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Wealth and Asset Management Regulatory Guide

Q2 2018

Update on key timings and trends

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

▲ Megatrends

MiFID II

Despite over 1.6 million regulatory paragraphs, a common 'working understanding' is still required to ensure consistent reporting and disclosures across the industry. Regulators are seeing variations in firms' application of their obligations. Given that enhanced transparency is intended to deliver greater comparability of products and services, 2018 will bring further regulatory guidance and a tightening of areas still open to broad interpretation. High priority areas will be:

- Costs and Charges Disclosures
- Accuracy of Transaction Reporting
- Package Trades and the Derivatives Trading Obligation.

Guidance will be welcomed by investment firms, for although MiFID fatigue is very much prevalent, more prescriptive guidance should serve to reduce residual regulatory risk.

Brexit

Brexit will have two direct impacts for UK Investment Managers:

1) The ability to remotely manage EEA domiciled funds. As a third country, the delegation of activity from EEA-domiciled management companies is expected to become more restricted. Managers will need to host more Front Office activity within the EEA to continue to service EEA clients
2) After exiting the EEA, all UK-domiciled UCITS funds will lose their UCITS funds designation and will be considered AIF instead. As a result of this, those firms wishing to maintain their UCITS designation will need to re-domicile them to an EEA location.

Brexit represents a direct threat to the privileges of "remote management", allowing managers in London to manage funds domiciled across the EEA without impediment. So-called "delegation rules", allowing portfolio activity to be delegated back to a Third Country, has taken on greater significance.

Recently, ESMA has provided greater clarity on the EU presence required in order to delegate activities to London. Investment Managers are likely to need to enhance European operations to ensure they do not fall foul of "Letter Box" provisions.

Vulnerable customers

At the end of 2017, the FCA published the 'Financial Lives Survey' and the interim 'FCA Mission: Our Future Approach to Consumers'. Both papers highlight that somebody should be viewed as vulnerable if, *"due to their personal circumstances, they are especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care."* Firms are struggling with corporate definitions, policies, considering the most appropriate operating model(s), and understanding how capable Front and Back Office staff are at identifying and dealing with vulnerability. Areas for review include:

- **Systems and processes:** need to be geared to deal with vulnerable customers – typically, Financial Services are set up for people who are ideal consumers, not vulnerable people
- **Policy vs. practice gap:** there may be a policy in place to deal with vulnerable customers, but frontline staff are often not trained and made sufficiently aware
- **Flexible products and services:** customer vulnerability should be considered at the start of the product /service design, not at the end of the process
- **Identifying vulnerability:** along the customer journey within organisations but also to identify it early on, rather than when it is too late.

FSCS funding

The FCA will publish a policy statement on how the FSCS is funded in H1 2018, in response to their consultation that closed 30th Jan 2018 which sought answers to proposals on a number of aspects. These included:

- Merging the Life and Pensions and Investment Intermediation funding classes
- Requiring product providers to contribute around 25% of the compensation costs which fall to the intermediation classes
- Moving pure protection intermediation from the Life and Pensions funding class to the General Insurance Distribution class
- Increasing the FSCS compensation limit for investment provision, investment intermediation, home finance and debt management claims to £85,000.

Rules consulted on in the paper will be made in time for implementation in the 2019/20 financial year.

Dormant Assets

In March 2017, the Dormant Assets Commission identified untapped assets in the sector that could total £715 million. The scheme has already distributed £360 million from accounts to go towards supporting good causes. Extending it could deliver lasting change to the way voluntary and charity sectors are funded. Ministers will consider the commission's findings, but if they decide to follow its recommendations to expand the dormant assets scheme and distribute the cash, charities could be in line for a significant funding boost. Whilst participation in the extension will be voluntary, investment firms should be poised in 2018 to respond to potential amendments.

▲ HOT TOPIC: Revised Prudential Framework for MIFID investment firms

On 29th September 2017, the EBA published its response to the European Commission's call for advice on the prudential regulation of investment firms. This new framework is relevant for firms undertaking MiFID business including IFPRU and BIPRU firms, collective portfolio management investment firms as well as CRR investment firms. The regulation does not apply to AIFMs or UCITS-only managers.
The regulation will impact requirements for the measurement of capital, the quality and total of liquid assets, governance and remuneration. The extent of the impact will be dependent on the classification between classes:

- Class 1 firms are the larger, systemic firms and will be supervised and treated as credit institutions under the full weight of CRDIV
- Class 2 firms are other non-systemic investment firms and will be supervised under a more tailored regime
- Class 3 firms are non-interconnected firms providing a limited range of services for which the impact is limited to a potential increase in capital requirement.

