COVINGTON

Bulletin - UK Financial Services and Regulation

November 2014

Financial Services

November has been a month filled with headlines and firsts in the United Kingdom (UK). The Prudential Regulation Authority (PRA) has, in conjunction with the Financial Conduct Authority (FCA), issued its first fine to banks in the RBS Group for IT failings. This action is also notable as the first time the PRA and FCA have taken joint enforcement action. In addition, the FCA has issued a record combined fine to five banks for huge failings in their FX trading businesses. Elsewhere, the new Payment Systems Regulator (PSR) has published its first consultation setting out its proposed regulatory framework to govern the £75 trillion UK payment systems industry. Other highlights include the PRA issuing a consultation on the proposed senior managers regime for insurance firms, and the FCA following suit, publishing its own on revisions to the Approved Persons regime in light of Solvency II and the recommendations of the Parliamentary Commission on Banking Standards.

Contents

Speeches

1. Karina McTeague sets out the FCA's vision for fair and competitive retail banking

The FCA's Director of Retail Banking, Karina McTeague, has delivered a speech on the FCA's approach to creating a fair and competitive environment for retail banking in the interests of consumers. The speech was published by the FCA on 26 November 2014.

The speech focused on two key areas for the retail banking industry, competition and innovation. Ms McTeague discussed the challenges to both of these and the way in which the FCA and the industry proposes to address them. She opened by highlighting the FCA's forward looking approach and its responsiveness to the changes facing the retail banking industry at the moment. She stressed that the FCA's supervisory work during this year has acknowledged the changes in consumer behaviour, UK demographics and technology, and market participants. She also touched upon the digitisation of the banking industry, referencing the withdrawal of paper statements as an example, and welcomed the change. However, she mentioned that firms must be mindful of the impact of digitisation on customers who are not able to "embrace the digital world". Ms McTeague also briefly referred to the growth in consumer credit and mortgages, and the inherent risks in the use of IT (especially cybercrime) as areas of future conduct risk.

One of the key challenges facing the retail banking industry is the restoration of trust and confidence of consumers in retail banking. To build trust, she explained, firms must look at what has gone wrong in the past (which they are doing), carry out robust root cause analysis and follow this up with delivery of effective plans to fix the underlying causes of the problems as well as the symptoms. Firms have made a good deal of progress in this area and Ms McTeague stressed that they must continue to build on this progress and continue to put the customer at the heart of any remediation strategies and transformation programmes. She remarked that the FCA is pleased with the progress relating to cultural change in banks, but the task is now for firms to embed this change fully. The right conversations are taking place in institutions and most big firms understand where they need to go; they just need to go there.

She explained that competition would be a major challenge of the future. Consumer choice is an important part of the financial services industry and the ability to shop around will provide firms with incentives to "up their game" in order to retain customers and win new business. She set out a number of initiatives which the FCA is using to support the delivery of its competition objective, including:

- understanding how key markets are working through market studies;
- identifying and addressing practical obstacles for consumers; and
- reducing barriers to entry.

On reducing barriers to entry, Ms McTeague mentioned that the new Payment Systems Regulator will help through its focus on ensuring effective competition and innovation in the systems and infrastructure which underpin retail banking.

The FCA is also looking to reduce the time it takes for applicant firms to obtain authorisation, including the use of a "mobilisation" phase and changes to the capital and liquidity regimes for new banks. She also discussed the importance of innovation for retail banking and explained that Project Innovate was designed to look to the needs of tomorrow's consumers as well as to those of today. The FCA's Innovation Hub includes a team dedicated to supporting innovation in financial services with the aim of improving the lives of consumers. In addition, she said that innovation should be a powerful driver of effective competition.

2. FCA Chairman discusses vital relationship between regulator and advisory industry

John Griffith-Jones, the FCA's Chairman, delivered a speech at The Association of Professional Financial Advisors (APFA) Annual Gala Dinner at Banking Hall in London on the crucial relationship between the FCA and the advisory industry. The FCA published the text of the speech on 18 November 2014. In it, Mr Griffith-Jones explained that for consumers to access the financial services market place, it is essential that there are experts readily available to help them understand the complex products and difficult decisions which they face. Therefore, the financial advice on offer to consumers must be of a very high standard. He referred to the FCA's continued drive to increase the professionalism of advisors as required by the Retail Distribution Review (RDR), and explained that the transformation of the industry since the introduction of the RDR has been significant.

