September 2019

Risk&Compliance

BULLETIN

What's Inside...

- FCA Senior Managers and Certification Regime Banking Stocktake Report
- FCA establishes implementation group to help industry with proposed responsible lending rule changes
- New guidance from the ICO on subject access request timescales

Foreword by

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Regulatory development has been quieter than previous months with Parliament being in summer recess through August. Nevertheless, the FCA has continued to deliver on its regulatory agenda with several publications aimed at supporting its supervisory objectives and driving forward positive change across the sectors it regulates.

The FCA has published the findings of a review into the banking sector regarding the embedding of the Senior Managers and Certification Regime (SM&CR). This publication will be of interest to firms, including Target who are in the process of embedding SM&CR as part of its extension to all FCA solo-regulated firms from 9 December 2019. The review identifies some common pitfalls and misconceptions which should be considered not just by banks, but also those firms who will soon be caught by the Regime, to support a smooth transition

The FCA has also published an insight article highlighting several Board level considerations regarding the use of Artificial Intelligence-based technologies within their systems and processes. Whilst industries are now beginning to understand the broader benefits and risks of Artificial Intelligence (AI), it is paramount that Senior Managers fully understand the finer details of AI systems, as the regulator does not consider a lack of technical expertise as an acceptable reason for failure or unintended consequences caused by inadequate application.

Over recent months, the impact of the financial crisis and subsequent regulatory reforms on lending practices has received significant interest from the Government, trade bodies and regulatory supervisors, in the context of borrowers often referred to as 'mortgage prisoners'. These are home owners with mortgages which are tied into reversion rates and are unable to switch to cheaper rates offered in the market, as they would not satisfy post reform affordability requirements.

To address the issue, and alongside the conclusions of its Mortgage Market Study which found that a high proportion of mortgage consumers who could switch to a lower rate don't do so, the FCA has put forward proposals to change its responsible lending rules. The proposed new rules will allow firms to apply a modified affordability assessment for borrowers who are up to date with their mortgage repayments and are not looking to borrow more. Whilst the FCA is still considering stakeholder feedback to its consultation, it has established a working group to support implementation of the changes, should it decide to proceed at the end of this year.

Happy reading!

This Month's Headlines

General

- FCA Senior Managers and Certification Regime Banking Stocktake Report
- FCA podcast on Culture and the Senior Managers and Certification Regime
- House of Commons Treasury Committee report on the work of the FCA and the perimeter of regulation
- FCA insight article on Artificial Intelligence in the boardroom
- New guidance from the ICO on subject access request timescales
- FCA warns Claims Management Companies to raise their advertising standards
- Government launches a call for evidence on enabling secure digital identity solutions

Consumer Credit

- There are no material updates this month for this sector

Mortgages

- FCA establishes implementation group to help industry with proposed responsible lending rule changes

Investments

- HMRC proposed changes to ISA returns

Financial Crime

- FCA Podcast on using technology to fight financial crime

Enforcement

- There are no material updates this month for this sector

Dates for the diary

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General

1.1

FCA Senior Managers and Certification Regime Banking Stocktake Report

The FCA has published its findings following a review into the embedding of the Senior Manager and Certification Regime in the banking sector. These findings will also be of interest to solo-regulated firms who will be within scope of the Regime from 9 December 2019 and insurers for which the regime commenced in December 2018. Key observations include:

Senior Manager accountability
Senior managers across all firms were clear on what accountability means in the context of their jobs and day-to-day activities, however many senior managers expressed concern around understanding the meaning of 'reasonable steps' in the context of their business. The expectation is that senior managers should be doing what they reasonably can to prevent misconduct.

Certification
Firms have broadened their approach to assessment of staff beyond solely technical skills, and managers are in a better position to assess the behaviours of their certified staff. However, the FCA did not see evidence in general that firms had made significant changes to their performance assessment processes for certification, other than incorporating expected behaviours.

Regulatory references
All firms were positive about the concept of regulatory references and its intention to address the potential issue of 'rolling bad apples'. However, firms felt that more could be done to improve the quality and timeliness of references.

