RQC Group Quarterly Regulatory Newsletter April 2021

Introduction

Welcome to our Q1, 2021 newsletter. This is part of a series that aims to provide you with a quarterly update of key regulatory issues affecting the UK/EU and the USA.

As the dust settled after Brexit, attention turned to the ongoing practicalities of UK and EU market participants conducting business in each other's jurisdictions. Will there be a conscious uncoupling or a messy divorce? The stated UK intention to obtain swift 'equivalence' determinations, potentially facilitating cross-border activity, has not yet come to fruition. Although there has been some superficial mud-slinging, relations between the various countries have remained cordial. Connected to this is the extent to which the UK's regulatory framework will diverge from the EU's in 2021. There are a myriad of factors to consider, including the nuances of the UK's legal system, the way in which legislation is enacted, the role and functioning of the UK regulators, including the FCA and the sheer importance of financial services to the UK economy. Will we see a 'Singapore-upon-Thames' light touch regulatory framework? Probably not. However many market participants will hope that after the piling up of a series of EU legislative initiatives, with both inter-locking and contradictory elements, regulation will become more efficient.

With the new-year, the U.S. saw a definitive shift in approach to climate change and other environmental concerns. Upon taking office, President Biden signed an executive order returning the U.S. to the Paris Agreement. With the tone set, various executive actions followed and the focus continues this spring in April with the U.S. hosting the Leaders Summit on Climate. U.S. regulators have also increased resources to address Environment, Social, and Governance ("**ESG**") matters. The appointment of Satyam Khanna as a Senior Policy Advisor for Climate and ESG and the development of the Climate and ESG Task Force, within the Division of Enforcement, will allow the SEC to better understand how these issues relate to the current regulatory framework. We eagerly await additional guidance from both the SEC and CFTC in relation to compliance requirements affecting asset managers, including investor disclosure expectations.

As ever, we hope that you enjoy reading our newsletter and that you find it helpful. If you have any feedback please share it with your consultant.

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UK/EU - Ongoing Developments

Turning regulatory themes into priorities: A conundrum facing firms

A significant challenge for firms regulated by the UK Financial Conduct Authority (FCA) is establishing and maintaining internal mechanisms to appropriately manage the regulatory risk pertaining to their business activities.

There is a huge volume of regulatory requirements. The FCA Handbook is divided into 54 'sourcebooks'; many of these comprise hundreds of pages. There is also relevant legislation that is not included in the FCA Handbook, including legacy EU regulations which had direct effect (and continue to apply) in the UK. Firms have the unenviable task of working out which parts of the regulatory framework applies to them, and which elements should be prioritised.

The FCA seeks to provide guidance to firms on how to do this. Via publications and speeches, it frequently signals its regulatory priorities. Over the past 12 months, two general themes have emerged. The first is that Covid-19 has changed the regulatory risk profile of most (it not all) FCA regulated firms, and it expects such firms to react accordingly. The second is that Covid-19 should not cause firms to lower their standards; notwithstanding additional challenges faced by firms due to the pandemic.

As well as providing guidance, the FCA supervises firms and it can direct firms to correct deficiencies – which can be a costly and time-consuming task. It also has significant enforcement powers. For instance, it can sanction both firms and individuals within firms, and bring criminal prosecutions.

There are various specific regulatory topics that have been recently highlighted by the FCA. These include:

Market Abuse:

Market abuse is concerned with unlawful behaviour on the financial markets, and includes insider dealing and market manipulation.

Firms are expected to maintain, and update as applicable, a market abuse risk assessment, and to put in place additional measures such as processes to identify actual instances of market abuse, restricted lists/insider lists, information barriers, personal account dealing rules and recording telephone lines.

The increased market volatility at the start of the lock-down prompted the FCA to comment on the correlation between such volatility and market abuse risk.

More recently, the 'GameStop incident' has prompted commentators to consider the linkage between social media forums and market manipulation.

At any one time, the FCA is investigating hundreds of potential instances of market abuse. In March 2021 the FCA sanctioned a proprietary trader for 'wash trading' (a type of market manipulation). In February 2021 the FCA instigated two separate criminal prosecutions for insider dealing. In December 2020 the FCA sanctioned a hedge fund portfolio manager for market manipulation. On that occasion the wrongdoing was identified by the FCA's internal surveillance systems.

The FCA has also sanctioned firms for having inadequate market abuse systems and controls.

Financial crime:

Financial crime includes money laundering, terrorist financing, bribery and fraud. Covid-19 has made it more difficult to monitor instances of financial crime, due to remote working. There are increased opportunities for criminals to exploit weaknesses in a firm's anti-financial crime systems and controls framework.

Financial crime is an important regulatory topic, due to the adverse impact of such crimes on wider society, and the significant number of ways that the financial services industry could be used as a conduit

for such crimes. There is also a risk to individuals within the industry due to the various criminal offences that they could commit. (For example, one does not need to be an actual money launderer in order to commit a money laundering criminal offence!)

The FCA therefore expects firms to react to the challenges posed by Covid-19, for example, ensuring that customer due diligence processes remain fit-for-purpose.

Cyber Security:

Cyber security was a regulatory 'hot topic' pre-Covid-19; the pandemic has served to further increase cyber security risks.

This is in part due to the increased prevalence of remote working, leading to difficulties in setting and reviewing security protocols. Anecdotally, there are more 'cyber criminals' in part since other criminal activity has become unavailable to them, due to lockdowns.

It has become vitally important for individuals to identify the main types of cyber security risks and to take appropriate action.

Conduct, culture and accountability:

The regulatory initiative to improve standards of conduct and culture, and to revise the parameters of individual accountability, is long-standing. For most FCA authorised firms, a watershed moment was the implementation of the Senior Managers and Certification Regime (SMCR) in December 2019. Among other things, SMCR sets a framework of accountability for senior managers and for the first time creates a code of conduct for almost all individuals working in the financial services industry.

Certain aspects of SMCR are subject to a transitional phase which expired on 31 March 2021. Thereafter, the regulatory expectation is that firms will have implemented SMCR in full. Arguably, the transitional phase has also been a 'grace period', to enable firms to get to grips with the new regime. However, given the importance that the FCA is placing on individual conduct and accountability, it's anticipated that the FCA supervisory effort will now shift its focus to SMCR, and enforcement action could follow.

SFDR takes effect – uncertainties remain for non-EU firms

The European Union has been one of the front runners with respect to establishing a sustainable finance framework. In 2018, the European Commission adopted an "Action Plan on Financing Sustainable Growth". This seeks to further connect finance with sustainability by setting out actions that can be divided into three categories:

- Reorienting capital flows towards a more sustainable economy
- Mainstreaming sustainability into risk management
- Fostering transparency and long-termism

Pursuant to this, the European Commission adopted a package of measures including the Sustainable Finance Disclosure Regulation ("**SFDR**"), which took effect on 10 March 2021. This requires financial institutions to make various disclosures on their website and in documentation related to a financial product, which includes portfolio management and investment advisory services, AIFs, and UCITS funds. Such firms must also ensure that marketing materials do not contradict these disclosures. See page 4 of our 2020 Q3 Newsletter to read our earlier article on the detail of SFDR.

