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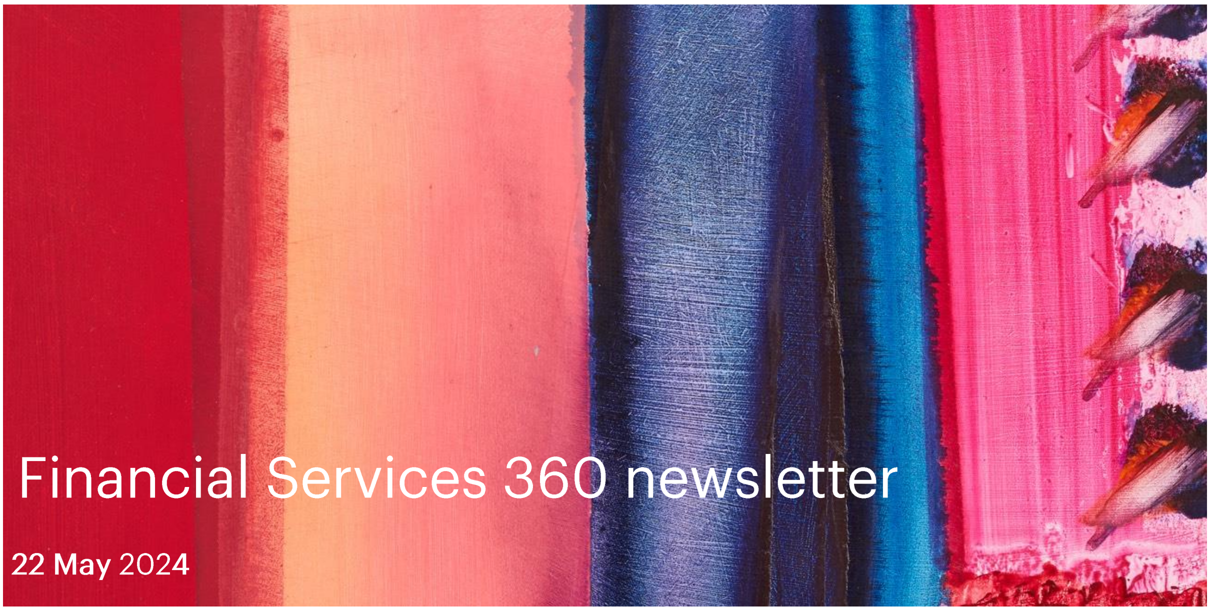

Financial Services 360 newsletter

22 May 2024

Welcome to our Financial Services 360. This provides concise updates on some of the key UK legal and regulatory matters from each quarter relevant to UK financial services firms, including UK asset managers, private banks and others.

In this edition for Q1 2024, we cover a variety of topics split into five sections:

- **General regulatory**: We cover topics including the Consumer Duty, updates on financial promotions, the regulators' business plans, AI and Big Tech, debanking and some recent speeches by Nikhil Rathi, Chief Executive of the FCA.

- **Funds**: We cover topics including the recent "Dear CEO" letter to asset managers, AIFM hosting, the FCA consultation on payment optionality for investment research, the Overseas Funds Regime, and common errors made by firms in applying for authorisation.

- **Consumer Credit, Retail Banking & Mortgages**: We cover the PRA's supervisory priorities for deposit takers, the FCA's recent "Dear CEO" letter to consumer lending firms, Kumar v LSC Finance and the FCA's policy statement on borrowers in financial difficulties.

- **Enforcement and financial crime update**: This covers (briefly) the FCA's new approach to Enforcement, its recent AML update, proposed amendments to the Financial Crime Guide and a cases digest.

- **ESG**: This includes links to the FCA's recent consultation on extending the SDR to portfolio management and its finalised guidance on the anti-greenwashing rule, and our guidance on both.

If you have any questions on any of the topics covered please do not hesitate to contact a member of the Farrer & Co Financial Services team.

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1. General Regulatory

Consumer Duty

At the end of July, the scope of the Consumer Duty will be extended to apply to closed products and services, and by then firms must have produced their first Board reports assessing implementation. Over the last few months, the Financial Conduct Authority (FCA) has been busy publishing a number of reports and speeches, which we covered in our recent briefing.
In March 2024 the FCA published its 2024-25 Business Plan, which we cover in more detail below, in which it set out some of its ongoing and planned work on the Consumer Duty. In the coming year the FCA intends to review unit-linked pensions and long-term savings products to test the transparency of charges across value chains, how firms assess overall product value and their response where they identify unfair value.

The FCA will also be undertaking multi-firm work, looking at how swiftly the insurance industry responds to claims, including where customers are more likely to show characteristics of vulnerability.

Financial promotions: social media guidance

The FCA published its finalised guidance on financial promotions on social media. This applies to all firms using social media as part of their marketing strategy, and not just “finfluencers”. Firms are reminded that:

- Financial promotions must be standalone compliant, and should give a balanced view of the benefits and risks.
- If a risk warning is required, it should be displayed prominently and there are illustrated examples of what the FCA considers to be acceptable / unacceptable.
- Firms must take into account the constraints of a particular social media platform.