Whilst no significant change in capital requirement is expected across the industry, some individual firms, such as investment advisors and execution brokers, may see big increases as Pillar 1 risks are captured for first time.

For Class 1 and 2 firms, the new regime will require significantly improved risk management and data capabilities:

- Business strategy and risk appetite will need to be revised in light of the new regulatory costs imposed by the regulation
- Enhanced governance procedures implemented including the embedding and evidencing of capital management use within the business, management sign off and board preparation
- Capital and liquidity management policies, procedures and transition plans developed to meet enhanced requirements
- Risk data and infrastructure will need to be upgraded to provide the management and regulatory reporting required
- Investment firm-only groups will need increased reporting and management to ensure they do not have excessive leverage and capital gearing.

Whilst there is still some clarity outstanding in classification between class and component parts of the capital calculation such as K-factors, there is sufficient detail that firms should be assessing the impact of the regulation.

▲ HOT TOPIC: SMCR in 2018

In summer 2017, the FCA announced its intent to extend the SMCR to all FCA solo-regulated firms by mid/late 2019. The aim of the new SMCR is to reduce harm to consumers and strengthen market integrity by making individuals more accountable for their conduct and competence.

The new regime is broken down into three elements: the Senior Managers Regime, the Certification Regime and the Conduct Rules. The key activities firms will have to perform across those three elements include;

- Assess the suitability of existing governance frameworks and decision-making processes to ensure they are fit to meet the SMCR requirements
- Review and allocate responsibilities to senior managers based on the FCA's prescribed responsibilities and proposed senior manager's functions
- Ensure the responsibilities actually assumed by each senior manager are accurately documented and understood by the individuals themselves
- Define the reasonable steps each senior manager has to take to fulfil their duty of responsibility
- Identify the population of certified individuals and define how those should be assessed and deemed "fit and proper"
- Identify training needs for each category of staff and develop a training delivery roadmap.

The key for Investment Management firms is to define how to implement SMCR strategically based on the existing business model, and successively embed this into BAU. As immediate steps, firms should consider the following:

- Project mobilisation: Mobilise internal project teams and establish project governance, to ensure the project is run on a coordinated basis between key stakeholder functions (both internal and external - i.e. including the regulator)
- Senior Management engagement: Ensure the CEO, Board and executives are on board to ensure culture change is driven using the correct 'tone from the top'
- Regulatory analysis and scoping: Identify which part of the regime your firm falls in and determine which requirements must be met
- IT systems implications: Prioritise the identification of IT-related requirements and establish any requirement to implement new IT solutions to provide sustainable on-going solutions.

▲ HOT TOPIC: Tech trends in 2018

Increasingly diverse regulatory burdens, pressure from investors wanting better returns on their investments and reductions in fees, new market opportunities and enhanced transparency and control are challenges facing the industry. Technology advances will enable increased transparency of entire portfolios, visibility of asset performance, real-time risk calculations and detailed data to better understand the assets and automate the end to end management of investments.

AI, Machine Learning and data-driven investments

The increasing adoption of AI, automation technologies such as RPA, and open APIs offers Investment Management firms dramatic opportunities to gain competitive advantage. We are seeing that many CIOs are already prioritising investments in these three business-critical areas.

By aggregating data with analytics, AI and machine learning, new risk models are being created that enable enhanced transparency of the risk in any investment. Advances in technology will also improve the overall performance of an investment portfolio and provide opportunities to create predictive models that could forecast the impact of future events.

Investment Managers will be able to make much smarter, faster decisions for investors via improved risk management and a clearer understanding of performance. In recent years, some funds have moved toward true machine learning, where artificially intelligent systems can analyse large amounts of data at speed and improve themselves through such analysis. Firms now exist that process every single trade using AI and have removed the need for human interaction.