Significantly, these SFDR has the potential to impact on firms that do not have a specific focus on sustainability. For example, a fund manager that employs strategies where sustainability is not a core focus but is factored into investment decision-making and risk management, might be impacted.

- **Extra-territorial impact**

The applicability of SFDR to firms outside of the EEA (including the UK, which opted to not adopt SFDR post-Brexit) is not clear-cut.

On January 7, 2021, the European Supervisory Authorities wrote a letter to the European Commission with a number of fundamental threshold questions relating to the application of the SFDR, including the following:

"Does SFDR apply to non-EU AIFMs, for example when they market a sustainable EU Alternative Investment Fund under a [EU] National Private Placement Regime?"

This question focuses on non-EU Alternative Investment Fund Managers ("**AIFMs**"), including those based in the UK, marketing a sustainable EU Alternative Investment Fund ("**AIF**"). It does not directly address other scenarios including: non-EU AIFM markets a non-EU AIF; non-EU AIFM markets a non-sustainable AIF; non-EU firm that is not an AIFM markets a product or service. However, it could be construed that this question is a proxy for the nature of SFDR's extra-territorial impact in the wider sense.

In the absence of a definitive response from the European Commission, which to date has not been forthcoming, firms outside of the EEA, that either market its products or services into the EEA or have EEA-based clients, have adopted a number of approaches with respect to whether or not to comply with SFDR and if the former, how SFDR applies to them.

Some commentators have opined that 'product level disclosures' (i.e. pre-investment and periodic disclosures) should apply since these are equivalent to other disclosure requirements which apply to non-EEA firms. For example, a non-EEA firm that is an AIFM and is seeking to market an AIF in the EEA, is obliged to comply with the disclosure requirements in AIFMD. Hence the SFDR disclosures are seen to be an 'extension' of these other disclosures.

Among the commentators opining that product level disclosures apply, there is not a consensus on the applicability of the 'firm-level disclosures' (i.e. website disclosures).

Some firms have considered these disclosure requirements from a commercial as distinct from a regulatory perspective i.e. having regard for the expectations of clients, investors and other stakeholders.

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- **UK Framework**

The UK is implementing a multi-industry framework for making climate-related disclosures – see page 5 of our 2020 Q4 Newsletter for our earlier article on this. Whilst these disclosures focus on a narrower range of issues compared to SFDR, there remains the potential for a financial institution to become subject to a plethora of regulatory disclosure requirements, dependent upon where they are domiciled, or performing investment or promotional activity. A key challenge for legislators and regulators is to ensure that the frameworks are neither unnecessarily duplicative nor overtly burdensome, to the extent that the disclosures lose their true meaning.

UK/EU - Regulatory News

FCA announces it will consult on SPACs

31 March 2021

The FCA has announced that it will be consulting on amendments to the Listing Rules and related guidance to strengthen protections for investors in Special Purpose Acquisition Companies ("**SPACs**").

A SPAC is a shell corporation that is listed on a stock exchange in order to purchase a private company. Therefore the company can issue financial instruments to the public without having to go through an initial public offering ("**IPO**") process.

SPACs have existed since the 1990's but have recently become increasingly prevalent, with exponential growth in the value of SPAC IPOs over the past 2 years.

The FCA's announcement follows a government report on reforming the UK's listing rules which covers both the need for the UK to be an attractive market-place for SPACs with the necessity for them to be appropriately regulated.

The FCA's consultation will consider the structural features and enhanced disclosure, including a minimum market capitalisation and a redemption option for investors, required to provide appropriate investor protection.

In addition, there is currently a presumption of suspension of the listing of SPACs at the point of announcement of an acquisition target. The FCA opines that this will no longer be required, and the consultation will cover this aspect.

The FCA is aiming to make the new rules and/or guidance by early summer 2021.

UK quoted companies: New online portal for TR-1 Form notifications

29 March 2021

The recent edition of the FCA's Primary Market Bulletin ("**PMB 33**") published on 29 March 2021 contains some helpful information on the new portal for submitting major shareholdings notifications ("**TR-1 Form**") which went live on 22 March 2021.

This is relevant to companies with shares admitted to listing (Premium and Standard segments) and to companies with shares admitted to trading on AIM. DTR 5 (Vote Holder and Issuer Notification Rules) applies to an issuer whose shares are admitted to trading on a regulated market and to an issuer whose shares are admitted to trading on a prescribed market (which includes AIM).

- **What's the new process?**

PMB 33 notes that under the new process, holders and persons reporting on their behalf will be required to complete a two-step registration to gain access to the FCA's Electronic Submission System ("**ESS**") and the new "Major shareholding" reporting section within that system. To submit notifications to the FCA, holders must complete an electronic TR-1 Form. This is available on the "Major shareholding" reporting section of ESS.

- **Can we still submit completed TR-1 Forms by email?**

No. TR-1 Forms are not accepted by email. The FCA will only consider notifications sent via the new portal for the purpose of monitoring compliance with the reporting requirements under DTR 5.

- **What about submitting TR-2 Forms by email?**

Notifications for the market making exemption (TR-2 Form) can still be submitted by email to majorshareholdings@fca.org.uk

- **What are the benefits of the new system?**

In the FCA's view, the new online portal is a more efficient way to give the FCA information on holdings of voting rights in issuers. It will also give holders and their reporting persons the ability to:

1. Search the system by ISIN and issuer name
2. complete and download an electronic TR-1 Form, that can be also sent to the issuer of the relevant shares for publication via a regulatory announcement
3. Upload CSV files to report holdings of voting rights held via financial instruments
4. Access reference numbers on completion of submissions
5. Search and view historical TR-1 Form submissions and amend them at any time
6. Create a "My Notifications" bookmark to view the notifications relevant to holders and persons reporting on their behalf

EU Short Selling Regulation

15 March 2021

In March 2020, the European Securities and Markets Authority (**"ESMA"**) lowered the initial private disclosure threshold for net short positions in shares under the EU Short Selling Regulation to 0.1% (from the usual 0.2%) of the issued share capital. This emergency measure was first introduced due to the increased market volatility resulting from the onset of the COVID-19 pandemic and was renewed by subsequent decisions published by ESMA in June, September and December 2020.

On 15 March 2021, ESMA announced that it would allow its latest renewal decision to expire. The final trading day on which the 0.1% threshold applies was 19 March 2021. Thereafter, position holders should revert to reporting only if their net short positions reach or exceed 0.2%.