Financial promotions: high net worth exemption

The Government has legislated to reinstate the previous eligibility criteria to qualify as a high net worth or sophisticated investor under the Financial Promotions Order, which had been increased as of 31 January 2024. The Government will carry out further work to review the scope of the exemptions.

The FCA published a statement in response, rather obliquely pointing out that they disagreed with the Government on this (it has a link to their April 2023 letter to the Treasury Select Committee stating their concerns about the exemption).

It is our understanding that this policy reversal was in response to a letter to the Chancellor from the Start-up Coalition, a group of executives, tech groups and start-up investors. The group had been campaigning against the decision to increase the thresholds for those exempted from restrictions on financial promotions, saying it would block vital investment and disproportionately affect women and ethnic minority groups.

Smarter Regulatory Framework

In March the Treasury published an update on the Smarter Regulatory Framework (SRF), setting out progress so far, work underway and the Government’s approach on the next phase. It has identified 777 pieces of assimilated law relating to financial services within scope of the SRF, and as of February 2024 had removed 44 per cent of these, including repealing those which were identified as being redundant after Brexit.

The Government is currently in the process of replacing regulations including Solvency II and parts of the Payment Services Regulations 2017, relating to contract termination.

The next stage (Tranche 3) will include assimilated law which has been identified as having the biggest potential benefits to UK economic growth, such as MiFID, the Alternative Investment Fund Managers Directive and the UCITS Directive, and for which the Government intends to undertake a policy review to decide which parts should be retained. The Government intends to adopt a multi-staged approach, in order to minimise the burden on industry, and will update the Regulatory Initiatives Grid with its plans.

Debanking update

Debanking continues to be in the news. On 21 February the APPG for Fair Business Banking published a report on debanking. Among other things, the report sets out concerns that some businesses are refused banking facilities purely due to running a certain type of business which is considered high risk, for example oncourse bookmakers or yachtbrokers. They also gave the example of the industry body for cryptocurrency, CryptoUK, which was refused a bank account even though they do not accept fees in crypto. The refusal was allegedly based on their name.

The APPG accepts that running accounts for these types of businesses does create more costs for banks, for example because of more AML checks or because they rely more on cash. According to the report, retail banks spend around two thirds of their total annual spend on compliance on customer due diligence.

The report concludes that:

- The industry should consider offering basic bank accounts to small businesses, similar to those which the designated banks are required to offer to consumers.

- Some protections should be introduced to stop banks withdrawing facilities solely on the basis of cost. This would require banks to be more transparent (which is in line with the Government's current reforms to consumer account termination),and should offer customers alternative facilities such as its proposed basic bank account, or a fee-based account to cover its costs.

- Banks' role as a utility provider should be explicitly accepted. The report recommends that the FCA should reverse its position on reputation (which is currently that firms should consider it as part of its money laundering considerations), and issue guidance that requires banks to disregard the consideration of reputation in all cases other than unlawful conduct.

- Firms should take action against a suspect transaction, rather than the client.

- It is likely that some firms have been using "financial crime" as a blanket reason for closing accounts. The Treasury should reconsider its approach of requiring firms to give explanations for closing accounts, as they may continue not to give accurate reasons.

On 21 April the Treasury Committee published a press release relating to correspondence it has had with the Financial Ombudsman Service (FOS) regarding the jump in complaints relating to debanking. It announced that there had been a spike in debanking complaints of 44 per cent overall, and 81 per cent relating to business bank accounts.

Speeches by Nikhil Rathi

Nikhil Rathi, Chief Executive of the FCA, has given a number of speeches over the last few months, which always provide a useful insight into the current priorities of the FCA. These include:

- A speech on 23 January entitled “Leaning in on making consumer tech a force for good”. It is worth reading for some examples of how firms may use data in the future to personalise products.

- A speech on 13 March at the JP Morgan Pensions and Savings Symposium, on “the future of pensions: act today to plan for tomorrow”. He made the following points of note:

    - Under the Consumer Duty **value is crucial**, so the Government’s new Value for Money framework will help by requiring operators to be transparent about their investment returns, costs and other metrics.

    - There are £1.4tn in assets in private defined benefit schemes and similar amount in defined contribution schemes. Just 5 per cent is invested in UK economy so the UK Government is keen for this to grow: regulators are looking at removing what are referred to as “inappropriate barriers”.

    - There are eight LTAFs currently authorised: target assets after three years is nearly £6bn and they have a number currently being authorised.

    - Advice Guidance Boundary review: More than half (53.58 per cent) of all pots accessed for the first time in the contract-based retirement income market were accessed without advice or guidance. More than a third (34 per cent) of over-45s with DC funds don’t understand their decumulation options. The FCA is concerned that too few people seek financial advice, so new mechanisms are needed to ensure consumers have the support they need.

