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Wealth and Asset Management Regulatory Guide

Q2 2017

Update on key timings and trends

Your guide to critical regulatory milestones, analysis of hot topics and emerging regulatory trends

Megatrends

Geo-political risk

Brexit and the U.S. election brought home the reality that we are living in an ever-changing global society where a sense of anti-establishment and rebellion is driving change. These developments are heralding a heightened state of geopolitical tension and risk, which affects not only inter-linked economies, but also stock and bond markets which determine the value of private portfolios. A successful reading of political and economic risks is arguably more important than ever for firms operating in a global marketplace. As the Brexit negotiations unfold, a well thought-out plan will be a necessity for Wealth and Asset Managers. There are three key decision points that have the largest impact on Wealth and Asset Management firms:

- Management companies
- MiFID II
- Fund passports.

In the near-term, there is unlikely to be any clarity on the UK's future EU relationship and this period of uncertainty could directly impact the growth of the UK Wealth and Asset Management industry. Before Brexit, London would have been the natural choice for firms looking to establish a European presence. Now, that is no longer necessarily the case.

Asset Management Market review

In November last year, the FCA published their interim findings on the Asset Management Market review which analysed whether retail and institutional investors obtain value for money when purchasing Asset Management products and services. The FCA has proposed a significant package of remedies based on their findings that include a strengthened duty on Wealth and Asset Managers to act in the best interests of investors, reforms to hold managers to greater account, introducing an all-in fee to make it easy for investors to see what is being taken from the fund, and measures to help retail investors identify the most appropriate fund. Their final report will be published in Q2 2017 and whilst it remains unclear exactly what the FCA will seek to implement, one thing is clear: they have the Asset Management industry firmly within their sights.

Robo-advice

The use of automation and digital techniques to build and manage portfolios has gained significant attention and this trend looks set to continue. The capabilities could deliver significant and far-reaching changes in how advice is delivered. The "mass-affluent, delegator" market segment, which has traditionally been underserved, appears to be the source of much of the initial uptake. Firms are looking at robo-advice as a way to serve smaller accounts and increase advisor productivity. It also offers benefits to insurance companies as a way of expanding their presence in wealth management while allowing agents to maintain their focus on insurance sales. Whilst robo-advice will not suit every investor, there has been a notably quick uptake among firms and individual investors, as it offers an avenue to reduce operational costs and reach new investors.

Vulnerable customers

An ageing client base and a rise in the number of clients suffering from dementia in the UK has put the issue of vulnerable customers firmly on the regulator's radar (figures from the Office for National Statistics show more than 61,000 people died from dementia in 2015 – 11.6% of all recorded deaths in England and Wales). Examples of others that fall into the 'vulnerable' category include widows / widowers whose deceased partner managed the finances to people who have suffered life-altering injuries. Having the procedures in place to both recognise and then deal with vulnerable customers is going to be crucial, as part of a firm's duty of care to ensure that all customers understand the decisions being taken. Providing training on how to recognise signs that a customer's mental capacity may be reduced to all staff who come into contact with them, not just frontline Wealth and Asset Managers, should be a focus for firms.

Outsourcing providers

We expect the FCA to continue its scrutiny into transfer agencies and outsourcing providers. Towards the end of 2016 we saw the FCA issue a significant fine for failing to ensure a firm had adequate controls and oversight arrangements to effectively control the outsourcing of client money and external reconciliations, in relation to custody assets. The FCA will continue its mission to ensure firms are clear that activities can be delegated, not abdicated, and we can expect further enforcement action this year.

HOT TOPIC: Getting ready for GDPR

By May 2018 any firm holding any European citizens' data will have to comply with GDPR or face fines of €20m or 4% of its annual turnover; whichever is highest. The intention is to strengthen individuals' privacy and security rights, as well as simplifying the flow of personal data in the EU. EU firms and firms servicing EU citizens are in scope.