By contrast, net short positions in relation to UK-listed shares will continue to be subject to the initial threshold of 0.1% until further notice. Following the end of the Brexit transition period, new regulations took effect in the United Kingdom amending the initial disclosure threshold generally to 0.1%. Notifications in the United Kingdom are made through the FCA's Electronic Submission System.

The initial public disclosure threshold for net short positions in both EU and UK-listed shares remains at 0.5%.

FCA publishes equity transparency results

15 March 2021

As required by the Markets in Financial Instruments Regulation ('MIFIR') (as transposed into UK law), the FCA has published the annual equity transparency calculations. These calculations are available through 'FCA FITRS' (Financial Instrument Transparency Reference System) (Equity: https://data.fca.org.uk/#/fitrs/fitrsEquity; Non-equity: https://data.fca.org.uk/#/fitrs/fitrsNonEquity), the FCA's transparency calculations publications database.

The calculations include:

- The liquidity assessment
- the determination of the most relevant market in terms of liquidity (MRM)
- The determination of the average daily turnover (ADT) relevant for the determination of the pre-trade and post-trade large in scale (LIS) thresholds
- The determination of the average value of the transactions (AVT) and the related the standard market size (SMS)
- The determination of the average daily number of transactions (ADNTE) on the most relevant market in terms of liquidity relevant for the determination of the tick-size regime

Based on the calculations, the FCA assessed 497 shares and 341 equity-like instruments (a category that includes Exchange Traded Funds, depositary receipts and certificates) as having a liquid market.

FCA announces dates for end of LIBOR settings

05 March 2021

The FCA has confirmed that all LIBOR settings will either cease to be provided or will no longer be representative:

- Immediately after 31 December 2021, in the case of all sterling, euro, Swiss franc and Japanese yen settings, and the 1-week and 2-month US dollar settings
- Immediately after 30 June 2023, in the case of the remaining US dollar settings

The FCA does not anticipate that LIBOR settings will become unrepresentative before these dates, based on undertakings from panel banks. Representative rates will not be available beyond the dates above and publication of LIBOR settings will cease after these dates.

The announcement confirms the importance for firms relying on LIBOR to prepare for the change away from this benchmark. The FCA is likely to engage further with firms to ensure the transition timelines are met.

The FCA will consult in Q2, 2021 regarding certain LIBOR contracts that are difficult to amend ahead of LIBOR panels ceasing, and will seek to use new powers under the Benchmark Regulation to require continued publication of 'synthetic' LIBOR settings for certain so-called 'tough legacy' contracts.

In a further development on 29 March 2021, the FCA and Bank of England announced that they support and encourage liquidity providers in the sterling non-linear derivatives market to adopt new quoting conventions for inter-dealer trading based on SONIA instead of LIBOR from 11 May 2021. This is to facilitate a further shift in market liquidity toward SONIA, bringing benefits for a wide range of users as they move away from LIBOR.

New online fees portal

04 March 2021

The FCA has announced the launch of a new online invoicing portal on 12 April 2021 for users to access their invoices and arrange payment of their fees.

The existing Online Invoicing portal is no longer available after 31 March 2021.

The new online portal will be reached using the 'FCA Connect' login details.

Update on the Double Volume Cap

05 March 2021

The FCA has published a revised version of its Statement of Policy regarding the Double Volume Cap ("**DVC**").

The DVC is designed to limit levels of dark trading in equities, by limiting the level of dark trading to a certain proportion of total trading in an equity.

The FCA's temporary power under UK MiFIR allows it to choose to apply the DVC if this is considered necessary to advance its integrity objective, e.g. if dark trading is harming the ability to markets to make well informed decisions.

The FCA has previously determined not to automatically apply the DVC to UK equities, and is now extending this to all equities.

The regulator states that, relation to instruments with "significant trading on trading venues in another jurisdiction as well as in the UK", it will be willing to replicate suspensions of relevant pre-trade transparency waivers announced in that jurisdiction, if that jurisdiction makes an equivalence decision in respect of the UK.

MiFID II: product governance review

26 February 2021

The FCA has conducted a review of product governance in a sample of 8 asset management firms.

Product governance is a concept introduced by MiFID II in 2018. It requires firms to follow certain requirements when acting as the manufacturer or the distributor of a financial product or service.

The asset management firms sampled had assets under management ranging from £2 billion to over £100 billion, and the products selected for review were collective investment schemes made available to the retail public.

The FCA concluded that some asset managers are not undertaking activities in line with the product governance regime. As a result, there is significant scope for asset managers to improve their product governance arrangements.

A key finding was that asset managers and product distributors need to prioritise effective cooperation and information sharing to address the potential harm to consumers from poor product design and distribution processes.

The FCA grouped its key observations into 4 main areas: product design, product testing, distributors and governance & oversight.

The FCA advised that they are likely to undertake further work on this subject. Whilst the focus of this review was on retail financial products, certain observations are also applicable to other product types, including with respect to conflicts of interest, scenario and stress testing, due diligence on, and communications with, product distributors, and record-keeping arrangements.

EU publishes draft UK data protection adequacy decision

19 February 2021

The European Commission has published a draft decision on adequacy in data protection under the General Data Protection Regulation (GDPR). If this is agreed, it will again introduce a legal basis on which data can be transferred from the EU to the UK.

During the transition period, up until 31 December 2020, data transfers from the EEA to the UK were treated almost as taking place between member states. And, under the current trade agreement, transfers of personal data continue to be permitted for a period of at least four months.

If the draft adequacy decision is passed, it will replace the current transitional arrangement, and the UK will be treated as an EEA member for data transfers, for a period of four years.

FCA review on implementing technology change

05 February 2021

The FCA has published a review on how firms implement technology change, the challenges caused when changes fail, and steps firms can take to protect consumers from harm and disruption in the market.

The review found that failed technology changes are one of the main causes for operational disruption within firms, accounting for a quarter of all high severity incidents that cause harm to consumers and the market.

Furthermore, changes made by firms with strong governance and risk management strategies are more successful, that robust testing is an important part of the change process, and while testing automation has benefits it also presents challenges.

ESMA finalises rules on standardised information to facilitate cross-border distribution of funds

01 February 2021

The European Securities and Markets Authority ("**ESMA**") has published a final report on Implementing Technical Standards ("ITS") under the Regulation on cross-border distribution of funds. The ITS focus on the publication of information by National Competent Authorities ("**NCAs"**) on their websites, the notification of information by NCAs to ESMA and the publication of information by ESMA on its website.

The final report and draft ITS largely reflect the original consultation proposals, focused on the information to be published on NCAs websites regarding the national rules governing marketing requirements for funds, and the regulatory fees and charges levied by NCAs in relation to fund managers' cross-border activities.

The draft ITS also include provisions on the communication of information by NCAs to ESMA for the purpose of developing and maintaining a central database listing UCITS and AIFs marketed cross-border on ESMA's website.