    - The FCA has seen poor practice in firms in SIPP markets. Operators must act to deliver good outcomes for retail customers and avoid causing foreseeable harm to them. In December, the FCA had said that the treatment of interest earned by firms on customers’ cash balances, including in SIPPs, may not be in line with the Consumer Duty.

- A speech on 14 March at the Morgan Stanley European Financials Conference on “Investing in outcomes: a regulatory approach to deliver for consumers, markets and competitiveness”, covering topics including the Consumer Duty, Fair Value, motor finance discretionary commissions, prudential regulation and supporting investment and innovation.

New Special Resolution Regime

In January the Treasury published a consultation on Enhancing the Special Resolution Regime. These proposals relate to shoring up the regime for smaller banks, following the collapse of Silicon Valley Bank last year.

The Government is proposing the introduction of a new power for the Bank of England to use (as resolution authority) in the resolution of failed smaller banks, to be used alongside existing powers. Under the new power the Bank of England would be able to use funds from the FSCS to cover the costs associated with a resolution, including those relating to recapitalising and operating the failed bank.

It is hoped that this would prevent a run on withdrawals as there would be no delay in obtaining protected funds. Larger banks already have to hold a certain amount of equity that can be used to recapitalise them in the event of failure.

Dear Board Letters on Peer to Peer (P2P)

On 15 January the FCA published a Dear Board letter setting out its expectations for Loan-based Peer-to-Peer Lending platforms, and also published a Dear Board letter setting out its expectations for Investment-based crowdfunding platforms.

The letters set out key areas of concern for the FCA including:

- The new rules strengthening financial promotion rules for high-risk investments and firms approving financial promotions, and the follow-up review. The FCA is again asking firms to review the rules and their report and make any necessary changes.

- The Consumer Duty and firms' implementation of the outcomes.

- Liquidity/Solvency. Loan-based P2P firms have been asked to provide attestations relating to their liquid resources and monitoring, and also copies of their wind-down plans.

Artificial Intelligence (AI) / Big Tech

Both the FCA and the PRA are continuing to take a keen interest in the impact AI and Big Tech will have on financial services in the future. Nikhil Rathi is currently Chair of the Digital Regulation Cooperation Forum (**DRCF**), which brings together regulators with an interest in AI including the Competition and Markets Authority and Ofcom.

On 22 April Nikhil Rathi gave a speech to the DRCF entitled "Navigating the UK's Digital Regulation Landscape: Where are we headed?" Points of note include:

- Priorities for the DRCF, include leading a coordinated effort to make the most of the opportunities of Big Tech, and minimising disruption to financial markets by ensuring that they are operationally resilient.

- The DRCF AI and Digital Hub will provide informal advice from member regulators to tech innovators.

- The FCA is enabling an open API marketplace, through its innovation hub, policy and tech sprints, and its permanent digital sandbox. A key industry concern is the use, transfer and governance of data.
- The FCA and fellow regulators want to progress open finance, opening up data further, including across sectors, to increase competition and innovation. However, they need to overcome resistance from incumbent firms that own the data but feel the threat from fintech and Big Tech, from some Big Tech firms who may want to access finance data but not reciprocate or pay for it, and from Big Tech firms in adjacent markets which can constrain competition in financial services markets. They want to build trust and transparency around data.

In April the FCA also published its response (Feedback Statement FS24/1) to its Call for Input on the competition implications of Big Tech and data asymmetry.

- Respondents did not identify any immediate harms from data asymmetry. However, the FCA was concerned that there was a risk that the combination of cloud, data and AI would cement Big Tech's power in partnerships with firms across financial services and other sectors.
- Respondents lacked evidence of how valuable Big Tech firms' data from their core digital services could become in retail financial services.

The FCA also published a document setting out its approach to AI, further to the Government's request to regulators to set out what work they were doing on AI and how they were using it.
The PRA and Bank of England also sent a joint response to the Government, setting out the work they were doing on ensuring that Artificial Intelligence (AI) and Machine Learning (ML) are used safely within their regulatory remit. Their work had already shown that AI/ML is already being widely adopted in many parts of the financial sector to improve firms' operational efficiency, better detect fraud and money laundering, and enhance data and analytics capabilities.

Digital Securities Sandbox

On 3 April the Bank of England and FCA published a joint consultation paper on their proposals for a Digital Securities Sandbox. This is aimed at supporting innovation, providing a glidepath and protecting financial stability and market integrity as the use of limits (set by the Bank) will facilitate the safe-scaling of business. It will allow firms to use developing technology such as DLT in the issuance, trading and settlement of securities such as shares and bonds. However, the trading and settlement of derivative contracts and of "unbacked cryptocurrencies" such as Bitcoin are not in the scope of the DSS.

The intention is that financial market participants, such as companies that use capital markets to raise finance, or participants in financial markets who trade securities, should be able to interact with the firms inside the DSS as normal while benefitting from the new technology. Firms should be able to use the securities issued in the DSS as they normally would any other security, including in securities financing transactions, or as collateral. They can also write derivative contracts based on those securities, subject to the usual requirements.