Conduct Rules
Firms are often using their own values to articulate how they bring the conduct rules to life. However, there was insufficient evidence to be confident that firms have clearly mapped the conduct rules to their values and many firms were often unable to explain what a conduct breach looked like in the context of their business.

Impact on culture
All the firms talked about the work they had done to create a culture of challenge, escalation and provide a safe environment for staff to speak up. However, firms have found it challenging to find appropriate ways of measuring culture. It is therefore not clear to what extent the regime has been linked to culture.

Embedding and overcoming initial implementation issues
The FCA believes the initial implementation issues that firms faced have now been overcome, though there is room for further progress at the certification level and potentially more significant weaknesses in the implementation of the conduct rules for other staff.

In light of these findings, the FCA will increase its supervisory focus on the conduct rules and expects all SM&CR firms to ensure that they are embedding the conduct rules in their businesses to meet their obligations under the regime. The FCA will also continue to build on the links between the SM&CR and firm culture.

1.2

FCA podcast on Culture and the Senior Managers and Certification Regime

Ozge Ibrahim hosted an FCA podcast this month, joined by FCA Executive Director of Supervision for Retail and Authorisations, Jonathan Davidson, and former Chief Executive of Virgin Money, Dame Jayne-Anne Gadhia, to discuss the importance of achieving a healthy culture in financial services and embedding the Senior Managers and Certification Regime (SM&CR).

When describing what a healthy culture looks like, the FCA described an environment that is purposeful in its values and behaviours and an environment which can demonstrate psychological safety, where employees can speak up, are actively listening to one another and appreciating different perspectives, which will ultimately lead to healthy outcomes for everybody.

What the SM&CR provides, is a framework to allow individuals the opportunity both to understand how to behave and to justify their ethical positions when they're challenged to take risks that they may not be morally comfortable with.

It is hoped that the Regime will support cultural transformation by helping people 'feel both empowered and accountable because then that makes us all feel like we've got real vested interest in getting things right.'

1.3

House of Commons Treasury Committee report on the work of the FCA and the perimeter of regulation

Earlier this year, the FCA published its first Annual Perimeter Report which aimed to provide clarity around the FCA's regulatory remit and issues that have arisen over the last year. Within the report, the FCA outlined 3 broad challenges which arise at the edges of its regulatory perimeter including consumer confusion over how they are protected; firm activity outside the perimeter affecting its public interest objectives and swiftly evolving markets and business models.

In response, the House of Commons Treasury Committee has considered the FCA's observations and put forward several recommendations aimed at strengthening the regulatory perimeter and enhancing consumer protection:

- Where regulated financial institutions undertake unregulated activity, the regulatory system should ensure that clear and explicit warnings are provided at that point, with the potential consequences of the lack of regulatory cover clearly explained and sanctions for firms that fail to do so;
- The FCA should be given the power to be able to formally recommend to the Treasury changes to the perimeter of regulation, where this would enhance its ability to meet its objectives, in particular to prevent consumer harm;
- The FCA must not feel constrained from providing warnings on financial products that may cause consumer detriment. The FCA should be given powers to highlight the risks faced by financial services consumers including where an activity is beyond the perimeter of regulation. This would allow the FCA the identify and provide clear warnings about products and activities that might pose a risk to consumers, without fear of breaching its remit; and
- The Financial Policy Committee's powers to recommend that the Treasury order additional information from unregulated entities to help meet its objectives should be replicated for the FCA. There may also be case to exceed these powers by allowing the FCA to determine itself, whether it should gather data from non-regulated entities.

The report concludes that if the Treasury is not content to provide these changes then the Treasury must acknowledge that it has itself fully retained these responsibilities.

1.4

FCA insight article on Artificial Intelligence in the boardroom

The FCA has published an insight article on Artificial Intelligence (AI) aimed at supporting Board level discussions on questions of ethics, accountability, transparency and liability surrounding the use of AI in financial services.

Importantly, the FCA has emphasised that regarding AI as rooted in departments and among technicians would be a serious mistake, as having AI ringfenced in this way without adequate governance would leave an organisation exposed at the very top. Key considerations include:

Ethics
AI and machine learning technologies bring a new level of complexity to ethical decisions as accountability is less clear and the difference between right and wrong may be more nuanced.

