



# Regulatory Roundup

## 18 January 2012

### Issue 38



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**ESMA:** Compliance function guidelines

**CICA:** Final Notice issued to firm

**Fine End To The Year:** Total penalties down from 2010 to £66.14M

**Client Money: Auditor Failings:** PwC fined £1.4M

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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](#).

# Suitability: Draft Guidelines



## Useful links:

[Regulatory Roundup 28](#)

[Regulatory Roundup 31](#)

[ESMA CP Suitability](#)

‘Suitability’ can be found in COBS 9 of the FSA Handbook and is largely, although not exclusively, driven by MiFID requirements. As a reminder, the concept of suitability applies to a firm when making a personal recommendation or when managing investments and applies in respect of both retail and professional clients – albeit that certain assumptions can be made in respect of the latter (see COBS 9.2.8). As mentioned in previous Regulatory Roundups - e.g. issues 31 & 28 - the FSA has taken a great interest in “assessing suitability” with certain firms finding that they are subject to ongoing regulatory action.

A recent consultation paper (CP) issued by ESMA suggests that this is not simply a UK/FSA issue but rather that full and effective compliance with MiFID suitability requirements are not as consistent or as wide-spread across EEA member states as it could or should be. Areas of weakness noted include failing to collect the necessary information and failing to correctly interpret what information has been provided; overlooking the client’s education level; effectively letting the client decide on the suitability of an investment; and poor record keeping. (Please note, it appears that links to the ESMA website do not open on some web platforms. If you cannot access the document using the link please copy and paste the following address into your web browser: [http://www.esma.europa.eu/system/files/2011\\_445.pdf](http://www.esma.europa.eu/system/files/2011_445.pdf)).

The purpose of the CP is not to introduce new rules but rather to set out **guidelines** “to enhance clarity and foster convergence in the implementation of certain aspects of the MiFID suitability requirements”.

The guidelines include, but are not limited to, ensuring that the client actually understands the questions being asked; not relying unduly on the client’s own assessment of knowledge and experience (so presumably not simply asking the client to tick a box that best meets their needs etc.); and explaining to the client why certain questions are being asked and the importance of accurate and sufficient information.

The draft guidelines do not contain any radical proposals and probably many firms will already be following a similar approach. However with suitability being an FSA focus, firms should consider reviewing the (draft) guidelines in the light of their own business processes in order to identify – and if necessary remedy - any potential gaps. The consultation paper is fairly short (26 pages) and those firms that want to cut to the chase can go to section V on page 19. The consultation period ends 24 February. ESMA expects to publish its final report, and final guidelines, in Q2 2012.



# ESMA: Compliance Function Guidelines



## Useful links:

[ESMA Compliance Function](#)

**A productive time for ESMA: in addition to a consultation paper on suitability (see previous article), ESMA has also issued a consultation paper on guidelines relating to MiFID compliance function requirements.**

It is ESMA's belief that the financial crisis has highlighted the need for more clarification about the role of compliance. It also believes that compliance risk often takes second place to other risk areas within an investment firm. The purpose of the guidelines is to reinforce the **importance** of the compliance function and to "enhance clarity and foster convergence in the implementation of the MiFID organisational requirements relating to certain aspects of the compliance function".

Those firms that are familiar with e.g. SYSC 6.1 & SYSC 4.3 will probably find that the impact of the (currently draft) guidelines will be minimal but in any event firms may wish to review their current practices against the proposed guidelines (which can be found from page 22 onwards). Although the paper references MiFID requirements it is worth noting that the major elements of SYSC 6.1 & SYSC 4.3 are also directed at other firms, albeit as guidance rather than rules e.g. see SYSC 6.1.2A.

The guidelines include the need to: take a risk based approach; establish and maintain a suitable monitoring programme; and to send written compliance reports (page 8 of the paper suggests the matters which should be addressed in the written reports) to senior management. Other areas which are included – and which we sometimes find that some firms overlook – are the need to **include the compliance function** in the development of **relevant policies and procedures** and when there are **organisational changes**.

As mentioned in the previous article, links to the ESMA website do not appear to open on some web platforms. If you cannot access the document using the link please copy and paste the following address into your web browser: [http://www.esma.europa.eu/system/files/2011\\_446.pdf](http://www.esma.europa.eu/system/files/2011_446.pdf)).

The consultation period ends 24 February and ESMA expects to publish a final report, and final guidance, in Q2 2012.



**Useful links:**[Final Notice CICA](#)

Combined Insurance Company of America (CICA) had the honour of being the last firm to incur an FSA imposed financial penalty in 2011.

Although CICA's business is the provision of accident and sickness policies, many of the **failings identified** in the Final Notice would be **relevant** to a wider range of firms.