The Asset Management business model leaves firms particularly exposed to data protection issues due to the fact they collect and hold extensive data on their customers, with information often shared with other financial services firms.

Some high-level considerations for firms include:

- Consent – firms are required to obtain explicit permission to use customers' personal data
- Erasure – customers will have the right to request that a firm deletes all of their personal data
- Transfer of data – the directive will require systems in place to enable the transfer of personal data to a competitor e.g. when an investor moves their money to another manager
- Data breaches – firms will be legally required to disclose breaches to the regulators, and possibly make a public declaration.

Historically, Asset Managers have not had a clear line of sight to the end customer but GDPR will introduce new obligations to ensure that the data of the end customer is protected in a way they have not had to consider before.

The directive will introduce the roles of data processors and data controllers, both of which have different obligations. Firms will need to determine in what capacity they are acting (as either a controller or a processor) under GDPR and it is expected that further clarification will be forthcoming from industry bodies in determining market convention.

A large part of GDPR concerns the processes and operational aspects of data protection. Relevant staff training and implementation of the correct security processes is required. However, in many cases appropriate technologies will assist firms in automating the processes and treating data in the safest and most secure way. GDPR contains some onerous obligations, many of which will take time to prepare for. Although it does not come into effect until May 2018, it is essential that firms start tackling the challenges posed by GDPR now in order to ensure compliance by the deadline.

HOT TOPIC: SMCR: What to expect from the extension?

The SMCR will be extended to all regulated firms in the UK in 2018 and the FCA estimates that some 17,000 investment firms will be affected, amounting to over 100,000 individuals subject to enhanced levels of personal accountability. Senior individuals will need to understand the possible impact on them personally.

Whilst the detail of the extension remains unclear, there are working assumptions firm can employ:

- The broad components of the SMCR will apply to firms falling under the extension of the regime
- Responsibility maps and statements of responsibility will need to be completed
- Ongoing management of the regimes outputs will continue to be required. This will require either a system or people response or both.

Different levels of requirements may apply depending on the firm's size, scale and complexity.

Firms can prepare for the final details of the extension by:

1. Analysing potential business areas impacted - build out expected delivery timelines and assess the impact of ongoing management of the regulation
2. Identifying individuals / groups impacted by the regime early - define requirements for each group, ensure key individuals are engaged with the journey to embed the regime and drive implementation via the Chair / CEO of the firm, with input from key support functions including HR and Compliance
3. Reviewing record-keeping, governance and decision-making documentation - assess how MI and reporting processes must be changed to escalate breaches to senior management
4. Analysing the approach to embedding the regime - considering training needs assessments and delivery options
5. Reviewing existing governance arrangements - assess existing structures and reporting lines to determine if they are fit for purpose in the future state.

SMCR implementation must sit high on the priority list - it goes to the heart of firms' governance structures and must be embedded into the operational DNA. But also firms must consider the amount of effort required to maintain evidence for the regulator on an ongoing basis.

HOT TOPIC: CASS: Enhanced FRC Audit Assurance Standard

The new FRC Client Asset Assurance Standard applies to audit reports covering periods commencing on or after 1st January 2016, and so will be front of mind as many firms undergo their first CASS audit under the standard in 2017.

The guidance is the standard for auditors but the majority of the impact is falling on investment firms as they look to document and demonstrate CASS compliance.

Many firms have already prepared what seems like a mountain of process maps together with 1,000-line Excel spreadsheets capturing the relevant rules, firms' inherent risks, and mapping both to potentially hundreds of controls. Firms have also commenced detailed exercises to define the complete list of their products and services, the associated legal agreements, thus articulating their full CASS impact.

Feedback provided on the new standard to date suggests a more controls-based approach from auditors with greater reliance on controls testing. The effort required to produce high-quality controls documentation should reap dividends via helping auditors, and keeping a lid on the increasing audit costs.

