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COVINGTON & BURLING LLP

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Once again it has been a busy period in the world of financial services regulation. The coming of autumn and the clocks going back has, as usual, brought an upsurge in the volume of information coming out of both the UK's regulators and the EU. In the UK, we have seen the FCA bringing out a policy statement on enforcement warning notices, detailed consultations on CRD IV and consumer credit, as well as responses from both UK regulators to the PCBS report. In addition, there have been key speeches made regarding the direction of UK regulation. As ever, on the enforcement side, the regulator remains active, with a number of key actions taking place. On the European front, there has been an advance with regard to the single supervisory mechanism; the Commission has published a consultation in relation to EMIR; and MiFID II is back on the agenda again.

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UK PUBLICATIONS

1. FCA PUBLISHES LONG AWAITED POLICY STATEMENT ON ENFORCEMENT WARNING NOTICES

This month, the FCA published its long awaited Policy Statement on enforcement warning notices, which responded to feedback on its March Consultation Paper and set out its finalised rules on the area.

It conceded, following concerted pressure from regulatory lawyers and others, that in some situations it may not be appropriate to name individuals under investigation when publishing warning notices. However, it stated that it will usually provide the name of a firm under investigation. It still believes that the early publication of such notices is in the interests of transparency and the public, and so stressed that publication was much more likely than not, even if in certain circumstances the notice is anonymised.

In deciding whether to publish details of a warning notice, the FCA stated it will consider the circumstances of each case and see if it is appropriate to do so. If it is considered appropriate, then the FCA will look at whether the subject of the notice should be identified. In the case of individuals, the potential harm of early publication will usually outweigh the benefits of early transparency. The FCA will then consult the person(s) concerned, before making a final decision on whether to publish the warning notice. Tracey McDermott, the FCA's Director of Enforcement, said that the FCA had listened carefully to the feedback, and had now got the balance of the rules right.

2. BOTH THE FCA AND BANK OF ENGLAND PUBLISH RESPONSES TO PCBS REPORT

On 7 October, the FCA and Bank of England (encompassing the PRA and Financial Policy Committee) published their responses to the final report of the Parliamentary Commission on Banking Standards. Both documents set out how the FCA and the Bank of England plan to implement the recommendations and provide views and any commentary on them. Though dissenting in some areas, the FCA and PRA broadly concurred with the report and will set forth a number of different initiatives and consultations over the next year to implement the majority of the recommendations.

The responses covered the key areas set out in the final report, including:

a) the new senior persons regime and licensing arrangements, which are due to replace the current Approved Persons regime for the banking sector;

b) proposals for a new statutory remuneration code to ensure incentives and disincentives more closely reflect the business over the long run;

c) increased enforcement action against individuals;

d) corporate governance and ensuring that boards are responsible for risk management;

e) minimum standards on whistleblowing;

f) transparency of information on firms and their products; and

g) complaints and compensation.

3. FCA PUBLISHES CONSULTATION PAPER ON ITS DETAILED PROPOSALS FOR THE NEW UK CONSUMER CREDIT REGIME

At the start of October, the FCA published a Consultation Paper on its detailed proposals for consumer credit in the UK, together with accompanying appendices and a detailed cost-benefit analysis. The Paper forms part of the FCA's response to the transfer of responsibility for

consumer credit from the Office of Fair Trading to it, following a Government review. The FCA will take over responsibility for the consumer credit sector on 1 April 2014.

The Paper set out a number of changes to the proposals the Financial Services Authority made in its March Consultation Paper on high-level proposals for a new consumer credit regime, but it also set out new material for further consultation, including:

a) tougher requirements for firms offering high-cost short-term credit (such as so-called payday lenders);

b) a two-tiered authorisation process with strengthened requirements for firms wishing to carry on higher risk activities;

c) active supervision and enforcement; and

d) prudential requirements for debt management firms.

In addition, the Paper included a Policy Statement on finalised rules for the high-level proposals of the FSA's Consultation Paper and a timetable for the reforms. The consultation section of the Paper is open until 3 December 2013 and the FCA hopes to publish final rules and guidance in February or March of next year.