The updated cross-border distribution regime takes effect on 2 August 2021. Among other things it introduces the concept of 'pre-marketing' to AIFMD.

It is likely that the UK will not adopt this regime, however UK firms seeking to make collective investment schemes available to EU investors might be affected.

ESMA consultation on appropriateness and execution-only rules

29 January 2021

The European Securities and Markets Authority ("**ESMA**") has published a consultation paper: 'Guidelines on certain aspects of the MiFID II appropriateness and execution-only requirements.'

Under MiFID II, investment firms are required, when providing 'non-advised' services, to ask a client for information regarding his knowledge and experience relevant to the product or service. If the client does not show sufficient experience, the firm must warn the client. Under Article 25(4), under certain conditions, firms may provide non-advised services relating to non-complex product. When doing so, a firm must again warn a client that it is not required to undertake an appropriateness assessment, and the corresponding loss of investor protection.

In 2019, ESMA launched a common supervisory action ("**CSA**"), asking 24 national competent authorities ("**NCAs**") to carry out a review. Following a set series of questions relating to appropriateness and execution-only, NCAs surveyed relevant firms.

The CSA showed insufficient convergence between the member states in the understanding and application of the rules and hence a difference in investor protection across the EU. Therefore, ESMA decided to develop guidelines to enhance clarity and convergence in the application of the rules.

The Consultation Paper takes as a starting point ESMA's guidelines on suitability requirements, and adjusting these to the appropriateness and execution-only rules.

The consultation period closes on 29 April 2021.

FCA statement on recent share trading issues

29 January 2021

The FCA has published a statement that notes that share trading in volatile markets is risky, and that investors risk losing money; losses that are most likely not covered by the Financial Services Compensation Scheme ("**FSCS**"). It also notes that broking firms may withdraw services in line with their customer terms and conditions if they consider this necessary or prudent, and that periods of high transaction volume and price volatility may lead firms to make this decision.

The FCA also notes that it will itself take appropriate action where it sees evidence of firms or individuals causing harm to consumers or markets.

While not mentioning any names, it is reasonable to think that the FCA issues this statement in light of the activist-like trading activity of retail investors in GameStop and AMC. After days of small, retail investors buying shares in the two shares, several of the trading platforms closed down the possibility for these investors to continue add to their positions. The FCA is clearly monitoring the situation, and will intervene when it sees fit. The question is how soon or how late in the day this will be.

FCA, PRA and FRC issue joint statement on continued extended financial information timelines

27 January 2021

The FCA, Prudential Regulation Authority ("**PRA**") and Financial Reporting Council ("**FRC**") remind firms that certain measures remain in place which provides some flexibility to firms, including allowing

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listed companies two additional months to publish their annual audited financial statements. This is due to the ongoing coronavirus pandemic and the circumstances arising from this, including the new UK national lockdowns.

The FCA reminds investors and users of financial information that reporting timetables might be extended for the above reason and to take into account the context of any such delays.

The FCA also again reiterates the continued necessity to remain vigilant in terms of market abuse. The Market Abuse Regulation (MAR) remains in force, and the regulator again reminds firms of their obligations under the regime, including any need of listed companies to disclose, or any valid reason to delay disclosure.

Private companies, asset managers and fund managers should also take heed and ensure that all of their systems and controls around market abuse remain appropriate.

Clone Wars – a warning to the public, and to financial institutions

27 January 2021

If we talk about the Attack of the Clones – for some, it may conjure up high-budget battle sequences set in a galaxy far, far away – but back here on Earth, it seems to be the virtual fight we just can't win.

At the start of 2021, the FCA published a stark warning to the public about the proliferation of clone firm investment scams; fake investment firms set up by scammers to dupe consumers in parting with their money through the fraudulent use of a legitimate regulated entity's identifying information, e.g. name, address or even their FCA 'Firm Reference Number'.

It was revealed that from March 2020 to April 2020 the overall number of these scams rose a staggering 29% and during the 2020 calendar year over £78 million was stolen from consumers targeted by such scams.

Furthermore, it's not just the more well-known companies that have been scammed. Smaller firms have also been victims.

The rise of such investment scams will likely not come as a shock; not least, because over the last year regulators have continued to beat the drum of cyber resilience and continuously reiterated the need for firms to ensure that cyber controls are effective, and that employees remain vigilant to potential threat.

Yet, clone firms raise the issue that we need to consider the threat of overlap as much as divergence. Where possible preventative measures, such as identifying firms sharing similar domain names, regulatory reference numbers or addresses, should be embedded into the current cyber threat and vulnerability framework.

And whilst we have seen positive moves from regulators proactively identifying clone firms and publicly blacklisting them; for investment firms that fall victim to the cloning process it is a reputational risk that requires swift action. Notification to relevant regulators, police and fraud agencies are key to raising awareness as well as posting disclosures on their legitimate website and contacting domain hosts to share concerns are all recommended actions to stop these clones taking over.

But prevention is undoubtedly better than cure, and awareness through cyber training has a huge role to play to that end – click here to find out more about our suite of CPD-certified Cyber Security online training courses for UK Investment Firms.

FCA reminds firms to regularly review regulatory permissions

18 January 2021

The FCA is reminding firms of their obligation to regularly review regulatory permissions to ensure they are up to date and removed where they are not needed. The FCA expects Firms to notify them of any material changes and apply to make any necessary changes in a timely way.

They also highlighted that they have the power to cancel a firm's Part 4A permission if it has not carried on a regulated activity for at least 12 months, and have no current plans to do so, by applying for the cancellation using Connect.

The FCA has reminded firms about reviewing their permissions - and maintaining only those that are required to ensure the firms continue to meet their threshold conditions, are demonstrating effective oversight of their business and meeting their obligations under the Senior Managers Regime and are providing accurate information to consumers.

Firms are also reminded that they are required to make an annual attestation that the information held on the Financial Services Register is accurate.

Why is the FCA reminding firms now?

Due to new powers in the Financial Services Bill, which is currently making its way through Parliament, the FCA will be able to act more quickly if they consider firms are no longer carrying out regulated activities. With the new powers, the FCA will be able to serve notice on the firm, asking for a written response within 14 days. If the firm does not respond they will be able to publish a second, public notice, explaining it appears that the firm is not carrying on a regulated activity. The FCA can then vary or cancel the firm's permissions after 1 month.

This has potential implications – for instance - for firms that carry out certain regulated activities on a regular basis and others on a more ad hoc basis, or are largely dormant to be utilised should the opportunities arise. For example, many alternative investment fund managers have the ability to manage both alternative investment funds and segregated accounts, notwithstanding that the latter might not be activated at any given time. In part, this is an artificial construct caused by the juxtaposition of AIFMD (an EU initiative) and the UK's regulated activities regime. Nonetheless this presents a potential challenge for firms and the FCA alike.