There are potential benefits to be realised from this costly exercise. Quality of documentation and traceability is key, and can help in reducing CASS risk. Together, a suite of documents cross-referencing each other can be used to provide assurance over completeness and quality, ensure testing remains focused and enable consistency checks across multiple business lines.

Many in-scope firms are not huge global custodians and many large firms are without an army of CASS staff to produce and maintain all of this documentation. Some client asset oversight officers are using this to their advantage, using the new standard to demand more formal ownership and updating of documentation and controls by the business, leading to increased accountability.

A common opinion and approach remains absent from the usual forums and on both sides of the audit fence. Consequently, it is important to keep a view of what the 'pack' is doing. Baringa has recently launched a CASS survey – please feel free to get in touch to take part and see how you compare with peer organisations.

HOT TOPIC: MiFID II: The countdown

With less than eight months until go-live for MiFID II, firms are still grappling with the complexities of designing and implementing business solutions whilst waiting for further regulatory guidance on ongoing interpretive issues and challenges. Despite ESMA pushing back the introduction of the SI regime, other provisions remain firmly on course for 3rd Jan 2018 implementation. Given the necessary time required to test and embed solutions, firms are facing a huge workload throughout the remainder of 2017.

It has been widely acknowledged that the impacts of MiFID II are much broader than previous European regulations. Whilst initially targeting the front office, it is set to drive change across the entire governance framework – leading to a huge exercise in redrafting of existing policies and internal procedures and shaping new oversight mechanisms and escalation channels. Additionally, MiFID II is also accentuating the shift of power from risk-taking roles to risk management ones – those control functions have a huge amount of work to do to equip themselves for a further raft of new monitoring responsibilities.

From a data management perspective, the need for more effective data strategies in response to MiFID II is underpinning the fundamental redesign, or in some cases creation, of a central data repository, with real-time data feeds. Ultimately, this is about the immediate availability of critical instrument and client reference data to enable front office staff to understand the precise nature of their MiFID II obligations. Addressing these system and data needs is not just complex and costly, but also time consuming.

The stark reality is that uncertainty as to how the financial markets will evolve post-2018 remains prevalent. Investment firms (of all shapes and sizes) are developing solutions based on an instinctive understanding of what clients, counterparties and regulators will demand in the post-implementation world, but the fact is that these demands are not always compatible. Nevertheless, there is no 'silver bullet' available here – prioritisation calls, based on as much analysis as possible, are imperative so as not to fundamentally impede the ability to be ready for 3rd January.

About Baringa Partners

Baringa Partners is an independent business and technology consultancy. We help businesses run more effectively, navigate industry shifts and reach new markets.

We use our industry insights, ideas and pragmatism to help each client improve their business.

Collaboration is central to our strategy and culture ensuring we attract the brightest and the best. And it's why clients love working with us.

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Baringa's Finance, Risk and Compliance Team

Baringa's Finance, Risk and Compliance Team specialises in helping firms understand and respond to the strategic, financial and operational implications of new regulation and to enhance risk management. A trusted advisor to risk, compliance and treasury leaders, Baringa Partners' capabilities and credentials span banking, insurance, asset management, capital markets, commodities and wholesale energy.

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Regulatory Developments Tracker 2017-18+