4. SECOND FCA CONSULTATION PAPER ON IMPLEMENTING CRD IV FOR INVESTMENT FIRMS

On 10 October, the FCA published a second Consultation Paper relating to the implementation of the new Capital Requirements Directive ("CRD IV") for investment firms currently subject to the Capital Requirements Directive, UCITS management companies and alternative investment fund managers. This Paper complements the first FCA Consultation Paper on CRD IV for investment firms, published in July of this year, and is guided by the same principles regarding transposition as that paper. They should be read together.

The FCA's proposals include making changes to the FCA Handbook in the following areas:

a) remuneration, and specifically a cap on bonuses, as well as the use of proportionality;

b) a change to the transitional provision on countercyclical capital buffers;

c) reporting requirements for investment firms under the Capital Requirements Regulation;

d) interaction between the AIFMD and UCITS and CRD IV with regard to own funds, prudential requirements and reporting.

The consultation ended on 10 November 2013 and the FCA intends to issue a combined Policy Statement for both papers towards the end of the year, ensuring that final rules are available to firms before 1 January 2014, when CRD IV is due to be implemented.

In addition, the FCA also published a letter which it sent to the compliance heads of BIPRU investment firms, together with a related FAQ document. The letter stated that these firms need to ascertain whether they will remain subject to the current prudential regime or fall within the new CRD IV regime.

5. NEW FCA GUIDANCE CONSULTATION ON SWITCHING TO POST-RDR UNIT CLASSES

The new Guidance Consultation, published on 23 October, explains what the FCA wishes to see from firms involved in the transfer of investors from old unit classes in authorised unit trusts or investment companies with variable capital to those required under the Retail Distribution Review ("RDR"). The guidance is particularly useful for platforms, nominees, product providers and financial advisers, and the consultation is open until 23 November.

The guidance covers:

a) whether conversion to a "clean" class should be treated in the same way as a switch of units;

b) whether bulk conversions would be possible instead of individually;

c) whether unit holders need to provide express consent before conversions would be allowed;

d) whether advice would be required;

e) what role advisers would play in the conversion process; and

f) if a new disclosure document, such as the Key Investor Information Document should be provided before conversion takes place.

EUROPEAN UPDATE

1. EUROPE PUSHES AHEAD WITH THE SINGLE SUPERVISORY MECHANISM

The European authorities have been busy with regard to the proposed Single Supervisory Mechanism ("SSM"). On 10 October 2013, the European Parliament published the text of its decision approving the conclusion of an inter-institutional agreement with the European Central Bank ("ECB") on cooperation on procedures related to the SSM. The European Parliament has annexed the text of the inter-institutional agreement (which was approved by the European Parliament on 9 October 2013) to its decision.

The inter-institutional agreement sets out the accountability mechanisms that will apply to the ECB in its role under the SSM. The inter-institutional agreement will enter into force on the date that it is signed, or on the date of the entry into force of the SSM, whichever is later. The implementation of the inter-institutional agreement will be assessed by the ECB and the European Parliament every three years.

On the 14 October 2013, the ECB published a speech given by Mario Draghi, the President of the ECB. The speech provides an update on progress towards establishing the European Banking Union.

Mr Draghi stated that the ECB was awaiting the "urgent adoption" in October 2013 by the Council of the EU of the legal framework for the SSM, following its adoption at first reading by the European Parliament in September 2013. According to the speech, it appears that the ECB is expecting to take on its supervisory responsibilities under the SSM in November 2014.

In his speech, Mr Draghi also called for arrangements to be put in place for recapitalising banks, if and when needed, including the provision of a public backstop if private funds cannot be acquired. He suggested that these arrangements should be in place before the ECB concludes its forthcoming assessment of banks' balance sheets, as required by the European Council in June 2013.

On 15 October 2013, the Council of the European Union published a press release announcing that it has voted to adopt the proposed legislation establishing the SSM. A vote was taken at a meeting of the Economic and Financial Affairs Council, without discussion.

The SSM legislation consists of a proposed Regulation setting up the SSM by conferring specific tasks on the ECB, concerning policies relating to the Prudential supervision of credit institutions, together with a proposed Regulation amending the EBA Regulation (Regulation 1093/2010).