Most, if not all, of the findings have appeared in past Final Notices and include: remuneration by commission, thus **concentrating on sales volume** rather than quality; inadequate complaints handling, including ineffective use of **root cause analysis**; and failing to ensure that the necessary skills and knowledge were in place to ensure that customers received suitable advice. With regard to the latter the Final Notice informs us that whilst the induction course included a TCF test it had no pass mark and hence could not be failed. Furthermore the **competency assessment** was structured such that a candidate could fail all product questions and still pass.

As might be expected with a firm with mainly retail end users, the importance of treating customers fairly (TCF) appears several times (and with para 2.6(3) reminding all that **TCF** has been an **FSA priority** since 2004) with a key issue being a failure to embed a TCF culture within the firm.

Firms for which TCF is a relevant issue should note that the financial penalty imposed on CICA was **not determined by any customer detriment**. Indeed, the Final Notice advises that because of the failings the FSA was concerned that customers **may** have suffered financial detriment, although it has not made any findings in this regard nor made any findings of customers being sold unsuitable products or suffering detriment – CICA has agreed to an independent review of past business being carried out. In addition such firms should also note from para 6.7 of the Final Notice that the FSA considered that the imposition of a “**significant financial penalty**” was necessary in order to “... **encourage TCF compliant behaviour...**” by other firms.

The firm was subject to a financial penalty of £2.8M – it would have been £4M if it had not qualified for the usual Stage 1 30% discount.

# Fine End To The Year

## Client Money: Auditor Failings



### Useful links:

[FSA Fines Table 2011](#)

**As mentioned in the article concerning Combined Insurance Company of America, the latter's Final Notice was the last published in 2011 and brought the total of financial penalties incurred by miscreant firms to £66,144,839.**

2010 remains the record year where the total was £89,121,281.50 (if you're wondering, the 50p is down to the penalty of £66,062.50 imposed on Andre Scerri for market abuse), although this figure included several large penalties including Goldman Sachs (£17.5M); and J P Morgan (£33.32M).

The link will take you to the FSA's database of fines.

### Useful links:

[AADB Decision](#)

[Regulatory Roundup 16](#)

**It may be recalled that the Client Money failings at J P Morgan Securities Ltd (JPMSL) resulted in an eye-watering financial penalty of £33.32M being imposed by the FSA in June 2010 (see Regulatory Roundup 16).**

The failings, concerning the segregation of client money, occurred over the period 1 November 2002 to 8 July 2009. In the seven financial years within that 'Relevant Period' the financial statements were audited by PwC. In that time, PwC had complied with SUP 3.10.4 and SUP 3.10.5 which essentially requires a firm's auditor to submit an annual client assets report to the FSA confirming that the firm has been in compliance with all the client money/custody rules and that it maintains adequate systems in place to comply with those rules (or, where applicable, confirm that the firm does not hold client money/assets). Ironically it was JPMSL that discovered its client money failings and not PwC – the latter confirming every year that there were effectively no client money issues.

The Accountancy and Actuarial Discipline Board (AADB) issued a formal complaint against PwC (obviously the FSA would have no jurisdiction over the auditor) for conduct falling short of expected standards.

The AADB considered various penalties which could be imposed on PwC. The penalty of £33.32M imposed on JPMSL by the FSA represented 6.9% of the firm's after tax profits in the year it was levied. A similar proportion of after tax profits at PwC would be £44.3M, representing £40,634 per member. After discussions a fine of £1.4M, plus costs, was imposed on PwC for its failings.



# Insider Dealing



## Useful links:

[Insider Dealing](#)

The FSA has issued a brief press statement to the effect that Richard Joseph has been charged with eight counts of insider dealing and two counts of money laundering.

Mr Joseph is currently on bail and will next appear at Southwark Crown Court on 6 March.

The article advises us that the FSA has secured **11 convictions** to date in relation to insider dealing and is currently **prosecuting 15** other individuals for insider dealing – see the link for further details of those cases.





## Useful links:

[Past issues](#)

[Searchable archive](#)

Past issues of Complyport's Regulatory Roundup are available to view using the link provided.

You can access a searchable version of our Regulatory Roundup archive by clicking on the link.

The Regulatory Roundup archive allows search in three modes: by topic; by issue number; or by text search.

If you are using the text search for more than one word or a consecutive phrase the use of " " will help speed your search e.g. a search for "regulatory fees" will ensure that only articles that contain that term are found (rather than articles containing the words 'regulatory' and/or 'fees').

Please note that there is a small time-delay between the publication of the latest Regulatory Roundup and its availability in the searchable archive.



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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](#)**

**Or for details of any other of Complyport's services, please contact [Jon Wedgbury](#)**

**Complyport is always interested to receive feedback and general comments on either the Regulatory Roundup or the Complyport website. Comments can be sent to [info@complyport.co.uk](mailto:info@complyport.co.uk)**

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