Regulators' annual business plans

The Financial Conduct Authority (FCA), Payment Systems Regulator (PSR), and Prudential Regulatory Authority (PRA) have all published their business plans for 2024-25 during March and April. Summary details below.

The Financial Conduct Authority 2024/25 Business Plan

On 19 March the Financial Conduct Authority (FCA) published its annual Business Plan, which details its work over the next 12 months, its priorities for 2024/2025, as well as progress on its three-year strategy. Its three-year strategy set out how it would deliver its objectives, focusing on reducing and preventing serious harm, setting and testing higher standards, and promoting competition and positive change.

The FCA aims to continue to deliver on its thirteen public commitments, including the following planned work:

- **Commitment 1: Reducing and preventing financial crime**. Among other things, the FCA aims to proactively assess AML systems and controls for those firms deemed higher risk, and improve its capabilities to identify and request the removal of unauthorised financial promotions, associated websites and social media accounts.

- **Commitment 2: Putting consumers' needs first**. As well as its work on the Consumer Duty, the FCA will start multi-firm work and market studies across different sectors to drive up standards, including looking at unit-linked pensions and long-term savings products to test the transparency of charges across value chains. The FCA will also continue its work on savings rates, and finalise changes to mortgage, consumer credit and overdraft rules to provide more support for consumers in financial difficulty.

- **Commitment 3: Strengthening the UK's position in global wholesale markets**. The FCA intends to support industry work on the move to T+1 settlement, deliver its Primary Market policy reforms including its review of the Listing Regime, ensure derivative markets are ready to implement the new reporting rules under the UK European Market Infrastructure Regulation, and continue its work on the consolidated tape, tokenisation, and transparency for bonds.

- **Commitment 4: Preparing financial services for the future**. The FCA will continue to work closely with the Treasury on the Smarter Regulatory Framework, to ensure that where assimilated law is repealed it is replaced, where appropriate, with FCA rules.

- **Commitment 5: Dealing with problem firms**. The FCA intends to increase its auto-detection capabilities of problem firms and individuals, as well as continuing to identify firms that are breaching the Threshold Conditions.

- **Commitment 6: Taking assertive action on market abuse**. The FCA is seeking to increase its capability to tackle market abuse in 2024/25 whilst still supporting innovation to lower industry costs. As part of the Smarter Regulatory Framework process, the FCA intends to publish a discussion paper on transferring MiFID data reporting regimes for transactions (RTS 22) and reference data (RTS 23) and it will publish the results of its peer review of market abuse systems and controls in providers of Direct Market Access. In Q3 of 2024, the FCA will publish its revised Market Cleanliness Data.

- **Commitment 7: Reducing harm from firm failure**. The FCA will use data and horizon-scanning mechanisms to anticipate firms that are at risk of failure, and continue to support firms through work including its financial resilience return and examples of good and poor practice of wind down planning.

- **Commitment 8: ESG priorities**. The FCA will integrate the SDR regime and anti-greenwashing rule, and continue to work with partners, as well as preparing to have regard to a new "Nature" regulatory principle coming into force.

- **Commitment 9: Shaping digital markets to achieve good outcomes**: As well as the work set out above that the FCA has already published on Big Tech and data asymmetry, the FCA will continue to assess the impact of AI on UK markets and continue to investigate consumer digital consumer journeys and the use of "sludge" practices.

- **Commitment 10: Improving the redress framework**. The FCA intends to ensure that customers receive appropriate and effective redress and that the firms which cause the harm, bear more of the cost of redress. It intends to continue its work on redress Guidance, its proposed capital deduction for redress for personal investment firms, and the Advice Guidance Boundary.

- **Commitment 11: Enabling consumers to help themselves**. The FCA will continue its work on financial promotions, and will also work with OFCOM on implementing the relevant parts of the Online Safety Act. It will also publish a response to the Advice Guidance Boundary Review discussion paper.

- **Commitment 12: Minimising the impact of operational disruptions**. The FCA will be continuing its work on operational resilience. From 31 March 2025, all relevant firms will need to maintain their business services without intolerable harm to consumers and markets. The FCA intends to consult on its expectations on how firms should report operational incidents, which will help ensure that the FCA and firms are responding effectively.

- **Commitment 13: Improving oversight of Appointed Representatives (ARs)**. The FCA will continue to work to improve principals' oversight of their ARs, as well as targeting its resources through deeper analysis of existing and new data.

The Prudential Regulation Authority

The Prudential Regulation Authority (PRA) published their 2024-25 Business Plan. Some highlights include:

- Initiatives aimed at promoting the UK's competitiveness and growth, under their new secondary objective, including:

  - Their “Strong and Simple” project, which aims to simplify regulatory requirements for smaller banks, with the aim of reducing the compliance burden.
  - The “Solvency UK” reforms of insurance capital standards, which is aimed at reducing bureaucracy in the regulatory regime, while also allowing insurers to invest in a wider range of productive assets.
  - The Banking Data Review, which aims to reduce burdens on firms by focusing their data collection on the most useful and relevant information.
  - Improvements to their authorisation processes – they claim to have made significant progress in improving the speed and efficiency of authorisations without sacrificing the robustness of the process.
  - Reforms to ring-fencing, following the independent review led by Sir Keith Skeoch.