ESMA reminds firms of MiFID II reverse solicitation rules post-Brexit

13 January 2021

The European Securities and Markets Authority ("**ESMA"**) has issued a statement concerning what it calls "questionable practices" by firms following the end of the UK transition period on 31 December 2020.

ESMA reminds firms that, while reverse solicitation, i.e. a client initiating "at its own exclusive initiative the provision of an investment service or activity by a third-country firm", is provided for in Article 42 of MiFID II, this does not extend to situations where a third-country firm does in fact "solicit clients or potential clients in the Union or promotes or advertises investment services or activities together with ancillary services in the Union". This includes cases of contractual disclaimers or 'pop-up' tick boxes on websites, which are clearly designed to eschew the rules around solicitation.

The ESMA statement focusses on MiFID investment activities, however the concept of 'reverse solicitation' is often applied within the AIFMD framework, meaning the procurement of EU investors in the absence of 'marketing' activity as defined in AIFMD.

The statement might signal a clamping down on inappropriate 'reverse solicitation' practice by EU regulators.

Market Watch 66

11 January 2021

The FCA has published Market Watch 66, the latest edition in its series of communications on market conduct and transaction reporting.

The FCA reiterates its expectation that firms should continue to comply with their recording obligations. The regulator calls for firms to be vigilant around the increased use of unmonitored or unencrypted messaging platforms, such as WhatsApp, for sharing sensitive information. Firms need to ensure that the use of apps for in-scope activities, such as arranging deals and dealing, must be recorded, auditable and actively monitored.

The publication details areas of review for firms, including identification of communications that need to be recorded, ensuring that up-to-date recording policies are in place and training is provided on a firm's policies and procedures.

Firms should ensure they have reviewed their recording processes to ensure they operate effectively and take into consideration any increased risks given changes to the working environment over the last year. There is an emphasis on Senior Managers to engage in this process to ensure that they have established and implemented a robust culture of compliance and governance framework.

FCA publishes coronavirus financial resilience survey data

04 January 2021

The FCA has published the results of its financial resilience survey, which was sent to 23,000 FCA regulated firms.

The survey looked into the effect of the pandemic on firms' solvency.

Among other things the survey found:

- The asset management sector experienced a small decrease (2%) in available liquidity
- 59% of firms expected coronavirus to have a negative impact on their net income
- The retail lending sector saw the greatest decrease in profitable firms
- This sector had also made most use of the available government support (49% of Retail Lending firms had furloughed staff and 36% had received a government backed loan). By way of comparison, in the asset management sector 8% had furloughed staff and 3% had received a loan

UK/EU - Enforcement

FCA ramps up market abuse enforcement action

Following a hiatus, market abuse enforcement activity involving the FCA has returned to the fore. There has been a number of civil and market abuse cases, following on from the fine for Corrado Abbattista, a former hedge fund portfolio manager, over market manipulation, in late 2020.

5 March 2021

The FCA has fined and prohibited Mr Adrian Geoffrey Horn £52,500 for market abuse and prohibited him from performing any functions in relation to regulated activity.

Mr Horn was a market making trader at Stifel Nicolaus Europe Limited ("**Stifel**"). Following an investigation, the FCA found that Mr Horn engaged in a series of "wash trades" in the share McKay Securities Plc ("**McKay**").

Mr Horn intentionally placed buy orders in McKay shares that traded with his existing sell orders (and vice versa). In total, Mr Horn executed 129 wash trades during the period 18 July 2018 to 22 May 2019. Mr Horn entered orders into the market in such a way as to try and avoid anyone detecting that he was wash trading.

Mark Steward, Executive Director of Enforcement and Market Oversight, said:

'Mr Horn's manipulative trading was serious. Wash trading is a form of manipulation which undermines market efficiency and integrity. 'The FCA has also developed ways to detect this type of manipulation as well as other forms of market abuse and, as this case demonstrates, we will take robust action against such abuse.'

16 February 2021

Mohammad Zina, an analyst at Goldman Sachs, and his brother, Suhail, formerly a lawyer at Clifford Chance have been charged with six offences of insider dealing and three offences of fraud.

The insider dealing offences relate to trading in ARM Holdings plc, Alternative Networks plc, Punch Taverns, Shawbrook plc, HSN Inc and Synder's Lance Inc between July 2016 and December 2017, culminating in a profit of £147,000.

The brothers also face charges relating to fraud due to loans of £95,000 being taken out from Tesco Bank.

It was said that the loans were for home improvements, but were allegedly used to finance the insider dealing activity

11 February 2021

The FCA has commenced a criminal prosecution against Stuart Bayes and Jonathan Swann for insider dealing. Mr Bayes has also been charged with improperly disclosing inside information, or encouraging another, whilst being an insider, to engage in dealing.

The alleged offending took place between 2 May 2016 and 10 June 2016 and involved trading in shares in British Polythene Industries plc ("**BPI**"), ahead of an announcement that RPC Group plc was to acquire BPI. During this period, Mr Bayes was employed by RPC Group plc, and Mr Swann worked as a tenancy support officer.

22 January 2021

In a case brought by the FCA and heard at Southwark Crown Court, Her Honour Judge Korner, CMG, QC made a consent confiscation order totalling £3,893,964.82 to be paid by Walid Choucair. In addition, the Court ordered Mr. Choucair to pay £403,552 in prosecution costs to the FCA.

In June 2019, Mr. Choucair was sentenced to 3 years' imprisonment in respect of five offences of insider dealing alongside Fabiana Abdel-Malek, taking place in 2013/2014. The trial was brought by the FCA. Mr Choucair, is the friend of Ms. Abdel Malek and accomplice of the UBS Compliance Officer who provided the information to Mr. Choucair.

The amount of the confiscation order takes into account the amount of profit in the sum of approximately £1.4 million made by Mr. Choucair from the five insider dealing charges together with profits arising from other trading carried out by him which the court is permitted to assume also represents proceeds of crime.

Ms. Abdel-Malek was employed as a senior compliance officer by the investment bank UBS AG in their London office and used her position to identify inside information which she passed to her family friend Mr. Choucair, an experienced day trader of financial securities, using pay-as-you-go mobile telephones.

They appealed their convictions alleging insufficient disclosure by the FCA before, during and after the trial made their convictions unsafe. The Court of Appeal dismissed the appeals in December 2020 and found there was no irregularity or unfairness.

The total amount confiscated exceeds the profits generated from the prosecuted offences. This is as a result of the application of the confiscation regime which permits the court in this case to assume that profits from other trading also represent proceeds of crime.

Mark Steward, Executive Director of Enforcement and Market Oversight, said:

'This confiscation order means Mr Choucair will have to surrender significant illegal trading profits following his convictions for insider dealing. Today's order demonstrates that insider dealing does not pay.'