Distributed Ledger Technologies and Blockchain

Investment Management trade processes can be manual and unwieldy. Typically a number of parties are involved in the trade lifecycle – from broker dealers, to intermediaries, to custodians, to clearing and settlement teams. With each party keeping their own copy of the same record of a transaction, it is undeniable that significant inefficiencies and opportunities for errors are created.

DLT has the potential to substantially change the way Investment Managers are operating today, offering important cost savings and efficiency gains in particular in the post-trade space. Regulators and law makers around the world, concerned with the regulatory implications of the technology, are increasingly joining the debate. The key advantage of a distributed ledger is the instantaneous settlement to ultimately streamline processes for Investment Managers.

Blockchain technology, a type of DLT, could provide an automated trade lifecycle where all parties involved have access to the exact same trade data. Advantages to this include infrastructural cost savings, stronger data management, faster processing cycles and the potential to even remove intermediaries altogether.

Cryptocurrencies

We are going to see a surge of cryptocurrency funds launching in 2018 and new cryptocurrency technology entering the Investment Management arena. Unlike traditional money issued by central banks, cryptocurrencies such as bitcoins are created digitally, or "mined", by members of the public processing computer code. Cryptocurrencies are not regulated by many financial watchdogs, including the FCA, and cannot be held by traditional mutual funds and most exchange traded funds. That said, it is worth noting that seven UK firms have come together to form a self-regulating body and Japan's 16 government-registered cryptocurrency exchanges are setting up a self-regulatory body to bolster trust in an industry rocked by a $530 million digital money heist that occurred in January.

In November 2017, Tobam, the $9bn Paris-based asset manager, launched what it claimed was Europe's first bitcoin fund. The unregulated fund is aimed at institutional investors and was cited as the latest evidence cryptocurrencies are pushing deeper into the mainstream. Tobam acknowledged that while bitcoin is "prone to significant risks", it also provides investors with diversification benefits.

Cyber Security

2017 was the year in which cyber security incidents across the globe demonstrated the debilitating and far-reaching impact that data loss events and cyber-attacks can have on businesses, of all sizes and sectors. Given this, Investment Management firms should better implement security and privacy into the fabric of their business if they are to thrive in 2018 and harness the opportunities that technology advances offer them and their investors. Cyber Security is a business imperative that underpins the above mentioned innovations. Robust Cyber Security initiatives have the potential to enhance market reputation, increase consumer confidence and ensure business resilience when the inevitable strikes.

