews Current Uses of RegTech and Considerations Before Deployment (Part Two of Two)" (Mar. 28, 2019); and "Cordium and Aite Group Survey Benchmarks Use of 'RegTech' by Asset Management Firms" (Feb. 8, 2018).

Demographic Changes

In light of persistent low interest rates; stresses in the housing and employment markets; and other factors, the FCA will "consider the changing financial needs of different generations, how the industry might respond, and how regulation may need to change as a result." To deepen that understanding, it will:

- publish a discussion paper and conduct follow-up on whether its existing regulatory approach is hindering innovation to address intergenerational issues;
- commence the second phase of the Financial Lives survey, first launched in 2017, to gain new insight on consumer harm, access to financial services and other matters; and
- publish guidance on the identification and treatment of vulnerable consumers.

Fair Treatment of Existing Customers

Concerned that "consumers are often being penalised for their loyalty," the FCA will continue to work with the U.K. Competition and Markets Authority (CMA) to address pricing practices in the cash savings, mortgage and general insurance markets. Its overarching goal is to ensure that "existing customers enjoy the benefits of increased competition and innovation."

Future of Regulation

As part of the FCA's ongoing efforts to ensure that its regulations keep pace with technological change and changing consumer needs, and to adapt to the post-Brexit world, the agency will:

- publish a feedback statement on the responses it received to its 2018 discussion paper on the imposition of a new duty of care to improve consumer outcomes;
- conduct "diagnostic" work to understand the costs and benefits associated with compliance with the FCA Handbook and a potential move to a "machine readable and machine executable Handbook";
- make "tactical adjustments" to the Handbook in light of Brexit, and work with the U.K. Treasury to ensure that the U.K.'s "regulatory framework adapts to [its] new constitutional position outside the E.U.";
- study the regulatory costs incurred by small authorized firms; and
- publish its annual statement on its views on its regulatory perimeter and possible gaps in regulatory protections.

See "FCA Pledges to Be More Innovative, Transparent and Forward Looking Following Practitioner Survey" (Aug. 23, 2018).

Sector Priority – Investment Management

In light of the three roles buy-side firms play as agents for investors, as market participants and as investment stewards, the FCA plans to focus on firms' operational resilience and on the value of the products and stewardship they provide.

Asset Management

In late 2015, the agency began an Asset Management Market Study (AMMS) that led to its adoption of rules to strengthen fund managers' duty to act in the best interests of investors and to improve the quality and completeness of information provided to investors.

See "FCA Issues Final Rules on Disclosure Concerning Use of Benchmarks and Guidance on Descriptions of Fund Objectives" (Jun. 6, 2019).

In the coming year, the FCA will work on implementing those new rules. In addition, it will work to incorporate into the FCA Handbook the remedies the CMA is imposing to improve disclosure of costs and charges by fiduciary management firms. The FCA is also working to extend its regulatory perimeter to incorporate investment consultants.

The agency will continue to publish data pertaining to whether the harms identified by the AMMS have been addressed, including updated summary data on asset manager profitability. It will also begin publishing summary data on the pricing and performance of certain actively managed and index/tracker funds, along with pricing data to assist in comparing actively managed and passive funds.

See "FCA Report Explores the Impact of Platforms, Governing Bodies and Manager Compensation Structures on Fund Competition (Part One of Two)" (Apr. 6, 2017).

Stewardship

The FCA will continue work on implementing the Revised Shareholder Rights Directive and will evaluate the responses it received in connection with its discussion paper on improving stewardship in the U.K. financial markets.

Prudential Regulation

The agency will work on implementing a new prudential regime for investment firms regulated under the Markets in Financial Instruments Directive (MiFID) that will be aligned with the E.U.'s Investment Firms Directive and Regulation. The purpose of the regime is to "reduce unnecessary costs to firms" and change certain reporting requirements.

See "What Are the Implications for Investment Managers of the Revised Prudential Framework for E.U. Investment Firms?" (Mar. 22, 2018).

Regulation of Firms Investing in Illiquid Assets

To ensure that retail investors understand the risks of investing in funds that hold illiquid assets, and to mitigate the associated risks, the FCA will publish a policy statement with final rules and guidance pertaining to standards of liquidity management for those funds.

Standardized Key Information Documents

The E.U.'s Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation imposed standardized disclosure obligations on in-scope retail products, requiring funds to deliver a "key information document" to investors. The FCA will continue to work to address industry concerns about the PRIIPs regime that were expressed in response to its 2018 call for input and 2019 feedback statement.

See "Dechert Partners Discuss Domiciling Funds in Germany or Ireland to Access the E.U. Post-Brexit, the Possible Introduction of PRIIPs and the Rising Prominence of UCITS Structures (Part Two of Two)" (Nov. 17, 2016).

MiFID II

As part of the FCA's upcoming review of MiFID implementation, it will "assess how asset managers oversee the design of their products, identify their target market and monitor their products and distribution activities, in compliance with MiFID product governance requirements."

See "ACA Panel Reviews Effects of Impending MiFID II on U.S. Advisers" (Dec. 7, 2017).

Sector Priority – Wholesale Financial Markets

Cross-sector work on operational resilience, financial crime, SMCR and governance are particularly relevant to the wholesale financial markets because their "effectiveness relies on them being visibly fair, transparent and efficient," according to the FCA. The agency will thus focus on:

- working with market participants and other regulators to ensure that they understand the Market Abuse Regulation; examining firms' controls over inside information, particularly in the fixed income markets; and developing new tools to monitor and detect market manipulation. See "E.U. Market Abuse Scenarios Hedge Fund Managers Must Consider" (Dec. 17, 2015);
- continuing to supervise firms' transition away from the LIBOR regime. See "How Hedge Fund Managers Can Prepare for the Anticipated 'End' of LIBOR" (Jan. 3, 2019);
- continuing to use MiFID II data to detect market abuse;
- pursuing a call for input on the potential risks of anticompetitive or collusive behavior associated with access to, and use of, data;
- taking steps to minimize fallout from Brexit, including implementing the E.U.'s Prospectus Regulation, Securitisation Regulation, Amendment to the Capital Requirement Regulation and Covered Bond Regulation;
- implementing reforms on annual corporate reporting;
- assuming a role as supervisor of trade repositories, credit rating agencies and securitization repositories in lieu of the European Securities and Markets Authority following Brexit; and
- following up on its 2017 discussion paper on possible changes to the U.K. listing regime.