Mr Griffith-Jones stressed that professionalism had to mean something more than simply professional qualifications and certificates. In fact, the FCA expects it to mean a state of mind that dictates how a person conducts themselves and how they conduct their firm when dealing with customers. Professionalism has to run right through the core of a firm from senior management down to customer facing staff. To this end he said that the FCA will ask itself the following four questions when conducting its work:

- What is the firm's business model?
- What is the culture of the firm?
- How does it run its business?
- Does it keep the client at the heart of its business, in practice as well as in theory?

The FCA's emphasis is on ascertaining whether firms put professionalism into practice when actually interacting with clients rather than simply ticking compliance boxes.

Mr Griffith-Jones mentioned that the FCA has recently published the outcomes of its work on the perceived expectations gap between regulators and the industry and has also asked whether market development is being held back by uncertainty around FCA rules, or concerns over retrospection. He remarked that the FCA does not always get it right, but it does ensure it listens to any feedback when it does not. He explained the FCA has recently clarified rules on independent financial advisors using internal specialists and made data reporting less burdensome for firms.

He stated that the FCA is sensitive to the fact that many people are unable to obtain access to decent financial advice, since they cannot afford it. It is looking at ways the industry may use technology to lower the cost of appropriate advice or guidance for such people. He ended by reiterating that whilst the industry has come a long way, it still has a good distance to travel, and he reassured the audience that the FCA will continue to listen and have its door open.

3. FCA encourages closer engagement from senior management on conduct risk

The FCA published a speech by Robert Taylor, its Head of Wealth Management and Private Banking, on 28 November 2014, setting out the FCA's views in relation to conduct risk. One of the key themes in the speech was the fact that boards and senior management must take a closer look at conduct risk and discuss it in more detail at board meetings and within firm committees.

He stressed that "trust" would remain the fundamental issue within the industry. Firms need to think seriously about how the service they provide to clients helps to build and maintain such trust. In particular, they should ask themselves what they are doing to have earned the trust of clients who invest their money into such businesses. First and foremost, they must understand that clients will be anxious about whether or not the individual to whom they are talking at the firm is actually going to provide them with the right outcomes.

He explained that the industry should rightly be proud of what it has accomplished and the high standards that it sets, but it must continue to operate to the highest professional standards possible. Firms must be able to put their hands on their hearts and say that they are carrying on their business activities to the highest standard possible and that that journey is never going to end. Firms must always ask what could be done better and what could be improved upon? In addition, boards and senior management must spend as much time on a firm's financial circumstances as they would on client outcomes. They need to understand that every decision a board makes has an impact on customers. They must be able to demonstrate how they have discussed in what ways any decisions made could have an impact on customers. Customers will gain confidence knowing that businesses are led by individuals who are asking the right questions and engaging with issues before they become a problem.

Mr Taylor went on to explain that one of the key risks in the wealth management and private banking sector was anti-money laundering orientated and related to whether individuals with whom firms do business pose a risk or are currently on a sanctions list. Allied to this is the issue of ascertaining whether such persons are Politically Exposed Persons (PEPs). Firms must be absolutely sure that such individuals are not transacting business through their institutions at this very moment. He stressed that this issue must be at the top of any agenda at board meetings right now. It is crucial that the wrong people do not do business through the UK.

Mr Taylor also touched upon sustainability. Firms must actively review their business models to ensure that they are sustainable whilst at the same time being able to meet the new standards and deliver good services to customers. They must ask themselves whether their business model would stand up to another down-turn, and whether clients will still receive the right treatment in the event that profits drop off. Finally, he explained that firms need to think about who their clients will be in future and to be prepared for changing demographics. His comments followed a recently published study by the British Bankers Association which stated that the average client in the industry is over 60, and in some cases over 70.

4. Bank of England explains UK leverage ratio and need for effective bank boards

The Bank of England (the Bank) published a speech by Martin Taylor, an external member of the Bank's Financial Policy Committee (FPC), in which he put forward his own views on the role of the leverage ratio in the UK and the question of how boards of banks may most productively carry out their duties.

On the leverage ratio, Mr Taylor stated that such a measure was essential in the UK, since having a risk-weighted capital ratio on its own is not infallible in practice. The models used to calculate the risk-weighted capital ratio are inherently incomplete and imperfect, as well as inherently pro-cyclical. He then briefly considered how the leverage ratio should be calibrated and commented that the FPC is looking to hold a position of "complementary neutrality" between the two ratio measures. He also explained that the FPC has rejected the use of an unvarying leverage ratio, and has proposed that it should vary over time, with a counter cyclical leverage ratio buffer, just as the risk-weighted capital ratio will do, thanks to the counter-cyclical capital buffer. In his view, both ratios should move in proportion. He also explained that systemically important firms should expect to have a higher leverage ratio and provided some comments on what types of capital should be allowed to account for leverage ratio purposes.