Mr Choucair is required to pay the confiscation order by 1 March 2021. If he fails to do so he will need to serve 5 years in default of payment.

On 7 August 2020, the Southwark Crown Court made a consent confiscation order against Ms Abdel-Malek in the sum of £34,194.53. That order was satisfied in full on 10 September 2020.

FCA reiterates importance of AML systems and controls

24 March 2021

On 24 March 2021, Mark Seward, the FCA's Executive Director of Enforcement and Market Oversight, delivered a speech on the importance of purposeful anti-money laundering controls.

Among other things, the speech covered:

- Reference to specific AML enforcement action including: the ongoing case against NatWest (see below) and the recent fines for Commerzbank and Goldman Sachs over AML systems and controls failings
- The FCA has 42 AML investigations against firms and individuals currently
- Emerging AML risks from the past 12 months, including online scams and cryptocurrency

Mr. Seward closed the speech as follows: "...the aim of AML regulation is not to catch anyone out but to set high standards of probity and scrutiny to inhibit illicit money flows in the financial system and to encourage participants in the system to behave as custodians and guardians of the public interest in preventing money laundering."

The speech follows the FCA announcement that it has commenced criminal proceedings against National Westminster Bank Plc (NatWest) in respect of offences under the Money Laundering Regulations 2007 ("**MLR**"). The FCA alleges that NatWest failed to adhere to the requirements of MLR between November 2011 and October 2016.

The case arises from the handling of funds deposited into accounts operated by a UK incorporated customer of NatWest. The FCA alleges that increasingly large cash deposits were made into the customer's accounts. It is alleged that around £365 million was paid into the customer's accounts, of which around £264 million was in cash. It is alleged that NatWest's systems and controls failed to adequately monitor and scrutinise this activity.

This is the first criminal prosecution under the MLR by the FCA; in the past the FCA has pursued a civil remedy against financial institutions over money laundering systems and controls failings.

FCA publishes Decision Notice against Jon Frensham for non-financial misconduct

29 March 2021

The FCA has banned John Frensham, an independent financial adviser, for not being a fit and proper person.

In March 2017, Mr Frensham was convicted of attempting to meet a child following sexual grooming. He committed this offence whilst he was an approved person. Mr Frensham was sentenced to 22 months' imprisonment, suspended for 18 months.

The FCA concluded that Mr Frensham lacks honesty and integrity and his senior management functions were withdrawn.

This case is a reminder that the FCA can find an individual to be not fit and proper over conduct not related to financial services matters.

Restrictions placed on Dolfin Financial (UK) Ltd

12 March 2021

The FCA has imposed a number of restrictions on Dolfin Financial (UK) Ltd (Dolfin) stopping it from carrying on any regulated activities due to concerns about the way it conducts its business.

Dolfin is a wealth management firm that provides services to retail and professional clients on a range of financial instruments, including shares, government and corporate bonds and investment funds. The firm also provides Tier 1 investor visa services.

The restrictions will stop Dolfin from carrying on any regulated activity and prevent it from reducing the value of its assets, or any of the client money or custody assets it holds, without the consent of the FCA.

The FCA has identified a number of serious concerns around the way that Dolfin operates its business, including the firm's Tier 1 investor visa business activities and financial crime controls.

The FCA has been working with Dolfin while it took steps to try and address these concerns, including imposing voluntary restrictions on its regulated activities on 24 December 2019, and commissioning a 'Skilled Persons Review', which is a view from a third party (a 'skilled person') about aspects of a regulated firm's activities where the FCA has concerns or wants further analysis.

However, following the conclusion of the Skilled Persons Review and developments that have taken place since, the FCA has determined that it is appropriate in the interests of protecting the integrity of the UK financial system to stop the firm from carrying out regulated activities and has imposed these restrictions.

It is currently uncertain how long it will be necessary for the restrictions to remain in force as this is subject to the FCA's concerns being addressed by the firm.

USA - Ongoing Developments

SEC Division of Examinations announces 2021 examination priorities

03 March 2021

Every year, the SEC's Division of Examinations (the "Division") publishes its examination priorities to provide insight and transparency into its risk-based approach. While the recently published 2021 Examination Priorities confirm that the SEC will continue its long-standing focus on advisers to private funds, we do, however, see some relatively new themes being addressed and we anticipate these will further evolve with time.

Private Funds

In line with what we've observed during examinations of our clients in prior years, the Division will remain focused on the overall strength of advisers' policies and procedures and how they address firm risks and conflicts of interest.

The Division will continue to review for, inter alia, preferential treatment of certain investors where a private fund has experienced liquidity issues, portfolio valuations and their impact on advisory fees, adequacy of disclosures with respect to cross trades, principal investments or distressed sales and any other conflicts brought about by adviser led fund restructurings.

An emerging theme this year centers around the focus on advisers to private funds that have a higher concentration of structured products, such as CLOs and mortgage-backed securities, to assess whether the funds are at "a higher risk for holding non-performing loans and having loans with higher default risk than that disclosed to investors". Further, the Division will examine advisers to private funds where there may have been material impacts on underlying portfolio companies due to recent economic conditions.

Information Security

As the COVID-19 pandemic unfolded, the Division's examination focus shifted to whether advisers' business continuity plans were updated, operational and effective, and addressing the increased cybersecurity risks facing firms and investors.

The Division published a number of Risk Alerts during 2020, emphasizing the importance of information security to the operation of financial markets. Specifically, the Division released its examination observations related to cybersecurity and operational resiliency practices taken by market participants

Given the increase in remote working operations, the Division has increased concerns about, among other things, endpoint security, data loss, remote access, use of third-party communication systems, and vendor management. Firms must ensure implementation of sufficient policies and procedures to safeguard customer accounts, oversee service providers, address malicious email activities, such as phishing or account intrusions, and manage operational risk as a result of dispersed employees in a work-from-home environment.

Not surprisingly, there will be focus not only on procedures, but also controls relating to investor information, firm books and records, and third-party cloud providers. If your firm did not provide cybersecurity training to staff in 2020, we highly recommend you do so now.

ESG and Climate Change

The Division notes that advisers are increasingly offering investment strategies that focus on sustainability, a trend that we too have observed amongst our clients. With a focus on the ESG arena the Division intends to review for commonly known private funds deficiency areas including consistency and adequacy of investor disclosure and false or misleading statements in marketing. Interestingly and going further, reviews will include proxy voting policies and procedures and votes "to assess whether they align with the strategies."

This new focus area is significant if we consider that other regulatory jurisdictions have already taken steps to codify ESG-related rules, and how briefly the topic has been covered in prior years. The recently announced creation of a Climate and ESG Task Force by the Division further emphasizes the importance of the new initiative.