2. ESMA CONSULTS ON TECHNICAL ADVICE UNDER EMIR, RELATING TO IMPOSING FINES AND PERIODIC PENALTY PAYMENTS ON TRADE REPOSITORIES

The European Securities and Markets Authority ("ESMA") has published a consultation paper dated 16 October 2013 relating to procedural rules on imposing fines and periodic penalty payments for trade repositories ("TRs"). This is in response to a request from the European Commission for technical advice.

A Consultation Paper sets out ESMA's preferred options in relation to the rules and cover a number of topics including:

- Procedures to guarantee the rights of defence both during and on completion of investigations, including on any oral hearings.
- A reasonable time limit for written submissions.
- Procedures regarding access to files by the persons subject to investigation and the protection of confidential information affecting third parties.
- Documents to be submitted by the Independent Investigation Officer to ESMA's Board of Supervisors.
- Limitation periods for the imposition or enforcement of penalties.
- Methods for collecting fines or periodic penalty payments.

The Consultation Paper explains ESMA's view that a panel or committee should be appointed to carry out particular steps of the procedure, in order to achieve a more effective process, whilst fully respecting the rights of defence of those subject to investigation.

The consultation period is open until 15 November 2013. ESMA will deliver its technical advice to the European Commission by 31 December 2013.

Also in relation to EMIR, Counsel of the EU published a press release in which the Council confirms that it will not object to the delegated Regulations relating to exempted entities and fees charged by ESMA to trade repositories made under EMIR.

3. EUROPEAN COMMISSION CONSULTATION ON CROWDFUNDING IN THE EU

The European Commission has published a consultation paper on crowdfunding in the European Union. Accompanying the Consultation Paper is a set of frequently asked questions. The Consultation Paper describes crowdfunding as an alternative form of financing, directly connecting those who can give, lend or invest money, with those who need financing for a specific project. The Consultation relates to all types of crowdfunding, from donations and rewards to financial investments. The Consultation Paper also sets out the benefits and opportunities of crowdfunding; sets out the risks and challenges; highlight safeguards against illegal practices in crowd funding; and considers how to unleash its full potential.

The Consultation closes on 31 December 2013. The online questionnaire must be submitted by 20 December 2013.

4. THE COUNCIL OF THE EU PUBLISHES A COMPROMISE PROPOSAL ON SRM REGULATION

On 16 October 2013, the Council of the EU published a compromise proposal on the European Commission's legislative proposal for a Regulation establishing a single resolution mechanism (SRM Regulation) for the European Banking Union.

The Council published a previous compromise proposal, dated 27 September 2013. In the most recent compromise proposal, changes to the previous compromise text are highlighted in bold and underlined and deleted text is also identified.

5. MiFID II LEGISLATIVE PROPOSALS TO BE CONSIDERED

The European Parliament will consider the MiFID II legislative proposals at its 24-27 February 2014 plenary session. The European Parliament updated its procedures files on the MiFID II legislative proposals on 17 October 2013. The procedure file for the proposed MiFID II Directive and the procedure file for the proposed MiFID II Regulation ("MiFIR") indicate that the European Parliament will consider the legislative proposals in its plenary session to be held from 24-27 February 2014. This has been put back from the plenary session of 9-12 December 2013, when the European Parliament previously indicated that it would consider the legislative proposals.

6. EUROPEAN PARLIAMENT TO CONSIDER PROPOSED MORTGAGE CREDIT DIRECTIVE

The European Parliament updated its procedure file on the proposed Mortgage Credit Directive on 17 October 2013. The proposed Mortgage Credit Directive is also referred to as the proposed Directive on credit agreements relating to residential property, or CARRP.

The proposed Directive previously was going to be considered at the plenary session of 21-24 October 2013, but will now be considered by the European Parliament at the 18-21 November 2013 plenary session. Certain amendments to the Directive were adopted by the European Parliament on 10 September 2013, but the European Parliament did not adopt a legislative Resolution at the first reading.

SPEECHES

1. MARTIN WHEATLEY, CEO OF THE FCA, LAYS "THE MYTHS TO REST" REGARDING A STRONG CONSUMERIST REGULATOR

In a speech At the British Bankers' Association Annual International Conference in London on 17 October, Martin Wheatley, CEO of the FCA, set out his belief that good regulation and a strong consumerist regulator was good for long term growth and profitability and good, therefore, for the UK banking industry. It is a myth, he argued, that regulation has acted as a "handbrake" and it must now help to get banking back into the trust of the consumer.