Mr Taylor moved on to discuss the effectiveness of bank boards and explained that there is profound unease in the industry, as well as confusion, as to how boards at these institutions should conduct themselves. In order to deal with the volume of work required and so as to operate more efficiently, boards of directors have increasingly delegated important decisions to board committees. He believes that the drive for efficiency has effectively led to reduced board cohesion and downsized the space in which boards are able to operate. It also means that boards are usually unable to see the bigger picture.

However, Mr Taylor is of the view that there are specific matters of which the board of a bank absolutely must have collective understanding and for which they must take responsibility. These include:

- The risk framework and model which determines how much capital the bank believes necessary.
- The incentives that underlie the remuneration system and behaviours which are likely to be encouraged by the way in which staff are paid.
- How capital is allocated in the business and an understanding of both the mini-cycles and larger cycles in banking markets.
- A full ability to understand all of the different activities in which the bank is engaged.

He stressed that “every one of these considerations is too big to delegate”. His message was loud and clear: were boards to apply themselves to these issues properly, they would not need to worry about any of the new sanctions available to regulators as part of the incoming senior managers regime.

UK Publications

1. **Payment Systems Regulator issues consultation on new regulatory framework**

On 13 November 2014 the new Payment Systems Regulator (PSR) issued its first consultation paper on the new regulatory framework for payment systems in the UK (PSR CP14/1). The consultation, which closes on 12 January 2015, explains how the PSR intends to regulate the £75 trillion payments industry in the UK when it becomes fully operational on 1 April 2015.

The consultation proposals are aimed at furthering the PSR’s three main objectives which are:

- To promote a competition.
- To promote innovation.
- To ensure that payment systems are developed and operated in the interests of service-users.

Broadly, the measures set out in the paper are aimed at providing fairer and more open, direct access to payment systems and increasing transparency, as well as driving industry strategy and encouraging innovation in technology. The PSR also intends to open up the ownership, control and governance of payment systems.

The main policy proposals are:

- To introduce a new approach to industry strategy by taking control of the strategy development and setting processes to enable the UK to have a world class payments system. This will involve setting up a new Payment Strategy Forum which will have a broad representation of industry and service-users.
- To open up ownership, control and governance of payment systems, so as to give all service-users a voice when decisions are made, not just those that own the system such as the major banks. Conflicts of interest will have to be addressed and all payment systems operators will be required to publish board minutes and votes. In addition, all operators will be required to ensure service-users are appropriately represented in decision making. From 30 September 2015, operators will need to report back to the PSR on how they have made improvements.
- To provide fairer and more open direct access to payment system operators. This involves the operators of systems such as BACS, CHAPS and the Faster Payment Service providing access on an objective, risk-based, open and fair basis, as well as publicly disclosing their access requirements. This will permit fair and open access to the systems, thereby allowing banks and innovative payment service providers to gain access directly to payment systems on fair terms. Operators such as LINK, Mastercard and Visa will be required to disclose their access requirements publicly.

In addition, all operators will have to report on compliance with their relevant access rules annually.

- To offer greater transparency for persons seeking indirect access to inter-bank systems.
- Dealing with interchange fees and engaging with relevant authorities on the proposed EU Interchange Regulation.
- To impose high-level behavioural expectations through the three Principles mentioned above.

The PSR also intends to launch two market views by April 2015, one of which will review the competitiveness of infrastructure provisions and the other, provision of indirect access.

The PSR will have sufficient powers to investigate firms which fall short of its expectations and carry out enforcement action, including issuing penalties, censures and compelling firms to take remedial action. It will also be responsible for handling commercial disputes regarding access to payment systems or fees and charges relating to services provided by them.

2. FCA publishes thematic review of conflicts of interest arising out of wealth management and private banking firms' use of in-house investment products

On 24 November 2014, the FCA published a thematic review report presenting its findings following the review of conflicts of interest arising from wealth management and private banking firms' use of in-house investment products ("IHPs") in retail discretionary and advisory investment portfolios. The FCA explains that this report follows on from the work which it had previously carried on in 2013 regarding suitability in the wealth management and private banking sector.

The report reiterates that identification and management of conflicts of interest are key parts of maintaining market integrity and the delivery of good outcomes for customers who rely on agents to act in their best interests. The FCA states that it conducted the review to discover whether wealth management firms and private banks were able to identify and manage conflicts of interest which could arise when providing investment products manufactured within the same group or firm, thereby putting customer outcomes at risk. The review was based on a sample of 18 wealth management and private banking firms which hold a total of £146 billion of retail customers' assets under management through discretionary and advisory services. Around 20% of this amount was invested into products which were manufactured by a party connected to the firm managing the assets.