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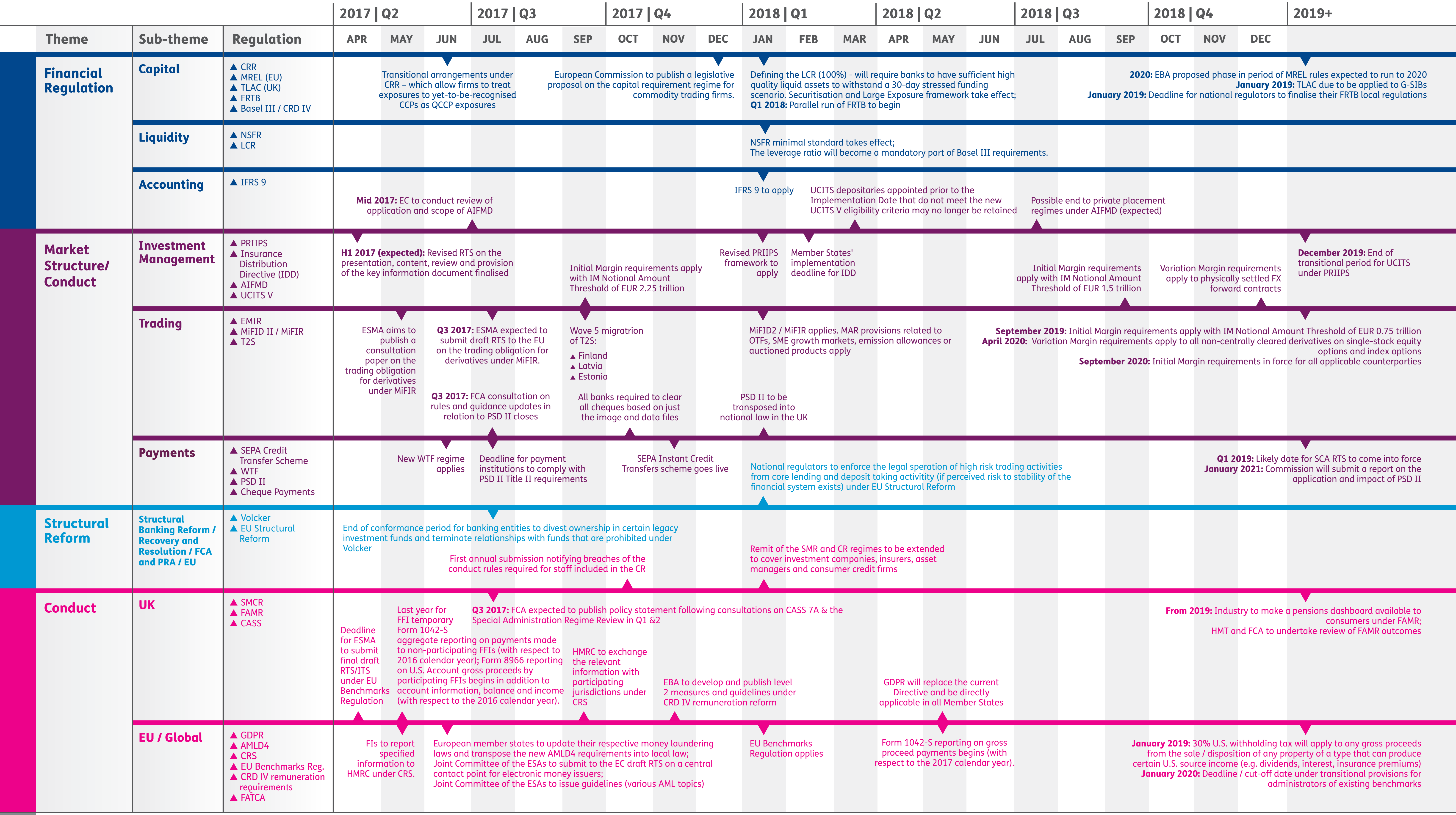

2017 | Q2 — APR, MAY, JUN
2017 | Q3 — JUL, AUG, SEP
2017 | Q4 — OCT, NOV, DEC
2018 | Q1 — JAN, FEB, MAR
2018 | Q2 — APR, MAY, JUN
2018 | Q3 — JUL, AUG, SEP
2018 | Q4 — OCT, NOV, DEC
2019+

Theme | **Sub-theme** | **Regulation**

Financial Regulation

Capital

▲ CRR
▲ MREL (EU)
▲ TLAC (UK)
▲ FRTB
▲ Basel III / CRD IV

Transitional arrangements under CRR – which allows firms to treat exposures to yet-to-be-recognised CCPs as QCCP exposures

European Commission to publish a legislative proposal on the capital requirement regime for commodity trading firms.