He reiterated that the previous regulatory structure had been too retrospective and was far too reliant on rules rather than culture. From now on, it must be forward looking, and anticipate and tackle issues before they become expensive global problems. The FCA and PRA have objectives to promote stability. They will scan the markets and use thematic reviews and market studies to offer direction. The regulator is also now developing a deeper understanding of the sectors it regulates, looking more at how firms make money and seeing how business models deliver against expectations of consumers.

He accepted that whilst firms are on the way to repairing their relationships with retail customers, there is still a long way to go. In addition, restructuring reward incentives through CRD IV and UCITS V is a good start and very important to achieve this, but the FCA does not agree with all the proposals. He said that there is much more to be done, but it would be churlish not to recognise progress.

With regard to Europe, he stated that it was important to work towards common rules and standards, but not at any cost. National regulators should have autonomy to make rules which influence their own firms and customers.

2. TRACEY MCDERMOTT, FCA DIRECTOR OF ENFORCEMENT & FINANCIAL CRIME, DISCUSSES RECENT DEVELOPMENTS IN ENFORCEMENT AND EMERGING ISSUES

In a speech given at the NERA Economic Consulting seminar in London, and published on 9 October, Tracey McDermott reflected on the first 6 months of the new FCA regime and its approach to enforcement. She stressed that the FCA is more committed than ever to showing firms and individuals that they must play by the rules. The FCA has strong powers to deal with offenders and it is using them increasingly. However, she claimed that the FCA still faced a huge challenge to change distorted behaviours which have become the norm and dramatic, disappointing failures.

Providing the examples of the PPI fiasco and Aberdeen Asset Management's fine for client money failings, she explained that, in relation to retail conduct matters, the FCA will continue to use all of the powers available to it to ensure that firms put the interests of consumers at the heart of their businesses. She also expressed the FCA's continued focus on financial crime and anti-money laundering controls.

On wholesale conduct, she elaborated on both the significant ICAP (for LIBOR-related misconduct) and JP Morgan (for a number of highly serious systems and controls breaches) fines, stating that repeated failures by senior management and rotten cultures were at the root of these. She argued that changing cultures at firms will remain a key priority going forward; that earlier intervention and tougher scrutiny of senior management are here to stay. Public perception of the industry must be changed and trust regained.

3. JOHN GRIFFITH-JONES, CHAIRMAN OF THE FCA, DELIVERS SPEECH TO THE WEALTH MANAGEMENT ASSOCIATION ON RESPECT AND TRUST ISSUES IN THE FINANCIAL SERVICES INDUSTRY

Complementing Ms McDermott's speech on enforcement matters on the same day (see above), the Chairman of the FCA spoke about respect and trust issues in the financial services industry to the Wealth Management Association in London. He argued that the starting point for the wealth management industry to regain the trust following a spate of high profile scandals is to ensure that firms produce consistent evidence of clients and consumers being placed at the heart of their business models. Whilst senior management within firms are making strides to change cultures, customers must start to see the benefits soon. Respect for the consumer and the markets is key. Firms and the regulators must engender mutual respect.

For wealth managers specifically, he set out three clear areas on which they must focus going forward. The FCA will continue to monitor the introduction of the RDR and in particular the "advice gap" issue. Suitability and ensuring that customers are treated correctly will remain another "live" topic. Finally, he stated that proper anti-money laundering controls in every firm would be key to restoring confidence in London. The message was clear: wealth managers, you have been warned.

He highlighted again that the FCA will not have relationship managers for the majority of members of the Wealth Managers Association. Contact will be primarily through thematic reviews, road shows and periodic visits. He added that, following the launch of the FCA's first market study into the UK savings industry, there is evidence that fair competition will act as a supplement to regulation. Touching on Europe, he stated that the FCA would be pushing to ensure that standards of the RDR are not compromised by the revision of MiFID. He also mentioned that the FCA is looking to obtain proportional disclosure requirements for Packaged Retail Investment Products.