Whilst the FCA is pleased to report that it has seen an increased focus by senior management within the firm on conflicts of interest, and that there was no evidence of remuneration structures that could have biased investment decisions unfairly towards the IHPs, it did find various shortcomings. These include:

- The fact that firms did not articulate clearly enough how IHPs fitted within their business model on strategy, or how they were aligned with customers' interests.
- That not all firms monitor the level of IHPs in customer portfolios, which could help to indicate how effectively they are managing conflicts.

- That communications about the nature of the firm's services and the extent to which IHPs might feature in customer portfolios were not always clear. The FCA stresses that any firms in this sector which use IHPs must remain aware of the fact that there is a risk of a conflict arising from such a business model, especially when they look actively to increase their assets under management and to pull in larger profits.

The report also states that the FCA will give individual feedback to firms at which it looked in detail. Any firms which have access to IHPs which were not part of the review must be ready to consider how their own arrangements will meet the standards set out in the report.

3. HM Treasury issues consultation on regulating individual conduct in UK branches of foreign banks

HM Treasury published an open consultation paper together with an impact assessment on regulating individual conduct in UK branches of foreign banks. These documents were published on 17 November 2014. The consultation arises from the powers contained within the Financial Services (Banking Reform) Act 2013 (Banking Reform Act) which enable HM Treasury to extend the new framework for individuals contained within the Banking Reform Act to cover UK branches of foreign credit institutions and investment firms. The Banking Reform Act implements key recommendations included in the final report from the Parliamentary Commission on Banking Standards (PCBS) entitled "Changing banking for good".

Provided that the necessary parliamentary approval is obtained, HM Treasury will prepare a draft Order compelling foreign financial services firms that have a branch in the UK and are credit institutions or PRA-designated investment firms to become "relevant authorised persons" (RAPs) under Part V of the Financial Services and Markets Act 2000 (FSMA). However, it is worth noting that the Order would not make a senior manager in such a branch potentially liable to the new offence relating to decisions which cause a financial institution to fail (as set out in Section 36 of the Banking Reform Act).

The consultation explains that both the FCA and PRA will have to make:

- Rules specifying the functions performed by individuals in branches that may only be performed by senior managers approved by the regulators (significant management functions).
- Rules specifying the functions performed by individuals in branches that can only be performed by persons that the RAP has certified as fit and proper (significant harm functions).
- Rules setting out the other classes of employee who will be subject to rules of conduct made by the regulators.
- Conduct rules for senior managers, certified persons and other employees specified by the regulators in their rules.

Both the PRA and FCA will also be able to make different rules for different types of branch and need not apply the rules that apply to UK deposit-takers or PRA-designated investment firms to UK branches of equivalent foreign firms. The consultation confirms that both regulators will be required apply the new rules to branches in an appropriate and proportionate way.

Since a branch does not have its own balance sheet or capital, the primary responsibility for prudential supervision of a foreign branch must remain with the competent supervisor in the relevant jurisdiction of the branch's parent entity. Under EU law, the PRA only has a minimal role in the prudential supervision of UK branches of institutions or investment firms incorporated within the European Economic Area (EEA). Therefore, the PRA does not expect to designate any senior management functions in UK branches of EEA credit institutions or investment firms. Branches of non-EEA firms will be subject to consultation but the PRA expects to specify only a handful of senior management functions in branches of such firms. It believes that in many cases branches may only need one individual approved by the PRA as a senior manager. On the other hand, the FCA expects that its regulation of conduct of business within foreign branches will be closer to its regulation of UK institutions or subsidiaries. It is likely that it will designate more senior management functions in branches than the PRA, and the same is true in relation to significant harm functions. The consultation closes on 30 January 2015.

4. PRA discusses senior managers' regime for insurers

On 26 November 2014, the PRA published its consultation paper (CP26/14) on the new regime it proposes to implement for senior insurance mangers at insurance firms (SIMR). The consultation looks at the changes to the PRA's rules needed so as to implement new requirements relating to governance and the fitness and proprietary of individuals under the Solvency II Directive in the UK. The consultation also discusses proposed changes to the current Approved Persons regime which will be required to introduce parts of the new senior managers regime. This new regime has its roots in the recommendations contained within the PCBS report on better banking which was originally intended solely for banks. Other rules needed to transpose the Solvency II Directive were consulted upon in August 2014 and are not mentioned in this consultation.