- The Bank’s ongoing programme of work to maintain the resilience of the UK’s banking and insurance sectors, particularly important given the high-profile failures of Silicon Valley Bank and Credit Suisse

- The implementation of the Basel 3.1 standards, which will complete the long process of post-financial crisis regulatory reform.

- Ensuring firms have adequate standards of operational and cyber resilience. Under FSMA 2023, the Bank has new powers to oversee the services provided to regulated firms by so-called “critical third parties”, and they will be implementing that regime over the coming year, including the wider operational resilience regime to be fully operational by March 2025.

The Payment Systems Regulator

The Payment Systems Regulator (PSR) also published its annual plan, setting out its workplan and how it intends to deliver against its four commitments: protection, competition, unlocking account-to-account payments, and access and choice.

- As can be expected, its focus this year will be on delivering its Authorised Push Payment (APP) fraud reimbursement scheme and accompanying data reporting requirements.

- It will be publishing the final report on its cross-border interchange fees market review. and the interim and final reports on its card scheme and processing fees market review. If necessary, it will also consult on appropriate remedies.

- It will be continuing its work on open banking, as well as deciding on changes needed to enable the phased expansion of variable recurring payments to begin, and will continue its focus on ensuring that the next generation of payments infrastructure for account-to-account payments provides improvements in fraud detection and access.

- With regards to access and choice, it will undertake work including reviewing the effectiveness of Specific Direction 12 (SD12) in maintaining access to free-to-use cash machines through the LINK network. It will also set out how it intends to support the take-up of digital payment methods, including exploring how businesses can offer a wider set of variable payment options.

2. Funds

Dear CEO letter to asset managers

In the context of the economic environment, and ahead of significant regulatory change to be delivered in 2024, the FCA has published an interim update portfolio letter setting out its supervisory strategy for the asset management and alternatives portfolio, setting out updates and intentions for the year ahead, including the following:

- The FCA intends to assess, under the Consumer Duty, how asset managers have considered the price and value of products and services they provide. This is in relation to unit-linked funds but from 31 July 2024, the Consumer Duty will also apply to closed products and services.

- The FCA reminds firms within the scope of Policy Statement 21/3 Building Operational Resilience that by 31 March 2025, they will need to be able to evidence that they are able to operate consistently within impact tolerances.

- The letter also reminded firms that this year will mark the implementation of the SDR and investment labels regime, and that if they make exaggerated or misleading sustainability-related claims about investment products this will be of concern.

- The FCA announced the commencement of multi-firm work on valuation practices in private assets to ensure that, as investors seek access to private markets, they can trust that valuations are robust and reliable in all market conditions.

- The FCA has prioritised maintaining market integrity, by ensuring that firms meet threshold conditions and closely monitoring high-risk firms. The FCA reminded firms that they should have systems and controls in place to counter the risk that they might be used to further financial crime and particularly highlighted elements of the buy-side that are vulnerable to market stress. The FCA is continuing work with the Bank of England to explore the behaviours of banks and non-bank financial institutions during stressed financial market conditions.

- The FCA outlined its ongoing support of innovation and its work to identify and harness potential innovative new technologies for the UK asset management industry. Further afield, the FCA is collaborating with regulators across the world to encourage convergence of global standards in this area.

- Finally, the FCA outlined how it would be promoting competition and positive change through regulatory enhancements, modernising the Fund Authorisation process and continuing in the development of international standards relating to the sector.

FCA consultation on Payment Optionality for Investment Research

Further to the Investment Research Review published last year, the FCA has published a consultation paper CP 24/7 on its proposal to allow additional optionality for paying for investment research, by allowing firms to use bundled payments for third party research and execution services. This new option would apply in addition to the current options of paying for research from the firm's own resources or using a research payment account.

The consultation closes on 5 June.

Alternative Investment Fund Manager (AIFM) hosting

On 25 March the FCA published a new webpage on information for AIFMS using the host model to manage alternative investment funds (AIFs) known as AIFM hosting. It sets out the findings from its 2023 review including potential harm caused by this model relating to a lack of oversight of secondees and potential conflicts of interest, insufficient involvement in investor due diligence (including financial crime responsibilities), and inadequacies in capital adequacy calculations. The FCA also found misleading claims from third parties that had seconded staff to AIFMs, for example, appointed representatives holding themselves out as investment managers, wealth managers and stockbrokers, even though seconded staff were only permitted to carry out those activities for the AIFM. The FCA warns that it has already taken action against firms where it found harm arising, and is continuing to monitor this area closely.

Reserved Investor Funds

Alongside its 2024 Budget Statement, the Treasury published a policy document along with a summary of responses to its 2023 consultation, on the scope and design of a tax regime for a new UK investment fund vehicle, being an unauthorised contractual scheme called the Reserved Investor Fund (RIF). The Treasury intends to publish detailed rules in a SI at a later date.