4. SPEECH BY LINDA WOODALL, DIRECTOR OF MORTGAGES AND CONSUMER LENDING AT THE FCA ON THE IMPLEMENTATION OF THE MORTGAGE MARKET REVIEW

Linda Woodall spoke to the Association of Mortgage Intermediaries on the progress of the Mortgage Market Review ("MMR") and the regulation of the market going forward at the Financial Services Expo. She explained that the majority of firms are well on their way to implementing the MMR on time. One area of concern for firms, which she highlighted, is the new execution only process (non-advised sales process), but Ms Woodall stated that it is not compulsory for firms to offer such a service. As part of the implementation process she unveiled a series of regional workshops and surgeries for firms, and mentioned that a series of factsheets would also be available shortly. She stressed that it is not too late for firms to get on track, if they have fallen behind.

Another key part of the speech was the new approach to supervision for mortgage intermediaries. Ms Woodall explained that the FCA would seek to do three key things when supervising firms in line with its new pro-active, more interventionist stance. It would seek to make better judgements, to be forward-looking and to be outcome-focussed. She also briefly set out the three pronged supervisory regime, explaining the workings of the Firm Systematic Framework, the FCA's event driven work, and issues and products work or thematic work in relation to mortgage intermediaries.

She also reiterated the FCA's stance that lifetime mortgages should only be sold by advisers with separate, appropriate qualifications, since they are hybrid and complex products. In relation to bridging finance, she confirmed that loans should not be provided to persons unless they could show that a mainstream lender will offer a mortgage at the end of the bridge. Lastly, she explained that mortgage advisers must be on the lookout for so called mortgage packagers, who are not regulated, but offer more than a business to business service, since the advisers will be ultimately responsible for any advice provided to the end consumer.

5. PAUL TUCKER GIVES SPEECH ON CURRENT INTERNATIONAL RESOLUTION ISSUES

Paul Tucker, Deputy Governor for Financial Stability at the Bank of England, gave a speech in Washington DC at the Institute of International Finance 2013 Annual Membership meeting on international progress on addressing the "too big to fail" problem through planning for orderly resolution.

He distinguished between the strategies for single point of entry ("SPE") groups of companies and multiple point of entry ("MPE") groups. In an SPE, resolution will work downwards from the group's top company. Losses in any subsidiaries would be transferred to the top company and, if it is bankrupted as a result, the group would require resolving and the bail-in tool would be used. In an MPE resolution, the group might be split into healthy and unhealthy parts. He also suggested that changes should be made to the Basel capital framework and the Basel Committee on Banking Standards' supervisory principles to reflect this. He argued that groups would need to think about which approach best suited them and to take steps accordingly.

With regard to US/UK regulatory interaction in relation to UK subsidiaries of large US financial groups, he asked the Bank of England to set out the conditions under which it would be prepared to stand aside to allow the US authorities manage a group-wide resolution. The Bank of England has previously stated that it would, in principle, be prepared to stand aside in such situations. He also asked for the US authorities to make a similar reciprocal statement where the situation was reversed once the Recovery and Resolution Directive is finalised.

6. ANDREW BAILEY, CEO OF THE PRA AND DEPUTY GOVERNOR OF THE BANK OF ENGLAND, GIVES COMMENTS ON NON-EEA BRANCHES

In the speech delivered at the British Bankers Association, Mr Bailey stated that the PRA would begin to take steps to restart the expansion of cross-border banking again, following recent progress made on bank resolution issues.

He confirmed that the board of the PRA had endorsed the regulator's Approach Document on the supervision of overseas subsidiaries and branches, published in April, and that, in this context, the PRA is prepared to see banks from outside the EEA open branches in the UK. He cited China as an example, and stressed that any arrangement involving Chinese banks would not be a special one, but simply part of a broader policy.

He did, however, provide that the PRA has added a further condition for non-EEA branches. They must stick to wholesale activities and not undertake critical retail banking functions (such as taking deposits) beyond de minimis levels, unless there is a very good case for it and a high level of assurance on resolution. The PRA will request information from home state regulators on recovery and resolution plans and assess whether these cover the UK branches adequately.