The new regime for senior insurance managers will look to ensure that senior persons who effectively run insurance firms, or who have responsibility for other key functions at those firms, will behave with integrity, honesty and skill. They shall be responsible and accountable for the sound and prudent management of their firms. The PRA explains that the new regime will be tailored to take account of the specific features of the insurance industry and the relevant legislative framework, including Solvency II requirements. The SIMR will cover senior insurance managers who are subject to pre-approval by the PRA for carrying out a controlled function, together with all other senior persons who are running insurance firms or who have responsibility for other key functions at those firms. Such persons will need to be assessed as being fit and proper by the PRA. Certain controlled functions will be known going forward as "Senior Insurance Management Functions", including the Chief Executive Officer, Chief Finance Officer and Head of Internal Audit. The Chief Actuary will be required to be a controlled function under this new regime, and at general insurance and reinsurance firms, the Chief Underwriting Officer will be included amongst others.

Where individuals are covered by the Solvency II Directive fit and proper requirements, but they do not exercise either a PRA or FCA controlled function, the PRA will supervise the in-firm assessments of whether such persons are fit and proper on an ex-post basis. The PRA also states that it will apply the requirements proportionately, ensuring that smaller firms and branches of third country firms may have more flexibility to combine responsibilities for different functions with a single individual if required.

The consultation states that for the period between 1 January 2016 and the implementation of the full SIMR, the current list of controlled functions in the Supervision Manual of the PRA Handbook will remain in place. The rules relating to key function holders will come into force on 1 January 2016.

In addition, the PRA will expect firms to allocate certain prescribed core responsibilities to individuals who have been approved for a controlled function by either the FCA or the PRA. The PRA is also proposing to require insurers to maintain a document, known as a "governance map", which will record the positions of those effectively running the firm, along with the key functions within the firm and the names of the individuals in each of these positions or with responsibility for a key function. The document will need to contain the allocation of significant management responsibilities, as well as reporting lines for each of the senior persons within the firm or group. These rules are expected to come into force on 1 January 2016.

As part of the reforms, the PRA proposes to revise the current conduct standards set out in the Statements of Principle and Code of Practice for Approved Persons manual of the PRA Handbook (APER). The aim is to ensure that the conduct rules proposed for individuals working at banks, investment firms and insurance firms are suitably aligned. The PRA will introduce a specific conduct standard for key function holders so as to ensure that appropriate attention is given to the protection of insured benefits for policy holders. The consultation states that these revised conduct standards will come into force from the date that the full SIMR is commenced.

The consultation also discusses the ways in which regulatory supervision of individuals and standards in relevant firms will change as a result of the new Solvency II framework. Chapter 3 of the paper sets out the PRA's new approach to supervising firms under the incoming regime. The PRA also explains that it will consult on changes to the regime for non-executive directors in a further consultation paper once the FCA and PRA have agreed their approach to this function under the respective regimes. The consultation paper is open for comments and feedback until 2 February 2015.

5. FCA issues consultation on changes to Approved Persons Regime under Solvency II

In addition to the PRA consultation on the senior insurance managers regime, the FCA published its own consultation paper on changes to the approved persons regime for firms covered by the Solvency II Directive (CP14/25) on 26 November 2014. The consultation is open for comments and feedback until 2 February 2015.

The consultation puts forward the FCA's amendments to its Approved Persons assessments so as to reflect the new Solvency II framework, which will supplement information the FCA requests in line with guidance provided by the European Insurance and Occupational Pensions Authority (EIOPA) on systems and governance and own risks and solvency assessments. The FCA states that it plans to consult in a later paper on particular changes to the form that firms must submit to it in order to apply for pre-approval for significant influence functions.

The FCA sets out its plans to adopt those executive, and other controlled functions that the PRA proposes to drop so that they would become subject to FCA pre-approval. It wishes to ensure that individuals who may have a significant impact upon the FCA's objectives remain within the scope of conduct regulation.

The FCA also proposes to defer consideration of whether to include non-executive directors within the amended Approved Persons regime whilst considering responses to its consultation on the new regime for senior persons within banks. It proposes to consult on this issue separately.

In addition, the consultation sets out the intention to apply new conduct rules to FCA and PRA approved persons which will mirror those which it has proposed for individuals in relevant authorised persons (banks, building societies, credit unions and PRA-designated investment firms) (RAPs). The FCA explains that these rules will build on the existing Statements of Principle set out in APER, as well as emphasise the importance of treating customers fairly and of responsible delegation by holders of significant influence functions.

The detailed rules and changes to controlled functions under the reformed regime are set out in Annex 1 to the consultation. The FCA has said that it intends to publish further details on the timetable for implementing the proposals later this year.