Digital Assets

Another focus area of the Division, for which a Risk Alert detailing recent examination observations was published in February 2021, is digital assets. Timely to the release of the examination priorities and intended to assist advisers in enhancing their compliance policies, the Alert provides transparency into the Division's approach to these examinations. While not new, additional color is provided in certain areas of focus such as portfolio management, maintenance of appropriate books and records, custody, disclosures to clients and investors and valuation. The Division will also consider issues more focused on staff, such as key person policies and outside business activities.

If you are interested in hearing more about what we are seeing in SEC exams, please do reach out. We remind all registered investment advisers of the importance of assessing compliance-based risks on an ongoing basis and are happy to assist our clients in this review.

Furthermore, we recognize the importance of empowering the industry with the tools to mitigate against the latest SEC Division of Examinations priorities, by providing cost-effective and scalable SEC Compliance and Cyber Security e-Learning courses – click here if you'd like access to our Free Demo courses.

The SEC's Division of Examinations' review of ESG investing

04 April 2021

The SEC's Division of Examinations (the "Division") has issued a Risk Alert highlighting observations from recent examinations of investment advisers, registered investment companies, and private funds offering environmental, social, and governance (ESG) products and services. The Risk Alert is intended to highlight risk areas and assist firms in developing and enhancing their compliance practices.

As investor demand has grown, investment advisers and funds have expanded their approaches to ESG investing and increased the number of product offerings across multiple asset classes. This rapid growth in demand, increasing number of ESG products and services, and lack of uniform and precise ESG definitions has created some confusion among investors where investment advisers and funds have not clearly and consistently articulated how they define ESG and how they use ESG-related terms.

Examinations of Investment Advisers and Funds

Division staff will continue to examine firms to evaluate whether they are accurately disclosing their ESG investing approaches, and whether they have adopted policies, procedures and practices that are consistent with these disclosures.

Exams of firms claiming to engage in ESG investing will focus on, among other matters, the following:

1. Examinations of Investment Advisers and Funds

Examinations will include a review of:

- Policies, procedures, and practices related to ESG and the use of ESG-related terminology
- Due diligence and other processes for investments in view of the firm's disclosed ESG investing approaches
- Whether proxy voting decision making processes are consistent with ESG disclosures and marketing materials

2. Performance advertising and marketing

Examinations will include a review of:

- The firm's regulatory filings
- Websites
- Reports to sponsors of global ESG frameworks, to the extent the firm has communicated a commitment to follow such frameworks
- Client presentations
- Responses to due diligence questionnaires, requests for proposals, and client/investor-facing documents, including marketing materials

3. Compliance programs

Examinations will include a review of written policies and procedures and their implementation and oversight by compliance.

Staff Observations

Division staff observed instances of potentially misleading statements regarding ESG investing processes and representations regarding the adherence to global ESG frameworks.

At a high level, staff observed that compliance programs were less effective when compliance personnel had limited knowledge of relevant ESG-investment analyses or oversight over ESG-related disclosures. In addition, the staff noted weaknesses in compliance controls regarding performance metrics included in marketing materials (such as risk, returns, and correlation metrics), and a lack of compliance review of the data underlying those measures.

1. Inconsistent portfolio management practices with disclosures about ESG approaches

The staff observed portfolio management practices that differed from client disclosures in required disclosure documents and other investor-facing documents. For example, the staff observed:

- Lack of adherence to global ESG frameworks where firms claimed such adherence
- Fund holdings predominated by issuers with low ESG scores where such predominance appeared inconsistent with a firms' stated approach

2. Inadequate controls to maintain, monitor, and update clients' ESG-related investing guidelines, mandates, and restrictions

The staff noted weaknesses in policies and procedures governing implementation and monitoring of clients' ESG-related directives. The staff observed that advisers had inadequate systems and controls around:

- Implementation and monitoring of clients' negative screens (e.g., prohibitions on investments in certain industries, such as alcohol, tobacco, or firearms)
- Consistently tracking and updating clients' negative screens leading to the risk that prohibited securities could be included in client portfolios

3. Proxy voting inconsistent with advisers' stated approaches.

Staff observed inconsistencies between public ESG-related proxy voting claims and internal proxy voting policies and practices. For example, the staff observed

- Public statements that ESG-related proxy proposals would be independently evaluated internally on a case-by-case basis to maximize value, while internal guidelines generally did not provide for such analysis
- Public claims regarding clients' ability to vote separately on ESG-related proxy proposals, but clients were never provided such opportunities

4. Unsubstantiated or potentially misleading claims regarding ESG approaches

The staff observed unsubstantiated or otherwise potentially misleading claims regarding ESG investing. For example, the staff noted:

- Marketing materials touted favorable risk, return, and correlation metrics related to ESG investing without disclosing material facts regarding significant expense reimbursement received from the fund-sponsor, which inflated returns for those ESG-oriented funds
- Unsubstantiated claims regarding substantial contributions to the development of specific ESG products, when, in fact, their roles were very limited or inconsequential

5. Inadequate controls to ensure that ESG-related disclosures and marketing are consistent actual practices

The staff observed inconsistencies between actual firm practices and ESG-related disclosures. For example, the staff observed:

- A lack of adherence to global ESG frameworks despite claims to the contrary
- Unsubstantiated claims regarding investment practices
- A lack of documentation of ESG investing decisions and issuer engagement efforts
- Failures to update marketing materials timely (e.g., an adviser continuing to advertise an ESG investment product or service it no longer offered)

5. Compliance programs inadequately addressing relevant ESG issues

The staff observed firms substantially engaged in ESG investing that lacked policies and procedures addressing their ESG investing analyses, decision-making processes, or compliance review and oversight.

The staff also noted a lack of policies and procedures to ensure firms obtained reasonable support for ESG-related marketing claims, and observed inadequate policies and procedures regarding oversight of ESG-focused sub-advisers

Staff Observations of Effective Practices

While the staff observed compliance deficiencies and weaknesses relating to ESG investing, some investment advisers and funds did have in place disclosures that accurately conveyed material aspects of the firms' approaches to ESG investing.

Some of the practices the staff observed include:

- Disclosures that were clear, precise and tailored to firms' specific ESG approaches, and which aligned with the firms' actual practices
- Policies and procedures addressing ESG investing and covering key aspects of the firms' relevant practices, including specific documentation to be completed at various stages of the investment process (e.g., research, due diligence, selection, and monitoring)
- Compliance personnel that are knowledgeable about the firms' specific ESG-related practices

The Division encourages all market participants promoting ESG investing to evaluate whether disclosures, marketing claims, and other public statements made to clients and potential clients related to ESG investing are accurate and consistent with actual firm practices.

Firms should also ensure that their approach to ESG is implemented consistently throughout the firm and are adequately addressed in the firm's policies and procedures. Finally, firms should take steps to document and maintain records relating to the various important stages of the ESG investing process.