Overseas Funds Regime (OFR)

On 1 May the Treasury and the FCA published a joint roadmap to implementing the Overseas Funds Regime. You can read our briefing on the new roadmap here. The joint roadmap includes a proposed timeline for the OFR but does note that the timelines are "subject to change and that any updates will be published on the Government and FCA websites. The current timeline is that:

- By end June 2024 HMT to publish the long-awaited implementing legislation for its January decision that EEA states in relation to UCITS regimes were equivalent for the purposes of the OFR regime.
- In September the FCA will open the OFR gateway for non-TMPR funds which can apply for recognition.
- In October, the OFR gateway will open for TMPR standalone funds. In November, the OFR gateway will open for TMPR umbrella schemes.
- Meanwhile, HMT intends to consult on extending the application of SDR to overseas funds.

Firms already in the TMPR will be offered (usually on an alphabetical basis) three-month landing slots in which to apply for recognition under the OFR, starting from October, over the following two years. In respect of funds that miss their landing slots or in respect of which the manager has failed to apply within the three-month window, will be removed from the TMPR, will cease to be a recognised scheme, and cannot be promoted to retail investors until a successful application under the OFR is made.

Firms must apply under the OFR using the FCA's online system Connect and firms will need to register as a user, which is a straightforward process. The application must be submitted using Connect, and we await details of the Form the FCA is expecting firms to use. The application fee must also be paid. The FCA will then have two months from receipt of a complete application to make its decision to recognise the scheme (or notify the applicant of a refusal).

Asset Management and common errors when applying for authorisation

The FCA published a webpage on common errors made by asset managers when applying for authorisation. The FCA also include some statistics on authorisation: in the last financial year, 73 per cent were approved in under eight months and 56 per cent were determined in less than six months (total of 310 applications).

18 per cent of applications were withdrawn or rejected due to various concerns, including:

- Senior management lacking experience or qualifications.

- Office locations outside the UK. The FCA notes it expects the mind and management of a firm to be in the UK, taking business decisions about portfolios and distribution, and effectively overseeing outsourced activities, in the UK on a day-to-day basis. The FCA also notes that it is not enough for a firm to do just compliance or administration in the UK or to have the people who make business decisions fly in from time to time.

- Business models exposing clients to risk. The FCA accepts that all business models impose some risk, but found that often applicants do not identify the risks that their business model poses or adequately consider and evidence how they might remove or mitigate those risks. Other firms have had business models which the FCA considered pose an unacceptably high level of risk to the firm's clients (particularly retail clients). The FCA has also seen examples of firms who appear to have structured their business model in a way that is intended to avoid rules that would give clients the expected level of protection.

- Outsourcing: underestimating their accountability. Firms have not considered the relevant rules, the applicant's responsibilities and the impact on their business when outsourcing. The FCA reminds firms that despite activities being outsourced, oversight and responsibility remains with the applicant firm.

- Conflicts of interest: failing to identify concerns. Asset managers will typically exercise a degree of control over client assets and money which can give rise potential conflicts of interest between the firm, the client and related parties. Some applicants fail to consider potential conflicts of interest adequately or at all. The FCA does not expect to be the one to identify potential conflicts or the risks of such conflicts and where it does then this raises concerns about the applicant.

- Redress: avoiding appropriate schemes that protect consumers. Some asset managers seek exemption from FOS and FSCS when this is not appropriate. The FCA reminds firms to consider the relevant rules on who is an eligible complainant re FOS and an eligible claimant re FSCS.

- Unready, unwilling or unorganised. The FCA expects firms to be ready, willing and organised to carry out the activities they plan to undertake. The FCA gives examples, where the relevant SMF holders had not yet been recruited or arranged for sufficient capital to be put in place. The FCA acknowledges that circumstances can change during the application but notes that it is not willing to put applications on hold for significant periods or accept significant changes to the proposed model (eg change in target market).The FCA reminds firms to review the supervisory correspondence pages for their business model before submitting an application and that firms may, if they meet the criteria, submit a request to the FCA's pre-application support service (PASS).

EU developments: AIFMD

On 26 March 2024, the Directive amending AIFMD and the UCITS Directive was published in the Official Journal. Directive (EU) 2024/927 came into force on **15 April 2024**, and must be implemented by Member States by **16 April 2026** (apart from certain measures which must be implemented the following year).

The Directive amends parts of Alternative Investment Fund Managers Directive (AIFMD), and modernises the framework governing Undertakings for Collective Investment in Transferable Securities (UCITS) level including making amendments to delegation arrangements, liquidity risk management, supervisory reporting, provision of depositary and custody services, and loan origination by AIFs.

3. Consumer Credit, Retail Banking & Mortgages

PRA's supervisory priorities for deposit takers.

On 11 January the PRA published a Dear CEO letter to UK Deposit Takers, setting out the PRA's supervisory priorities for 2024. the theme underpinning the priorities is the need for robust governance, risk management and controls at firms to enable the effective and proactive identification, assessment and mitigation of risks in an increasingly challenging and changeable operating environment.