6. FCA thematic review of small banks' management of AML and sanctions risks

On 14 November 2014, the FCA published its report setting out its findings from the thematic review it carried out of how small banks manage the risks associated with money laundering and sanctions. The FCA thematic review follows on from the review undertaken by the Financial Services Authority (FSA) in 2010-11 assessing 27 banks' anti-money laundering systems and controls in high-risk situations. That review also included the banks' dealings with PEPs, correspondent banks and wire transfers. This time, the FCA visited 21 smaller banks between October 2013 and June 2014 to assess their anti-money laundering and sanctions systems and controls. It looked at how the firms had used available regulatory guidance, the findings of the 2011 FSA review and enforcement action to inform its approach.

The FCA found that whilst some of the banks had implemented effective anti-money laundering and sanctions controls, there were continuing weaknesses at many. For example, it found significant and widespread weaknesses in key anti-money laundering controls, including risk assessments at both a business and customer level, and enhanced due diligence and on-going monitoring of high risk relationships such as those with politically exposed persons. Resourcing was also found to be an issue, with a third of the banks having inadequate resources. There was also weak staff knowledge and awareness of anti-money laundering and sanctions risks. In many cases Money Laundering Reporting Officers were deemed to be too weak by the FCA.

The FCA also found that overseas banks were too reliant on other parts of their groups to carry out customer due diligence on their behalf. Group policies and procedures, in various instances, were not consistent with UK legal and regulatory requirements and the chief executive officer could even have been a short-term posting from the home country, meaning that he would have little incentive to ensure that any risk controls met the UK standards. However, the report does point to an improvement in senior management engagement on anti-money laundering issues compared with the review conducted in 2011 by the FSA.

In spite of this, the FCA found that many banks were still slow to assess their systems and controls against the guidance arising from the FSA's 2011 review. With regard to sanctions controls, the FCA found that some banks were excluding specific transaction types from payment screening without first assessing the risk that this could pose.

The FCA has decided to take action against six banks where it found serious issues, including beginning enforcement investigations into two of these banks. The report contains numerous examples of good and poor practice, and the FCA has stated it intends to update its regulatory guidance on financial crime by including the further examples of good practice contained in Chapter 3 of the report.

Consumer Credit

1. **FCA publishes policy statement on high-cost short-term credit price cap**

On 11 November 2014, the FCA published its final policy on the price cap to be introduced on high-cost short-term credit (HCSTC) contained in its policy statement (PS14/16). PS14/16 follows the FCA's consultation on this area published in July 2014. The final rules are contained in a new chapter 5A to the FCA's Consumer Credit Sourcebook (CONC) which will come into force on 2 January 2015. The majority of proposals consulted on in the July paper are included in the final rules, subject to some specific changes and clarifications in response to feedback provided during the consultation period. The price cap remains the same as that put forward in the July consultation and includes:

- A cap of 0.8% per day of the amount borrowed on interest and fees charged on new loans or loans rolled over.
- Fees for default must not exceed £15. However, firms may continue to charge interest after default but not above the initial rate.
- A total cost cap of 100%, meaning that borrowers must never have to paid back more in fees and interest than the amount borrowed.

As mentioned above, the FCA has made some clarifications in the final rules to its proposals set out in the July consultation. These include:

- How the cap applies to loans made before 2 January 2015 but modified on or after that date.
- How the cap should be applied to loans which are re-financed.
- The obligation on borrowers in relation to any loans that are unenforceable because they breach the price cap.
- Various technical issues.

The FCA will review the price cap two years after its implementation in the first half of 2017. In the intervening period it will monitor whether there are any unintended consequences emerging from firms or consumers. It also points out that consumers who believe that the cost of their HCSTC loans reaches the cap should complain, in the first instance, to the lender and then to the Financial Ombudsman Service if they are still not happy.

The FCA mentions that it will be doing further work on certain aspects in relation to HCSTC including: assessing the impact of repeat borrowing and the extent to which lenders are adequately assessing affordability; and keeping under review the decision not to apply a price cap to other high-cost products at this time. Relevant to this is the forthcoming credit card market study and the Competition and Markets Authority investigation into person current accounts.

Investigations and Enforcement

1. **Five banks fined total of £1.1 billion for FX manipulation and failings**

On 12 November 2014, the FCA published a press release announcing that it has imposed fines totaling £1,114,918,000 on the following five banks for failing to control business practices in their G10 spot foreign exchange (FX) trading operations:

- Citibank N.A. (£225,575,000)
- HSBC Bank plc (£216,363,000)
- JPMorgan Chase Bank N.A. (£222,166,000)
- The Royal Bank of Scotland PLC (£217,000,000)
- UBS AG (£233,814,000)

With the press release the FCA published the final notices issued to each of the banks, together with technical briefings which contain a summary of the FX market and examples of attempted manipulation at each institution. The FCA states that, taken together, these fines are the largest ever imposed by it or the FSA before it, and it is also the first time that the FCA has pursued a settlement with a group of banks. The press release references the fact that it has worked in conjunction with regulators in Europe and the United States in bringing these actions.