Explainability
Whilst some coding approaches can make outcomes difficult to explain, simply trusting a machine is unlikely to be acceptable to regulators. Board members will need the confidence and the integrity to admit when they themselves do not fully understand any aspect of their firms use of AI, and to demand an explanation.

Transparency
For a firm to be transparent about its use of AI, its customers should know when and how machines are involved in making decisions and consent to that use should be an absolute requirement. Where consent is not given Boards will need to consider their approach and whether not providing an alternative means that they are excluding customers on unreasonable grounds.

Liability
Boards will need to keep an eye on the potentially changing nature of liability for services which include AI. For example, using AI to make a service more useful might expose a company to assuming greater liability for failure.

1.5

New guidance from the ICO on subject access request timescales

Following a Court of Justice of the European Union (CJEU) ruling, the ICO has updated its guidance around how long organisations must respond to subject access requests (SARs). In accordance with General Data Protection Regulations (GDPR), organisations have one calendar month to respond to requests pertaining to Individual Rights, including:

- Right of access;
- Right to rectification;
- Right to erasure;
- Right to restrict processing;
- Right to data portability; and
- Right to object.

The guidance previously stated that the day after receipt counted as day one, this has now changed and day one is to be counted as the day of receipt. The ICO has amended its guidance pages to reflect this change.

1.6

FCA warns Claims Management Companies to raise their advertising standards

From 1 April 2019, the FCA became the regulator of Claims Management Companies (CMCs) with the intention of extending the high-level standards that apply to all FCA-regulated firms to CMCs following concerns about misconduct in the sector.

This month, following a review of over 200 CMC adverts where it has found widespread poor-practice, the FCA has issued a press release reminding CMCs of their obligations under its authority, to ensure their financial promotions do not mislead potential customers. Examples of poor practice included firms:

- Failing to identify themselves as CMCs;
- Failing to state that the customer could make a claim directly, without using the services of the firm and without paying a fee;
- Giving consumers the impression that they would get a better outcome if they use the services of the CMC;
- Using the term 'no win no fee', but omitting other fees that the customer must pay;
- Including only examples of case studies where the compensation provided to consumers is very high, even though the average amount received by consumers is considerably lower; and
- Including important information in small font or in a position that is difficult to see, when it should in fact appear prominently in a promotion.

The FCA has been pursuing several courses of action in response to its findings and will be setting out actions for those firms deemed to have not met its Threshold Conditions through poor promotions. These firms will need to respond to the FCA's concerns accordingly to remain authorised and avoid having to close down.

1.7

Government launches a call for evidence on enabling secure digital identity solutions

The department for Digital, Culture, Media and Sport (DCMS) and the Cabinet Office have launched a call for evidence on enabling a Digital Identity System to support identity verification, aimed at improving citizen and consumer access to public and private sector services.

Despite all the technological innovation of recent years, the process of proving one's identity often remains difficult, time-consuming and repetitive. Current systems rely on paper documents and face to face meetings which are not themselves devoid of risks and can create barriers for individual who have complex lives and personal circumstances.

The DCMS and the Cabinet Office see significant benefits for citizens and consumers being able to create digital identities under their own control and then to use different verified attributes to access a range of services as and when needed. Such solutions could prove more private and secure than the existing framework, for example, authenticated systems under the control of the subject could verify facts rather than the underlying data such as verifying an individual is over 18 instead of disclosing a date of birth.

The consultation considers the needs and problems of identity verification, how best to establish an environment of trust in digital identity provision and the role of the Government and of the private sector in enabling secure digital identity solutions. Comments on overarching issues such as diversity, digital exclusion, privacy and ethics are of particular interest to this discussion.

The consultation closes on 15 September 2019 and a summary of relevant responses is expected later in the year.

Mortgages

2.1

FCA establishes implementation group to help industry with proposed responsible lending rule changes

Earlier this year the FCA consulted on changes to its responsible lending rules which aim to reduce regulatory barriers and help eligible consumers switch to a more affordable mortgage. The proposals introduce a modified affordability assessment which will allow lenders to offer products to mortgage owners who are up to date with their payments and not looking for any additional borrowing.

