COMPLYPORT
COMPLIANCE LEADERSHIP

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Regulatory Roundup

31 January 2011
Issue 25

In Brief:

FSCS Interim Levy: Additional charge for relevant firms to meet costs of consumer claims

Client Money: Barclays Capital fined £1.12m for client money failings

Remuneration Code Follow-up: Firms which are not broadly compliant must have in place a plan to rectify non-compliance

MiFID Review: Areas under consideration include High Frequency Trading and transaction reporting

Transaction Failings: City Index fined for transaction reporting failings

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If any of the topics discussed above raise questions or a need for guidance or support, please feel free to contact Peter Carlisle.

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FSCS Interim Levy

Useful links:

FSCS Letter

FSCS Press Release

FSCS Guidance

FSCS Exemption Form

Eligible Claimant

Keydata Investment Services Ltd

Reg Roundup 23

We are aware that several of our clients have been left reeling following receipt of an FSCS 2010/11 Interim levy request for further payment. The additional levy is to meet the costs of claims by consumers, chiefly in respect of Keydata Investment Services Ltd – it accounts for costs of £247m out of a total interim levy of £326m.

The costs are to be borne by FSCS 'Sub-Class' SD01 (Investments – fund management) and SD02 (Investments – intermediation). Because of the way that thresholds work, only £93m can be raised against 'intermediation' with the balance of £233m falling to 'fund management' (and payable within 30 days).

Firms that are FSCS exempt should not be subject to this interim levy. Although *all* firms are subject to pay an FSCS base cost, firms that do not undertake business that could give rise to a 'protected claim by an eligible claimant' can apply for exemption. It is important to differentiate between **'eligible claimant'** which relates to the FSCS and is covered in COMP 4.2 and **'eligible complainant'** which relates to FOS and is covered in DISP 2.7. It can be tortuous cross-referencing the various rules and definitions in the handbook but a high level summary would be that a **professional client** or eligible counterparty will **not be an eligible complainant** (DISP 2.7.9) but they **could be an eligible claimant.** The latter does not depend upon the client categorisation. COMP 4.2 (see 'Eligible Claimant' link) doesn't tell us what **is** an eligible claimant but rather tells us what **is not** an eligible complainant e.g. an authorised person or a large company will not qualify as an eligible complainant.

Any necessary exemptions from FSCS (and FOS) should have been dealt with at the authorisation stage. However a firm's business developments over the years may mean that whilst a firm was previously exempt, this is no longer the case (and vice versa). Although Complyport clients will already have the need to consider the relevance of any FOS/FSCS exemptions incorporated in any compliance monitoring programme that we have been asked to assist in implementing, firms may wish to give consideration to their FSCS status.

As you may be aware (e.g. see the link in Regulatory Roundup 23), the FSA provide a fees calculator which ordinarily allows firms to calculate/check their FSA/FSCS fees. Unfortunately, according to the website, it cannot be used for this levy.

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Client Money

Useful links:

[Reg Roundup 16]

[Final Notice - BarCap]

Not a good start to the year for Barclays. On top of the £7.7m fine for investment advice failings (Barclays Bank), Barclays Capital (BarCap) incurred a £1.12m fine for client money failings.

Although BarCap properly segregated client money overnight, when the deposits matured the following morning the funds flowed into BarCap's corporate account. It would remain there for between five and seven hours each day until the firm assessed the client money element which would then be segregated again and placed overnight, only for the cycle to continue. This happened over an eight year period; the highest amount at risk at any one time being £752m. As the press release mentions, should BarCap have become insolvent during that five to seven hour time period, the client money would have been at risk of loss. As is often the case, the firm discovered the co-mingling issue themselves. The discovery arose from a review following receipt of a Dear CEO letter last January, with the FSA being advised in March 2010. It was accepted that no clients of BarCap suffered any losses and nor did BarCap profit from the breach. The fine, before the traditional 30% discount, is the equivalent to 1% of the daily average amount of unsegregated client money. Although the fine is quite sizeable, it is only a shadow of last year's £33.3m fine against J P Morgan for client breaches – see Regulatory Roundup No 16.

Firms that do hold client assets are reminded that the FSA has set up a specialist unit to improve compliance with the regulatory regime to protect client assets. Although the majority of firms are in a different league to Barclays, relevant firms may consider this an opportune time to review their existing processes and procedures relating to the handling of client assets.

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Remuneration Code Follow-up

Useful links:
Reg Roundup 24

Firms should now be 'broadly compliant' with most of the Remuneration Code Principles in keeping with section 4.6 of PS10/20 'Revising the Remuneration Code' – see Regulatory Roundup 24 which also includes a link to PS10/20.

The one exception is Principle 12 ('Remuneration Structures') where firms coming into scope for the first time can take advantage of transitional provisions where compliance is required by 1 July 2011 at the latest (although Tier 3 & 4 firms can disapply several elements of Principle 12).

Firms are reminded that where any shortfalls are identified, a **time specific plan** to rectify them should be in place **by the end of January**.