Defining the LCR (100%) - will require banks to have sufficient high quality liquid assets to withstand a 30-day stressed funding scenario. Securitisation and Large Exposure framework take effect;
Q1 2018: Parallel run of FRTB to begin

2020: EBA proposed phase in period of MREL rules expected to run to 2020
January 2019: TLAC due to be applied to G-SIBs
January 2019: Deadline for national regulators to finalise their FRTB local regulations

Liquidity

▲ NSFR
▲ LCR

NSFR minimal standard takes effect;
The leverage ratio will become a mandatory part of Basel III requirements.

Accounting

▲ IFRS 9

Mid 2017: EC to conduct review of application and scope of AIFMD

IFRS 9 to apply

UCITS depositaries appointed prior to the Implementation Date that do not meet the new UCITS V eligibility criteria may no longer be retained

Possible end to private placement regimes under AIFMD (expected)

Market Structure/ Conduct

Investment Management

▲ PRIIPS
▲ Insurance Distribution Directive (IDD)
▲ AIFMD
▲ UCITS V

H1 2017 (expected): Revised RTS on the presentation, content, review and provision of the key information document finalised

Initial Margin requirements apply with IM Notional Amount Threshold of EUR 2.25 trillion

Revised PRIIPS framework to apply

Member States' implementation deadline for IDD

Initial Margin requirements apply with IM Notional Amount Threshold of EUR 1.5 trillion

Variation Margin requirements apply to physically settled FX forward contracts

December 2019: End of transitional period for UCITS under PRIIPS

Trading

▲ EMIR
▲ MiFID II / MiFIR
▲ T2S

ESMA aims to publish a consultation paper on the trading obligation for derivatives under MiFIR

Q3 2017: ESMA expected to submit draft RTS to the EU on the trading obligation for derivatives under MiFIR.

Q3 2017: FCA consultation on rules and guidance updates in relation to PSD II closes

Wave 5 migratrion of T2S:
▲ Finland
▲ Latvia
▲ Estonia

All banks required to clear all cheques based on just the image and data files

MiFID2 / MiFIR applies. MAR provisions related to OTFs, SME growth markets, emission allowances or auctioned products apply

PSD II to be transposed into national law in the UK

September 2019: Initial Margin requirements apply with IM Notional Amount Threshold of EUR 0.75 trillion
April 2020: Variation Margin requirements apply to all non-centrally cleared derivatives on single-stock equity options and index options
September 2020: Initial Margin requirements in force for all applicable counterparties

Payments

▲ SEPA Credit Transfer Scheme
▲ WTF
▲ PSD II
▲ Cheque Payments

New WTF regime applies

Deadline for payment institutions to comply with PSD II Title II requirements

SEPA Instant Credit Transfers scheme goes live

National regulators to enforce the legal speration of high risk trading activities from core lending and deposit taking activity (if perceived risk to stability of the financial system exists) under EU Structural Reform

Q1 2019: Likely date for SCA RTS to come into force
January 2021: Commission will submit a report on the application and impact of PSD II

Structural Reform

Structural Banking Reform / Recovery and Resolution / FCA and PRA / EU

▲ Volcker
▲ EU Structural Reform

End of conformance period for banking entities to divest ownership in certain legacy investment funds and terminate relationships with funds that are prohibited under Volcker

First annual submission notifying breaches of the conduct rules required for staff included in the CR

Remit of the SMR and CR regimes to be extended to cover investment companies, insurers, asset managers and consumer credit firms

Conduct

UK

▲ SMCR
▲ FAMR
▲ CASS

Deadline for ESMA to submit final draft RTS/ITS under EU Benchmarks Regulation

Last year for FFI temporary Form 1042-S aggregate reporting on payments made to non-participating FFIs (with respect to 2016 calendar year); Form 8966 reporting on U.S. Account gross proceeds by participating FFIs begins in addition to account information, balance and income (with respect to the 2016 calendar year).