The PRA priorities are credit risk, financial resilience, operational resilience, model risk, data risk and financial risks arising from climate change. The letter also mentions Resolution and Recovery.

The PRA warns firms that they should expect ongoing engagement with the PRA on credit and counterparty credit risk, including targeted requests for enhanced data and analysis.

The PRA also reminded firms to be mindful of the upcoming implementation of the Basel 3.1 standards, and to ensure that they plan accordingly to maintain financial resilience.

Consumer Credit portfolio letter

On 20 March the FCA published a Dear CEO letter to consumer lending firms, setting out its supervisory strategy. Three portfolios; High-Cost Lending, Mainstream Consumer Credit Lending and Credit Unions, are covered in the one letter. Points of interest include:

- There has been a contraction in high-cost lending since 2019, but consumer lending has grown overall by £6.5bn since 2021 to £118.5bn in 2023.

- The FCA priorities for the sector are:

    - Reducing and preventing serious harm, including ensuring that firms lend responsibly and sustainably.

- Setting and testing higher standards, including implementing the Consumer Duty. To note that it expects the Government to consult on moving most of the remaining requirements of the CCA 1974 into the FCA handbook “this year”.

- Promoting competition and positive change, including access to affordable credit.

Kumar v *LSC Finance Ltd*: case summary

In a recent High Court case *Kumar and others v LSC Finance Ltd*, the court examined the regulatory perimeter for regulated mortgages.

The appellants were the directors of Aureation Developments Ltd (ADL) and Aureation Construction Ltd (ACL). Each of the appellants personally, along with ACL and ADL, entered into a series of loan agreements with LSC Finance Ltd (LSC) to facilitate the purchase and developments of various plots of land. LSC was not authorised under the Financial Services and Markets Act 2000 (FSMA) to issue regulated loans or mortgages.

The loans eventually defaulted, and the appellants argued that the loans were unenforceable because they constituted regulated mortgage contracts under FSMA which LSC was not authorised to make and were, therefore, unenforceable. The High Court held, however, that the Loans were investment property loans within the meaning of Article 61A(6) of the Regulated Activities Order, and were therefore, enforceable. The evidence presented indicated that the Appellants had intended to sell the Properties to third parties and to utilise the proceeds to repay the Loans. This proved detrimental to the Appellants’ case. Ultimately, both requirements for an investment property loan were satisfied and the appeal was consequently dismissed.

This case highlights that the court will focus on ascertaining the true purpose of the loan irrespective of the lender's state of knowledge about it. This case serves as an important reminder to lenders to conduct sufficient enquiries into the borrower’s intended use before determining the regulatory status of, and entering into, a loan agreement.

Borrowers in financial difficulties.

In April the FCA published a Policy Statement PS24/2 on strengthening protections for borrowers in financial difficulty, consumer credit and mortgages. The FCA has incorporated relevant aspects of their tailored support guidance (TSG) into the FCA Handbook, together with further targeted changes to provide a stronger framework for firms to protect customers facing payment difficulties The FCA has also updated their non-Handbook guidance (FG 23/2) to reflect these changes. The rules come into force on 4 November 2024, from which date the TSG will be withdrawn.

4. Enforcement and financial crime update

FCA new approach to Enforcement

On 27 February the FCA announced changes to the way it will carry out its enforcement function. The FCA intends to improve the pace and transparency of cases and pursue a more streamlined portfolio of cases aligned to its strategic priorities where it can deliver the greatest impact. The FCA also plans to close more quickly those cases where no outcome is achievable.

As part of the new approach, the FCA is consulting on increasing the transparency of its investigations, by (among other things) announcing the target of investigations at an early stage, and providing updates during the course of the investigation. This will be subject to a public interest test. Currently investigations are only announced in very limited circumstances.

The proposal regarding publicising the start of investigations has proved extremely controversial, receiving widespread criticism from a range of stakeholders the Chancellor and industry associations. The FCA recently told the Treasury Committee that it expects to take "several months" to consider the feedback and decide next steps. We would hope that, given the extent of negative feedback, the FCA will make changes to its proposal and consult again.

AML update

In March the FCA wrote a Dear CEO letter to Annex 1 firms (businesses such as some lenders, brokers and other firms that carry out specified activities meaning they must be registered and supervised by the FCA for compliance with the Money Laundering Regulations) over AML failings. The FCA found common failings including:

- Discrepancies between firms' registered and actual activities.
- Financial crime controls which had not kept pace with business growth.
- A failure to risk assess firms own or their customers' activities properly.
- Inadequate resourcing and oversight of financial crime issues and requirements.