It is also worth bearing in mind that the FSA will be sending out to **all firms** in scope a **data return** that will require firms to certify that they are compliant with the Code, as well as various data on remuneration policies and practices (see section 4.7 and onwards of PS10/20). Note that we are told that the FSA will review the data to determine whether anything might 'warrant further investigation'. It is expected that firms will be asked to supply this data during the **second half of 2011**.

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MiFID Review

Useful links:

[MiFID Review Consultation]

[MiFID Review FAQ]

[PERG Q40]

It is now over three years since MiFID came into force, the requirements being reflected in the relevant parts of the FSA handbook.

In recognition of market developments since that time, the European Commission (EC) has launched a **MiFID Review** consultation.

Areas under consideration (and as the paper is 83 pages it will be appreciated that the following are only highlights) include the proposed **power of the EC** to 'ban the provision of investment services and the carrying out of investment activities in certain financial instruments' in 'clearly specified conditions'. Power would also be given to national regulators to ban or restrict the trading/distribution of a product or the provision of an activity – and should it be deemed that they have not acted appropriately then **the EU will step in** (see section 9.1).

As will be appreciated, SYSC 4.3.2 concerns the need for a firm's senior personnel to receive frequent (at least annually) written reports which can be broadly summarised as concerning **compliance**, **internal audit** (subject to proportionality) and **risk**. The review (section 7.3.2) proposes that these functions **should report directly to the board** and that the **removal** of any of those responsible for these internal control functions would be **subject to prior board approval** and notification to the supervisor.

The same section also proposes that the compliance function has a specific involvement in complaint handling and that the compliance report to the board – as per the above – should specifically **summarise complaints** received and their treatment.

High Frequency Trading gets a mention (section 2.3), including those entities that currently do not need to be authorised. Article 2.1(d) of MiFID allows certain entities to escape the need for authorisation – PERG 13.5 Q40 covers this exemption. The proposal is that subject to a minimum threshold **all persons involved in HFT** would need to be authorised as an investment firm. HFT is a subcategory of **automated trading**. Firms involved in the latter will need to have in place robust risk controls to mitigate potential trading system errors, and **any firm providing sponsored access** to automated traders would also have to have in place robust controls and filters to detect errors or attempts to misuse facilities.

(cont.)

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MiFID Review (cont.)

Useful links:

MiFID Review Consultation

MiFID Review FAQ

PERG Q40

Transaction reporting is also under the microscope (section 6). Currently, under FSA rules (SUP 17.1.4), reportable transactions are those transactions executed in either a financial instrument admitted to trading on a regulated/prescribed market (even if the transaction was not carried out on such a market) or transactions in OTC derivatives where the value depends upon an instrument admitted to trading on a regulated/prescribed market. It is proposed that the **scope is extended** to include transactions in instruments that are traded on an **MTF** or on an organised trading facility (OTF). A similar extension would be applied to those financial instruments which themselves depend upon the value of an instrument traded on an MTF or OTF. In addition, **commodity derivatives** that are not admitted to trading on a regulated market or MTF or organised trading facility will also be **captured**, as will be **depositary receipts** if they are related to instruments trading on a regulated market, MTF or OTF.

The consultation ends 2 February. It is expected that the EC will present a proposal for amending MiFID in mid-May.

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Transaction Failings

Useful links:

[Final Notice – City Index]

[Reg Roundup 20]

[Reg Roundup 17]

City Index Ltd is the seventh firm to be fined by the FSA in the past 18 months or so for transaction reporting failures. The last transaction reporting case was against Societe Generale in August 2010 – see Regulatory Roundup 20 for further information.

Five of the six previous actions have resulted in fines in excess of £1m (Barclays holds the record so far with a fine of £2.45m); the City Index penalty was £490,000.

The firm was responsible for in excess of 2m reporting breaches (60% of reportable transactions), 97% of which was down to incorrect population of reporting fields with the balance of 55,000 breaches because of a failure to report.

Ironically, it was the submission of a **Suspicious Transaction Report** by City Index that first alerted the FSA to a discrepancy between a transaction reporting submission and information held by the FSA.

There were various reasons for the failings including the non-resubmission of rejections (poor staff training) and mixing up the 'sells' and 'buys' (new trading platform).

As is usual now, the Final Notice isn't all rules based. Apart from SUP 17 reporting breaches, the FSA found the firm had breached Principle 2 ('skill, care and diligence') by failing to identify errors in the set-up of the new trading platform process relating to transaction reporting and Principle 3 ('management and control') in not having in place adequate transaction reporting processes and procedures to ensure that it was fully compliant with MiFID.

Firms that undertake transaction reporting may wish to review their own transaction reporting procedures in the light of the Final Notice. Portfolio managers do, of course, have the possibility of using the exemption in SUP 17.2.2G. Firms may find reference to the Transaction Reporting User Pack (TRUP) and Market Watch 35 of use - please see Regulatory Roundup 17.

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Or for details of any other of Complyport's services, please contact [Philip Chapman]

Past issues of Complyport's Regulatory Roundup are available to view at http://www.complyport.com/pyPage?docId=roundups.

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