NFA Notice re outsourcing regulatory requirements to third parties

15 March 2021

At the end of February, the NFA advised of an upcoming Notice to Members titled "NFA Compliance Rules 2-9 and 2-36: Members' Use of Third-Party Service Providers" that will set out NFA expectations when outsourcing regulatory requirements to third parties.

In particular, the Interpretive Notice will provide guidance on the following areas: (i) initial risk assessment; (ii) onboarding due diligence; (iii) ongoing monitoring; (iv) termination; and (v) recordkeeping.

If you are utilizing third-parties to undertake functions that would otherwise be the responsibility of the Member firm, please review your outsourcing policy to ensure the NFA's guidance is incorporated.

Click here to find out more.

NFA CPO Rule Submission Letter

11 March 2021

This week, the NFA sent a rule submission letter to the CFTC that will amend how CPO members notify the NFA of events affecting the pool's ability to fulfill its obligations to investors.

While certain elements of NFA Compliance Rule 2-50 are already reported to the NFA, this update will change the manner and timeframe of such reporting.

An NFA Notice to Members will be issued setting out additional detail but, in summary, the Rule requires prompt notification in the following circumstances:

- CPO Member operates a commodity pool that is unable to meet a margin call(s);
- CPO Member operates a commodity pool that is unable to satisfy redemption requests in accordance with its subscription agreements
- CPO Member operates a commodity pool that has halted redemptions and the halt on redemptions is not associated with pre-existing gates or lockups, or a pre-planned cessation of operations; or
- CPO Member receives notice from a swap counterparty that a pool the CPO Member operates is in default.

Click here to see the proposed rule and related Interpretive Notice for more guidance.
If you are utilizing third-parties to undertake functions that would otherwise be the responsibility of the Member firm, please review your outsourcing policy to ensure the NFA's guidance is incorporated.

Click here to find out more.

USA - Regulatory News

The Division of Examinations' continued focus on digital asset securities

02 February 2021

The SEC's Division of Examinations ("**Division**") issued a Risk Alert to provide observations made by Division staff during examinations of investment advisers, broker-dealers and transfer agents regarding digital asset securities that may assist firms in developing and enhancing their compliance practices. The Risk Alert also serves to provide transparency about areas of focus for the Division's future examinations.

Based on observations from recent examinations, future examinations of investment advisers will focus on regulatory compliance associated with, among other things:

1. Private Funds

The review of policies, procedures, and practices will focus in particular on the following areas:

- Classification of digital assets managed on behalf of their clients, including whether they are classified as securities
- Due diligence on digital assets
- Evaluation and mitigation of risks related to trading venues and trade execution or settlement facilities
- Management of risks and complexities associated with "forked" and "airdropped" digital assets (e.g., allocations thereof across client accounts, conflicts of interest, or other issues)
- Fulfilment of an adviser's fiduciary duty with respect to investment advice

2. Books and records

Examinations will review whether advisers are keeping accurate books and records, including the recording of trading activity. Digital asset trading platforms vary in reliability and consistency with regard to order execution, settlement methods, and post-trade notifications, all of which an adviser should consider when designing recordkeeping practices.

3. Books and records

Examinations will review the risks and practices related to the custody of digital assets by investment advisers and examine for compliance with the Custody Rule 206(4)-2. The staff will review:

- Occurrences of unauthorized transactions, including theft of digital assets
- Controls around safekeeping of digital assets
- Business continuity plans where key personnel have exclusive access to private keys
- How the adviser evaluates harm due to the loss of private keys
- Reliability of software used to interact with relevant digital asset networks
- Storage of digital assets on trading platform accounts and with third party custodians
- Security procedures related to software and hardware wallets

4. Disclosures

Examinations will include a review of disclosures to investors regarding the unique risks associated with digital assets, including any risks that are heightened as a result of the digital nature of such assets.

The staff will assess disclosures regarding specific risks, including the complexities of the products and technology underlying such assets, technical, legal, market, and operational risks (including custody and cybersecurity), price volatility, illiquidity, valuation methodology, related-party transactions, and conflicts of interest.

5. Pricing client portfolios

Investment advisers apply a variety of valuation methods to determine the value of digital assets managed on behalf of clients. Investment advisers may face valuation challenges for digital assets due to market fragmentation, illiquidity, volatility, and the potential for manipulation.

Examinations will include a review of the valuation methodologies utilized, including those used to determine principal markets, fair value, valuation after significant events, and recognition of forked and airdropped digital assets.

The staff will also review disclosures related to valuation methodologies, and advisory fee calculations and the impact valuation practices have on these fees.

6. Registration issues

Examinations will include a review of compliance matters including, among other things, understanding how the investment adviser calculates its regulatory assets under management, and characterizes the digital assets in the pooled vehicles it manages and the status of clients.

For private funds managed by investment advisers, this also includes understanding how the funds determine applicable exemptions from registration as investment companies.

The Division encourages market participants to reflect upon their own practices, policies and procedures, as applicable, and to promote improvements in their supervisory, oversight and compliance programs.

UK ICO provides clarity regarding transfers of personal data to the SEC

19 January 2021

The UK Information Commissioner's Office ("ICO") has published its analysis of the impact of UK data protection law, specifically the application of the UK GDPR, on transfers of personal data from certain UK-based firms to the SEC.

The ICO has concluded that the UK GDPR does not impose legal barriers to the transfer of personal data from investment advisers directly to the SEC for regulatory or enforcement purposes.

In summary, the letter clarifies that the UK GDPR permits UK firms to transfer personal data to the SEC directly in connection with, among other things:

- The SEC's evaluation of a firms' compliance with legal obligations in the US, including during an examination
- The SEC's efforts to prevent and enforce against potential unlawful behavior.

The ICO's analysis explains how UK firms with regulatory obligations to the SEC may rely on the "public interest" derogation of the UK GDPR when directly transferring personal data to the SEC, and demonstrates the important cooperative relationship the SEC has established with UK authorities in carrying out its investor protection missions.

NFA announces remote online testing available for futures industry proficiency examinations

01 January 2021

Candidates seeking to take the NFA's futures industry proficiency exams (Series 3, Series 30, Series 31, Series 32 and Series 34) can now do so remotely using a webcam-equipped computer and other online tools. The online testing will be delivered and remotely proctored by FINRA's testing provider, Prometric.

There are a number of technical and procedural requirements which need to be met, including:

- The download and installation of the ProProctor application from the Prometric website and performing a system check
- A 360-degree view of the workstation and surrounding environment
- Participation in a visual person check, including but not limited to a sleeve, pocket and glasses check

Firms considering online testing through their network and firm-issued equipment should review FINRA's technical requirements pertaining to equipment, networking and information security.

RQC GROUP

Thank you for taking time to read our quarterly regulatory newsletter. Please contact us if you have any questions or feedback.

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