Proposed amendments to Financial Crime Guide

On 25 April the FCA published a consultation on amending the Financial Crime guide with the following proposed changes:

- Sanctions: Following Russia's invasion of Ukraine in 2022, they conducted extensive assessments of firms' sanctions systems and controls and are proposing to update this section to reflect what they and firms have learned.
- Proliferation Financing (PF): The guidance is being updated to ensure PF is explicitly referenced throughout the Guide where appropriate, and to highlight a 2022 update to the MLRs which requires firms to carry out PF Risk Assessments.
- Transaction Monitoring: The FCA is proposing to set out some guidance for firms on how they can implement and monitor transaction monitoring systems and support responsible innovation and new approaches, such as use of AI.
- Cryptoassets: Cryptoasset businesses registered under the MLRs have been subject to FCA supervision for AML purposes since June 2020. They are proposing to make explicit reference that Cryptoasset businesses should consult the Guide.
- Consumer Duty: The FCA is proposing that the Guide makes clear that firms should consider whether their systems and controls are proportionate and consistent with their obligations under the Duty.

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Cases update

PRA fines HSBC £57m

In January, the PRA fined HSBC Bank plc (HBEU) and HSBC UK Bank plc (HBUK) (together, the firms) £57m for historic breaches of the Depositor Protection Rules, including the failure to identify deposits which were eligible for the Financial Services Compensation Scheme. As well as the Depositor Protection Rules, the firms were found to have breached several rules, including PRA Fundamental Rule 2 that a firm must conduct its business with due skill, care and diligence.

The PRA found that HBEU had incorrectly marked 99 per cent of eligible deposits by value as ineligible for FSCS protection. Despite an internal working group established to investigate the matter in 2019, HSBC failed to notify the PRA when it became aware of the potential scale of the issue.

As part of its finding that the firms had breached Fundamental Rule 6, that a firm must organise and control its affairs responsibly and effectively, the PRA criticised the firms for failing to ensure that a senior manager, under the SMCR, had been allocated ownership of the relevant processes.

Due to HSBC's cooperation with the regulators, its fine was reduced by 30 per cent from £82m to £57m.

FCA fines former LCF director for issuing misleading promotional materials to the public

Floris Jakobus Huisamen, a former director of the now-insolvent investment firm London Capital & Finance (LCF) has been fined £31,800 and prohibited from performing any regulated function after the FCA found that he had signed off misleading promotional materials to be marketed to the public.

Examples include false statements about investments having no hidden fees, claims that LCF's lending was secured against realisable assets, false marketing of minibonds as tax-free ISAs, and references to LCF being authorised by the FCA. Despite knowledge that all these statements were untrue, Mr Huisman repeatedly approved LCF's promotional messaging.

LCF is the subject of various ongoing regulatory investigations and litigation, including an SFO criminal investigation. On 7 May the Financial Reporting Council announced that it had fined three audit firms for breaches of audit rules, including a failure to obtain an adequate understanding of the nature of LCF's business and its internal controls.

WealthTek LLP investigation

In March the FCA announced that the High Court has permitted it to pause its civil proceedings against WealthTek LLP for 12 months whilst it prioritises a parallel criminal investigation into WealthTek and its CEO, Jonathan Dance.

In April last year, WealthTek was shut down by the FCA after it was discovered that there were potential serious regulatory and operational breaches. Mr Dance's assets were subjected to a £40m worldwide freezing order. It was later revealed that there was a shortfall of £71.7m in custody assets and £9.7m in client funds, after which the FCA initiated civil proceedings against Mr Dance.

In November, the freezing order was upgraded to a restraint order under the Proceeds of Crime Act, and the FCA initiated a criminal investigation against Mr Dance into the potential offences of fraud and money laundering. Specific alleged offences include misrepresentation to clients and prospective clients regarding the holding of their assets and money, forging a letter from the FCA setting out his permissions, and transferring significant amounts of client money to his personal bank accounts.

The FCA considers that this is one of the largest frauds carried out by a regulated individual in an authorised firm.

FCA secures £1.6m for investors from alleged unlawful investment schemes

In April the FCA announced that it had secured court approval to obtain £1.6m from Argento Wealth Ltd (AWL) and its sole director Mr Daniel Willis, who promoted two alleged unlawful investment schemes.

The FCA alleged that AWL unlawfully:

- Took approximately £2.8m as deposits under loan agreements and/or as part of an unauthorised collective investment scheme.
- Arranged investments in EMB Fund Limited (EMB) totalling about US$9m which breached the restrictions on financial promotions.

The settlement agreed by the FCA was intended to prevent all of AWL/Mr Willis' remaining assets from being used up to meet the ongoing legal and living costs. Without the settlement, there would have been a significant risk of the remaining investor money being used to fund legal fees, leaving nothing for investors.

5. ESG

The FCA published its finalised anti-greenwashing guidance, in advance of the anti-greenwashing rule (AGR) coming into force at the end of May.

In April the FCA published a consultation on extending the Sustainability Disclosure Requirements (SDR) regime to portfolio management.

You can read more on both these developments in our briefing. You may also be interested in our Dispute Resolution Trends & Insights report to learn about why we anticipate more ESG actions.

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With many thanks to Eleanor Fielding, an Associate our Financial Services team for contributing to this briefing.