Between 1 January 2008 and 15 October 2013, the five banks had insufficient mechanisms and procedures in place to exercise adequate and effective control over their G10 spot FX trading businesses. Traders were able to put their particular bank's interests ahead of those of their clients, other market participants and the wider UK financial system. The banks failed to manage obvious risks around confidentiality, conflicts of interest and trading conduct. The trading businesses were able to share information about the clients' activities which they were supposed to keep confidential and attempted to manipulate G10 spot FX currency rates, often in collusion with traders at other desks and firms, in a way that could disadvantage those clients and the market.

The FCA states that it expects firms to identify, assess and manage appropriately the risks that their businesses pose to the markets in which they operate and to preserve market integrity. Firms should do so regardless of whether such markets are regulated or not. Tracey McDermott, the Director of Enforcement and Financial Crime at the FCA, said that firms must understand and manage the risks their conduct might pose to markets and they should deal with any risks "quickly, decisively and effectively". Should they fail to do so they will continue to face significant regulatory and reputational costs. Martin Wheatley, CEO of the FCA stated that fines were not just about enforcement action, but a coordinated response aimed at driving up market standards across the industry.

The FCA states that it is already conducting a broader review of how effectively firms reduce the risk of traders manipulating benchmarks and how they ensure confidential information is not abused. It has also announced that it is to carry out an industry-wide supervisory remediation programme for firms to drive up standards across the market. As part of this programme, firms will have to review their systems and controls, policies and procedures and ensure that they are of the highest possible standard to manage any risks faced by the spot FX businesses. In addition, senior management will be required to attest that action has been taken and that firms' systems and controls are adequate to manage such risks. Some business reviews will need to extend beyond G10 spot FX, so that a number of firms will be requested to review FX Emerging Markets, FX sales, as well as derivatives and structured products referencing FX rates of precious metals.

2. UK Regulators hand banks within RBS Group joint fine for IT failings

On 20 November 2014, the FCA and the PRA jointly published final notices for the Royal Bank of Scotland plc (RBS), National Westminster Bank PLC ("NatWest") and Ulster Bank Limited (UB) stating that they have each fined the banks for failing to put in place resilient IT systems which could withstand, or minimise the risk of, IT failures. Importantly, this is the first time that both the FCA and PRA have taken joint enforcement action. They did so since the failings covered both conduct and prudential issues, which affected the statutory objectives for both regulators. The failures meant that the customers for each of the banks were unable to access banking services.

On 17 June 2012 the centralised IT function for the RBS Group, known as Technology Services, upgraded the software which processed updates to customers' accounts. The function discovered that there were problems and decided to uninstall the upgrade without first testing the consequences of that action. In addition, it did not realise that the upgraded software was not compatible with the previous version, which caused a failure of the system and huge disruption to customers on 20 June 2012. During the disruptive period, customers were unable to use online banking facilities to access their accounts or obtain accurate account balances from ATMs. Affected customers were also unable to make mortgage payments and some were left without cash in foreign countries. Incorrect credit and debt interest was also applied to customers' accounts and the Banks produced inaccurate statements. Further, some of the Banks were unable to meet their payroll commitments or finalise their audited accounts.

The final notice issued by the FCA sets out a fine of £42 million for the failings. It states that, between August 2010 and July 2012, the RBS Group breached Principle 3 of the FCA's Principles for Businesses since it failed to have adequate systems and controls in place to identify and manage exposure to IT risks. The failings were not the result of insufficient investment in IT infrastructure, but specific weaknesses in the banks' IT systems and controls. In particular, there were inadequate testing procedures for managing changes to software and risks which related to the design of the software system were not identified. The banks should have had a much greater focus on the design for such systems so that they would be able to withstand or minimise the effect of a disruptive incident. The FCA comments that that banks have since taken significant steps to address the IT failings so as to reduce the risk of similar problems occurring in future. The customer redress programme set up by the Group following the issues has paid out approximately £70.3 million to customers, and £460,000 to parties who were also affected.