Q3 2017: FCA expected to publish policy statement following consultations on CASS 7A & the Special Administration Regime Review in Q1 &2

HMRC to exchange the relevant information with participating jurisdictions under CRS

EBA to develop and publish level 2 measures and guidelines under CRD IV remuneration reform

GDPR will replace the current Directive and be directly applicable in all Member States

From 2019: Industry to make a pensions dashboard available to consumers under FAMR;
HMT and FCA to undertake review of FAMR outcomes

EU / Global

▲ GDPR
▲ AMLD4
▲ CRS
▲ EU Benchmarks Reg.
▲ CRD IV remuneration requirements
▲ FATCA

FIs to report specified information to HMRC under CRS.

European member states to update their respective money laundering laws and transpose the new AMLD4 requirements into local law;
Joint Committee of the ESAs to submit to the EC draft RTS on a central contact point for electronic money issuers;
Joint Committee of the ESAs to issue guidelines (various AML topics)

EU Benchmarks Regulation applies

Form 1042-S reporting on gross proceed payments begins (with respect to the 2017 calendar year).

January 2019: 30% U.S. withholding tax will apply to any gross proceeds from the sale / disposition of any property of a type that can produce certain U.S. source income (e.g. dividends, interest, insurance premiums)
January 2020: Deadline / cut-off date under transitional provisions for administrators of existing benchmarks

Abbreviations

AI	Artificial Intelligence
AIFMD	Alternative Investment Fund Managers Directive
AMLD4	Anti-Money Laundering Directive 4
BoE	Bank of England
BRRD	Bank Recovery and Resolution Drive
CASS	Client Assets
CCP	Central Counterparty
CRD/R	Capital Requirements Directive/Regulation
CR	Certification Regime
CRS	Common Reporting Standards
DGSD	Deposit Guarantee Scheme Directive
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EEA	European Economic Area
EMIR	European Market Infrastructure Regulation
EP	European Parliament
ESMA	European Securities and Markets Authority
EU	European Union
FAMR	Financial Advice Market Review
FATCA	Foreign Account Tax Compliance Act
FCA	Financial Conduct Authority
FFI	Foreign Financial Institution
FI	Financial Institution
FRC	Financial Reporting Council
FRTB	Fundamental Review of the Trading Book
FX	Foreign Exchange
GDPR	General Data Protection Regulation
GSIB	Global Systemically Important Bank
HMRC	Her Majesty's Revenue & Customs
HMT	Her Majesty's Treasury
IDD	Insurance Distribution Directive
IFRS 9	International Financial Reporting Standard 9
ITS	Implementing Technical Standards
LCR	Liquidity Coverage Ratio
MAD/R	Market Abuse Directive/Regulation
MI	Management Information
MiFID/R	Markets in Financial Instruments Directive/Regulation
MREL	Minimum Requirement for Own Funds and Eligible Liabilities
NSFR	Net Stable Funding Ratio
OTC	Over The Counter
OTF	Organised Trading Facilities
PRA	Prudential Regulatory Authority
PRIIPS	Packaged Retail Investment Products
PSD II	Payment Services Directive II
QCCP	Qualifying Central Counterparty
REM CRIP	New FCA Financial Crime Report
RDR	Retail Distribution Review
RRD	Recovery and Resolution Directive
RTS	Regulatory Technical Standards
SCA	Strong Customer Authentication
SEPA	Single Euro Payments Area
SI	Systematic Internaliser
SMCR	Senior Managers Certification Regime
SMEs	Small and Medium-Sized Enterprises
T2S	TARGET2-Securities
TLAC	Total Loss Absorbing Capital
UCITS	Undertaking for Collective Investments in Transferable Securities
WTF	Wire Transfer Fee