INVESTIGATIONS AND ENFORCEMENT

1. TWO FINANCIAL ADVISORS FINED AND BANNED FOR MISLEADING CLIENTS

The FCA has published the final notices issued to Mark Bentley-Leek and Mustafa Dervish on 18 October 2013. Both were directors of Bentley-Leek Financial Management Limited ("BLFM"). The action related to misleading clients and lacking honesty and integrity in advising clients.

Bentley-Leek and Dervish were found to have breached Principle 1 by misleading clients and Principle 3 (Systems and Controls), as they demonstrated a lack of integrity and competence. Bently-Leek was fined £525,000 and Dervish was fined £360,000. The FCA have said that the fines were substantial for individuals, but this reflected the seriousness of the breaches committed and the need to deter others. The two men have also been banned from holding any position in a financial firm and have had their approvals to perform controlled functions withdrawn.

Bentley-Leek and Dervish advised at least 300 clients to invest around £35m in a number of property developments in the UK and abroad, without informing clients that the UK investments were made through property investment companies of which they were both directors and shareholders, thus causing a conflict of interest. A large number of clients were promised very high guaranteed rates of return, despite the high risk nature of the investments.

The FCA has also issued a final notice cancelling the permissions of BLFM for failing to satisfy its Threshold Condition 4 (the need to have appropriate resources). The Financial Services Compensation Scheme ("FSCS") is currently considering whether affected clients will be entitled to claim compensation. The FCA has issued a press release concerning this.

2. FCA TAKES ACTION AGAINST CATALYST INVESTMENT GROUP FOR RECKLESSLY MISLEADING INVESTORS

The FCA has published its final notice dated 30 September 2013 issued to Catalyst Investment Group Limited. The FCA took action against the firm for recklessly misleading investors when promoting bonds offered by ARM Asset Backed Securities SA.

Catalyst offered bonds issued by ARM to investment intermediaries and independent financial advisors ("IFAs") in the UK. In turn, these promoted and sold the products to retail investors. ARM, which is based in Luxembourg, had applied for a licence from the CSSF, the Luxembourg

Financial Regulator in July 2009. Catalyst knew this and also that the CSSF had asked ARM to stop issuing bonds in November 2009, pending the decision. Despite this however Catalyst continued to accept funds from investors without disclosing the ARM's position, or the risk that ARM could be liquidated if its licence application failed: facts which should have been included in Catalyst's marketing material for the bonds. Catalyst also suggested to investors that ARM's licence application was voluntary and made no mention of the implications if the licence application failed.

The FCA found that Catalyst had breached Principles 1 (Integrity) and 7 (Communications with clients). The FCA would have imposed a £450,000 penalty, but instead, Catalyst was censured because it is in default and unable to pay a fine.

The FCA also took action against three senior officers of Catalyst, Alison Moran, Catalyst's former compliance officer; Timothy Roberts, chief executive of Catalyst and director of ARM; and Andrew Wilkins, a former director of Catalyst. Timothy Roberts and Andrew Wilkins have both referred their cases to the Upper Tribunal.

3. GREEN & ANOTHER V THE ROYAL BANK OF SCOTLAND PLC

The judgment on the case was published on 9 October 2013. The case related to an appeal against a High Court decision, rejecting the claim that The Royal Bank of Scotland ("RBS") had mis-sold an interest rate swap to Paul Rowley and John Green, who were business partners. The Court of Appeal upheld the High Court's decision, rejecting the argument that RBS owed Mr Rowley and Mr Green a common law duty of care to ensure that they understood the nature of the risks involved in entering into the swap transaction.

You can read the judgment here.

4. FCA STATEMENT ON FOREIGN EXCHANGE MARKET INVESTIGATIONS

On 16 October 2013, the FCA published a statement on foreign exchange ("forex") market investigations.

The FCA is conducting investigations (together with a number of other agencies) into a number of firms relating to trading on the forex market. Pursuant to this, the FCA is gathering information from a wide range of sources, including market participants.

Whilst the FCA's investigations are at an early stage and it would be some time before the FCA concludes whether there has been any misconduct that will lead to enforcement action, this will be an important initiative to watch.

If you have any questions concerning the material discussed in this bulletin, please contact the following members of our financial regulation practice group:

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