The consultation closed on 26 June 2019, and the FCA is currently considering responses with the intention of publishing a policy statement later in the year.

In the meantime, the FCA has set up an implementation group of trade associations, lenders and third-party administrators. This group will assist the industry preparations allowing them to take advantage of the proposed modified assessments sooner, should the FCA proceed with the proposed changes later this year.

The first group meeting, which was held on 2 August 2019, considered the necessary actions for all parties to prepare for, and act on including:

- The FCA confirming its policy position;
- Lenders deciding on their individual approaches to making use of any modified rules;
- Lenders providing transparency on their approaches to other stakeholders e.g. intermediaries;
- Simple and engaging communications direct to consumers;
- Any necessary consumer resources to inform subsequent decision making e.g. webpages and tools; and
- Support available from intermediaries.

A new webpage on the FCA's website page will provide summaries of the group's discussions after each meeting.

Investments

3.1

HMRC proposed changes to ISA returns

To simplify the submission process and reduce duplication in guidance, HM Revenue & Customs (HMRC) is proposing to change the statistical ISA returns (ISA25, ISA14 and ISA14a) and the ISA14 annual return and claim forms, replacing them with two consolidated forms.

The changes will see the introduction of a single ISA statistical form, similar to the current ISA14a form with two new Additional Permitted Subscription (APS) questions and information about total Dividends, Interest and Bonuses paid. HMRC is also looking to introduce a simplified ISA annual claim form which will include questions about Dividends, Interest and Bonuses removed.

ISA guidance will also be amended to reflect the changes, with three sections of guidance being replaced with two sections, one on annual returns of statistical information and another on tax claims for ISA managers.

Following consultation, the changes are intended to apply in time for the 2019/20 ISA returns.

Financial Crime

4.1

FCA Podcast on using technology to fight financial crime

FCA Director of Innovation, Nick Cook, hosted a podcast this month, joined by Global Head of Financial Crime Threat Mitigation at HSBC, Jennifer Calvery, and Co-Founder and CEO at digital banking consulting firm 11:FS, David Brear, to discuss how new technologies can be used to prevent and detect financial crime.

The discussion focused on harnessing new technologies to make better use of big datasets as an effective tool for identifying financial crime more quickly and efficiently. Anti-money laundering and financial crime innovations have not seen much activity within the FCA's regulatory sandbox space perhaps due to the risk of enforcement perceived by firms if they fail to satisfy their regulatory obligations as a result of unintended or unexpected consequences.

Effective collaboration, public and private partnerships and a coordinated regulatory framework will promote technological growth in this area and support open discussions on how data and technology can facilitate the development of new preventative measures to tackling financial crime.

Dates for the diary...

30 Sept 2019	EBA guidelines on Outsourcing Arrangements comes into force for new arrangements
31 Oct 2019	UK withdrawal from the EU
09 Dec 2019	SM&CR implementation deadline
10 Jan 2020	Implementation deadline: Fifth Anti-Money Laundering Directive
TBC	FCA Retail Banking multi-firm work on access and vulnerability
TBC	FCA changes to responsible lending rules and guidance

FCA scheduled reviews...

Innovation, data and data ethics	Publication type	Complete by
Data use and access to data in wholesale markets	Call For Input	Q2 2019/20
Operational resilience	**Publication type**	**Complete by**
Building the UK Financial Sector's Operational Resilience	Consultation Paper	Q3 2019/20
Investment management	**Publication type**	**Complete by**
Investment firm prudential regime	Consultation Paper	Q3 2019/20
Operational resilience	**Publication type**	**Complete by**
Cyber multi-firm review findings	Multi-Firm Review	Q4 2019/20
Innovation, data and data ethics	**Publication type**	**Complete by**
Treating Customers Fairly and Data	Discussion Paper	Q4 2019/20
The future of regulation	**Publication type**	**Complete by**
FCA Principles Review	Discussion Paper	Q4 2019/20
Retail banking	**Publication type**	**Complete by**
Payment Protection (PPI) complaints deadline	Final Report	Early 2020

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