The PRA final notice (which imposes its first financial penalty) states that the PRA has fined the banks £14 million for breaching Principle 3 of the PRA's Principles for Businesses. It explains that properly functioning IT risk management systems and controls are crucial to ensure a firm's safety and soundness and, significantly, for the stability of the UK financial system. Since it interfered with the provision of the banks' core banking functions, it was possible that it could have had an effect on the stability of the financial system in the UK. The PRA also reiterates that firms must understand that placing risk operations within group structures will not relieve a firm of its own obligations. Ultimate responsibility for that risk remains with the firm.

Tracey McDermott, the FCA Director of Enforcement and Financial Crime said in the FCA press release which accompanied its final notice that modern banking is dependent upon effective, reliable and resilient IT systems. She explained that the problems were due to failures at many levels within the RBS Group to identify and manage IT risk and that firms must focus on how they can meet their customers' requirements when looking at IT strategies and policies.

3. Chase de Vere given fine for Keydata product sales failings

The FCA published a final notice issued to Chase de Vere Independent Financial Advisors Limited (CdV) on 17 November 2014, which fined CdV £560,000 in respect of failings connected with the sale of Keydata traded life settlement products (the Keydata Products) to customers. CdV agreed to settle at an early stage of the FCA investigation and therefore qualified for a 30% discount on the fine. Were it not for the discount, the FCA would have imposed a financial penalty of £800,000.

In a period of almost four years, between August 2005 and June 2009, CdV sold 3,846 Keydata Products to 2,806 customers. The total amount these customers invested through CdV was £49.3 million, and of these, 139 customers invested a total of £4.4 million in Keydata Products which were in excess of the Financial Services Compensation Scheme (FSCS) compensation limit applicable during this period. The Keydata Products were complex and based on investments in corporate bonds which were issued by special purpose vehicles incorporated in Luxembourg. The funds raised via the issue of the bonds were then invested in a portfolio of US life insurance policies and cash.

During this period CdV did not put in place adequate systems and controls to ensure that the unusual features of the Keydata Products were researched to an adequate standard and consequently, did not understand the risks these products posed to investors or ensure that such risks were properly understood by advisors selling the products to customers. As a result, CdV was found to be in breach of Principle 3 of the FCA's Principles for Businesses, as well as rule 3.2.6 of the FCA's Senior Management Arrangements, Systems and Controls sourcebook (SYSC). In addition, CdV failed to put in place risk management systems to mitigate the risk that advisors would fail to describe the products they were selling in a way that was clear, fair and not misleading.

CdV also breached Principle 7 of the FCA's Principles for Businesses, since it failed to disclose to its customers certain features and risks attaching to the products. This, in turn, was also a breach of certain applicable rules set out in the Conduct of Business Sourcebook (at that time COB and subsequently COBS).

The FCA explained that the breaches revealed systemic weaknesses in CdV's internal controls, as inadequate research led to a failure to impose restrictions on sales of the products. CdV has agreed to review the situations of those customers who have not made a claim to the FSCS or CdV relating to their investments in Keydata Products. It has agreed to provide compensation where appropriate. CdV has also taken action to improve its business including its business quality monitoring, sales practices, systems and controls, product research, management information, compliance monitoring and complaints handling all of which mitigates the seriousness of the failings.

4. Former Moore Capital Management trader pleads guilty to insider dealing

The FCA announced via a press release published on 7 November 2014 that a former senior execution trader at Moore Capital Management LLC, Julian Rifat, has pleaded guilty to an indictment reflecting eight instances of insider dealing. The press release states that profits from the dealing exceeded £250,000.

The FCA states that Mr Rifat admitted passing inside information, which he obtained during the course of his employment, to an associate, Mr Graeme Shelley, a former broker at Novum Securities who then traded for their joint benefit. Mr Shelley had pleaded guilty to insider dealing earlier in 2014, in February. A third associate, Paul Milsom, an execution trader at Legal and General Insurance Management Limited pleaded guilty to insider dealing and was sentenced in 2013. Mr Rifat is the third individual to plead guilty to insider dealing offences arising out of Operation Tabernula which is the FCA's largest and most complex insider dealing investigation. The press release states that he will be sentenced in the new year, and that the FCA is currently prosecuting eight other individuals for insider dealing.

Tracey McDermott, the Director of Enforcement and Financial Crime at the FCA said that insider dealing investigations are long-running and complicated. She explained that the parties had taken steps to conceal the illicit activities including communicating via unregistered Pay As You Go mobile telephones and diverting profits from the trades to third parties. Ms McDermott said that the guilty plea is a reflection of the FCA's capability and determination to deal with such activities.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Financial Services practice group:

Charlotte Hill	+44 (0)20 7067 2190	chill@cov.com
William Maycock	+44 (0)20 7067 2191	wmaycock@cov.com