▲ 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 2018-19

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Theme	Sub-theme	Regulation	2018 | Q1 – 2019 | Q4 (JAN–DEC)
Financial Regulation	**Capital**	▲ Basel III ▲ FRTB ▲ CRD V / CRR II	01.01.18: BCBS target for the leverage ratio to be implemented as a Pillar 1 measure 21.07.18: Application date for new MMFs Q4 2018: Earliest date for political agreement by EU institutions on the Level 1 text of the CRD V/CRR II package 01.01.19: BCBS target to implement all rules as part of FRTB Q2-3 2019: Earliest date for secondary rulemaking to begin following a political agreement by EU institutions on a Level 1 text for the CRD V/CRR II package
	Liquidity	▲ NSFR ▲ Leverage Ratio ▲ European Reform of MMFs ▲ Fund liquidity risk management	01.01.18: NSFR becomes a minimum standard; 01.01.18: The leverage ratio will become a mandatory part of Basel III requirements; Q1-Q4 2018: ESMA is expected to consult on liquidity risk management; Q1-Q4 2018: ESMA is expected to publish guidelines on stress testing practices covering UCITS and AIFs 21.07.19: Application date for existing MMFs
	Accounting	▲ IFRS 9	01.01.18: IFRS 9 must be applied to annual reporting periods Q4 2018: First annual financial statement in which IFRS 9 applies
	Securities	▲ CSDR ▲ SFTR	Q1-Q2 2018: Application of SFTR reporting requirements for credit institutions and investment firms Q2-Q3 2018: Application of SFTR reporting requirements for CSD and CCPs Q3-Q4 2018: Application of SFTR reporting requirements for insurers and investment funds Q4 2018-Q1 2019: Application of SFTR reporting requirements for non-financial counterparties 10.03.19: Application date for CSDR settlement internalisation reporting Q4 2019: Estimated application date for CSDR settlement discipline rules
	Brexit	▲ Negotiating directives - transitional arrangements ▲ Triggering of contingency plans ▲ Guidelines - framework for future relationship ▲ Withdrawal agreement and ratification process ▲ UK exits EU	Q1 2018: EC to adopt additional negotiating directives on Brexit transitional arrangements; Q1 2018: Firms are expected to trigger their worst-case scenario contingency plans by March 2018 if no transition deal has been reached between the EU and the UK Q1 2018: EC to adopt additional guidelines in March 2018, in particular as regards the framework for the future relationship 01.10.18: EC's target for finalising withdrawal agreement and starting ratification process 29.03.19: UK exits the EU (in case of no extension agreed by EU27 members)
Market Structure/ Conduct	**Investment Manage-ment**	▲ PRIIPS ▲ AIFMD ▲ UCITS V ▲ IORP II	01.01.18: Revised PRIIPS framework to apply 18.03.18: Transitional period for depositaries under UCITS V ends End to NPPR under AIFMD 01.09.18: MIFID II Systematic Internaliser regime commences; 03.09.18: EC report on functioning of consolidated tape in relation to equities Q4 2018 (Expected): EC consultation on the review of AIFMD 01.01.19: EC report on making energy derivative contracts subject to the clearing obligation 12.01.19: IORP II rules enter into force 21.06.19: Category 3 firms subject to clearing obligation for interest rate derivatives; 21.06.19: Category 3 firms subject to clearing obligation for CDS 31.12.19: End of transitional period for UCITS KIDs to be converted into PRIIPs KIDs
	Trading	▲ EMIR ▲ MiFID II / MiFIR	03.01.18: MiFID2 / MiFIR applies. MAR provisions related to OTFs, SME growth markets, emission allowances or auctioned products apply 16.08.18: Transitional period for pensions schemes under EMIR ends 21.12.18: Category 4 firms subject to EMIR clearing obligation for interest rate derivatives Q1 2019: CCP supervision proposal expected to be finalised 09.05.19: Category 4 firms subject to clearing obligation for CDS 01.09.20: Initial Margin requirements in force for all applicable counterparties; Q2 2020: EC report on various aspects of MiFID II and MiFIR
	Payments	▲ PSD II	13.01.18: PSD II to be transposed into national law in the UK 13.07.18: Deadline for payment institutions to comply with PSD II Title II requirements 14.09.19: RTS for SCA and SCC to enter into force (some article 30 paragraphs to enter into force Mar 2019) Jan 2021: Commission will submit a report on the application and impact of PSD II
	CMU	▲ Corporate bond market liquidity ▲ Cross-border distribution of funds ▲ Retail investors study	Q1 2018: EC to launch a public consultation on corporate bond market liquidity; Q1 2018: EC to adopt a proposal to reduce the regulatory barriers to the cross-border distribution of funds; Q1 2018: EC to issue final findings from its study of the distribution of investment products to retail investors Q3 2018: EC to issue communication on corporate bond market liquidity
	FinTech	▲ EU FinTech Action Plan	2018: ESAs expected to publish joint report on relevant FinTech and digital issues; Q1 2018: EC's TFFT expected to publish policy proposals and recommendations in relation to FinTech
	Cyber Resilience	▲ PRA Cyber Standards ▲ NIS Directive	Q2 2018: PRA to give public indication of standards it is developing for the supervisory assessment of cyber resilience capabilities in firms and financial market infrastructures 09.05.18: NIS directive to be transposed into national legislation 09.11.18: Operators of essential services to be identified Q4 2019: Amended Directive expected to enter into force by the end of 2019 (i.e. 18 months after its publication, expected in mid-2018)
	EU / Global	▲ Securitisation Regulation ▲ MMF ▲ AMLD V ▲ PEPP	2018: Negotiations on PEPP regulation ongoing (regulation to enter into force 20 days after its publication in the Official Journal of the EU) 01.01.19: Securitisation regulation applies Oct-Nov 2019: Managers to submit first quarterly reports to NCA under MMF
Conduct	**UK**	▲ SMCR ▲ FAMR ▲ Asset Management Market Study ▲ Investment Platforms Market Study ▲ Retail Investment Review ▲ Vulnerable Customers	Q1 2018: FCA consultations following asset management market study final report; Q12018-Q1 2019: FCA is expected to publish results of its market study on investment platforms Q1-Q4 2018: FCA expected to publish review on unsuitable advice on complex products; Q1-Q4 2018: FCA expected to publish a wealth management suitability follow-up review 21.02.18: FCA consultation on operational aspects of transitioning FCA firms and individuals to SMCR closes Q2-Q3 2018: FCA and PRA to publish policy statements and final rules relating to extension of SMCR to all FSMA authorised firms; Q2 2018: FCA expected to publish a review on outcomes testing on auto-advice Q3 2018: FCA is expected to finalise its approach to consumers as part of its new mission In 2019: Industry to make a pensions dashboard available to consumers under FAMR; In 2019: HMT and FCA to undertake review of FAMR outcomes H2 2019: Expected extension of SMCR to all solo-regulated firms
	EU / Global	▲ EU Benchmarks Regulation ▲ SRD ▲ GDPR	01.01.18: EU Benchmarks Regulation applies 25.02.18: GDPR will be directly applicable in all Member States Q1-Q4 2018: FCA and FINRA leading work within IOSCO on senior investor vulnerability. Report to be released in 2018 10.06.19: Application date of amended SRD 01.01.20: Transitional arrangements for certain benchmarks will expire
	Global	▲ Shadow Banking ▲ Vulnerable Customers	Q1 2018: FSB expected to publish Global shadow banking monitoring report 2017 Q3-Q4 2018: FSB expected to publish a progress report on shadow banking

Abbreviations

AI	Artificial Intelligence
AIFMD	Alternative Investment Fund Managers Directive
AIF	Alternative Investment Funds
AMLD V	Anti-Money Laundering Directive V
API	Application Programme Interface
BoE	Bank of England
BCBS	Basel Committee on Banking Supervision
BIPRU	FCA categorisation for certain Banks, Building Societies and Investment Firms
CCP	Central Counterparty
CDS	Credit Default Swaps
CR	Certification Regime
CRD/R	Capital Requirements Directive / Regulation
CRS	Common Reporting Standards
CSD	Central Securities Depository
CSDR	Central Securities Depository Regulation
DLT	Distributed Ledger Technology
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EEA	European Economic Area
EMIR	European Market Infrastructure Regulation
ESAs	European Supervisory Authorities
ESMA	European Securities and Markets Authority
EU	European Union
FAMR	Financial Advice Market Review
FCA	Financial Conduct Authority
FINRA	Financial Industry Regulatory Authority
FFI	Foreign Financial Institution
FI	Financial Institution
FRTB	Fundamental Review of the Trading Book
FSB	Financial Stability Board
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act
GDPR	General Data Protection Regulation
GSIB	Global Systemically Important Bank
HMRC	Her Majesty's Revenue & Customs
HMT	Her Majesty's Treasury
IFPRU	Prudential Sourcebook for Investment Firms
IFRS 9	International Financial Reporting Standard 9
IORP II	Institutions for Occupational Retirement Provision
IOSCO	International Organization of Securities Commissions
KID	Key Information Document
LCR	Liquidity Coverage Ratio
MAD/R	Market Abuse Directive / Regulation
MiFID/R	Markets in Financial Instruments Directive/Regulation
MMF	Money Market Fund Regulation
NCA	National Competent Authority
NIS	Directive on security of network and information systems
NPPR	National Private Placement Regimes
NSFR	Net Stable Funding Ratio
OTFs	Organised Trading Facilities
PEPP	Pan-European Personal Pension product regulation
PRA	Prudential Regulatory Authority
PRIIPS	Packaged Retail Investment Products
PSD II	Payment Services Directive II
REM CRIP	New FCA Financial Crime Report
RDR	Retail Distribution Review
RPA	Robotics Process Automation
RRD	Recovery and Resolution Directive
RTS	Regulatory Technical Standards
SCA	Strong Customer Authentication
SFTR	Securities Financing Transactions Regulation
SI	Systematic Internaliser
SMCR	Senior Managers Certification Regime
SMEs	Small and Medium-Sized Enterprises
SRD	Shareholders Rights Directive
TFFT	Task Force on Financial Technology
UCITS	Undertaking for Collective Investments in Transferable Securities