



Finance Pass

CONSOLIDATED STUDY NOTES

For

CISI

Chartered Institute for Securities & Investment

UK Financial Regulation

(Level 3)

Edition: 26, December 2018

Relating to syllabus version 26.0

Covering examinations from

1 April 2019 to 31 March 2020

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UK Financial Regulation (Level 3)

Edition: 26, December 2018

Relating to syllabus version 26.0 covering examinations from 1 April 2019 to 31 March 2020

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Learning with Finance Pass Consolidated Study Notes

Finance Pass are providers of high quality eLearning material for professionals in the finance and investment industry. Our consolidated study notes are specifically designed to save time and enhance the learning experience of candidates taking professional finance examinations, principally with the Chartered Institute for Securities & Investment (CISI), the Chartered Financial Analyst Institute (CFA) and the Investment Management Certificate (IMC).

Full-time professionals who are exam candidates have limited time to read long, highly detailed course material more than once, it is often difficult to remember all the detail required and making notes is essential, but this is time consuming.

Finance Pass consolidated study notes are intended a stand-alone resource for exam preparation, they capture the required content of the approved course workbooks whilst at the same time removing unnecessary text and presenting the required content in a condensed, succinct, easy-to-digest format. Course workbooks consisting of several hundred pages of detailed information, that can often take days or even weeks to read and digest, are typically condensed into a document that can be read straight-through and clearly understood in usually less than a few days.

Ideally, exam candidates will have already read the approved course workbook and become familiar with the principles contained therein, although this is not essential. The consolidated study notes can then be used to reinforce, consolidate and bring together this knowledge and all the required material in a timely and efficient manner for an efficient exam preparation.

Section headings and numberings in the approved course booklets have been retained for ease of reference, where a section has been deleted the section numberings have not been changed.

For the longer, more detailed examination modules, the content is clearly marked as follows:

HIGH occurrence of examination questions



MEDIUM occurrence of examination questions



LOW occurrence of examination questions

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**1) FCA ensures financial markets work well, that consumers get a good deal.
Accountable to Her Majesty's (HM's) Government through HM's Treasury (HMT)**

**2) PRA focuses on financial stability, safety of deposit-takers, insurers, significant investment firms
Accountable to the BoE**

Regulators' powers govern:

Firms carrying out Regulated activities

Financial exchanges

Individuals carrying out particular functions for firms

Financial Policy Committee (FPC) – an official committee of the BoE, focuses on macro-economic and financial issues that could threaten UK economic long-term growth.

1.3 HM TREASURY (HMT)

HMT has overall responsibility for UK financial system, institutional structure & legislation

FCA directly accountable to HMT

HMT can appoint/dismiss FCA board and Chairman

FCA must submit annual report to HMT detailing operations, achievements, etc.

FCA non-exec directors also submit a report, both presented to Parliament

1.4 THE BANK OF ENGLAND (BOE)

BoE has two main core purposes:

i) Monetary Stability – i.e. stable prices (defined by inflation target) & confidence in GBP

BoE meets Government's inflation target through **Monetary Policy Committee (MPC)**

ii) Financial Stability – detecting & reducing threats to UK financial system (PRA area of interest)

PRA responsible for: promoting safety & soundness of banks, building societies, credit unions, significant investment firms

Prudential Supervision – i.e. that supervised firms hold sufficient capital

Works closely with the FPC at the BoE

FPC has responsibility to reduce overall risks to financial system€

2 THE FCA AND THE PRA AND THEIR STATUTORY OBJECTIVES

2.1 THE STATUTORY OBJECTIVES OF THE FCA & PRA

FCA Strategic Objective:

FCA Remuneration Code applies to **Dual-Regulated** (FCA & PRA) firms within the scope of **CRD IV** i.e. banks, building societies, PRA-Designated firms and UK branches of non-EEA headquartered firms.

6.10 THE ROLE OF OVERSIGHT GROUPS AND OTHER INFLUENCING BODIES

FCA requirements on firm's senior managers and directors are included in:
FCA/PRA Handbook Senior Management Arrangements, Systems and Controls (SYSC)

Number of control functions including compliance, internal audit, external oversight (auditors), these should be **independent** and can report directly to the CEO.

7 THE RELATIONSHIP BETWEEN THE FCA AND THE PRA AND VARIOUS OTHER BODIES

FSMA established two new schemes to protect consumers:

7.1 THE FINANCIAL OMBUDSMAN SERVICE (FOS)

FSMA provides for single scheme, deals with consumer-firm disputes

The **FOS** is a limited company, administers the scheme, makes rules.

Quick dispute resolution by an independent person.

FCA appoints Chairman/other Directors of FOS, otherwise independent from FCA.

FOS makes annual report to FCA.

FOS can make some rules, FCA must approve, FCA determines who is eligible to use FOS

7.2 THE FINANCIAL SERVICES COMPENSATION SCHEME (FSCS)

FSCS provides a safety net for customers when the firm cannot repay them.

Customers can make a claim with FSCS up to a certain limit (Chapter 5)

FCA appoints Chairman/other Directors of FSCS, otherwise independent from FCA.

FSCS makes annual report to FCA.

7.3 COMPETITION AND MARKETS AUTHORITY (CMA)

Introduced 2014, replaced the **Competition Commission** and the **Office of Fair Trading**
CMA promotes competition for the benefit of consumers, within/outside UK

CMA is responsible for:

Investigating mergers which may restrict competition

Market studies/investigations in markets having competition/consumer issues

Investigation of breaches of UK/EU prohibitions against anti-competitive agreements

Prosecute persons committing the **cartel offence**.

Some tools require direct client relationships e.g. supervisory/management visits
Others do not involve firms directly e.g. FCA public statements about risk of specific products, desk-based reviews

FSMA enables regulators to **change a firm's Part 4A permission** to conduct an activity if deemed a risk to the regulator's objectives

5 THE PROCESS FOR APPROVED PERSONS

FSMA requires persons carrying out Controlled Functions to be approved as fit and proper, the Approved Persons Regime (Chapter 1).

Approved persons must comply with the **Statement of Principles** and **Code of Practice**.

5.1 THE APPROVAL PROCESS

Candidate completes a form, then submitted to regulator by firm.

This establishes **employment history**, sometimes abbreviated for experienced candidates.

Approval times varies

Any new information about candidate must be divulged to regulator

5.2 FIT AND PROPER TEST

Firm must satisfy regulator that candidate is fit and proper to perform controlled function

Important criteria are:

Honesty, Integrity and reputation

Competence and capability

Financial soundness

5.3 CONTROLLED FUNCTIONS

Prior to introduction of FCA/PRA, FSA had five types of Controlled Function

Including four Significant Influence Functions (SIFs):

1) Governing Function:

Individuals directing the business e.g. directors/partners, shadow directors

2) Required Functions:

Specific functions fundamental to effective control of firm e.g. compliance oversight and money laundering reporting functions

3) Systems and Control Functions:

Individuals reporting to firm's governing body/board about its financial affairs, risk exposure and systems and controls

4) Significant Management Function:

In larger firms/proprietary trading firms, the level below the board with responsibility for a significant business unit e.g. head of equities/fixed income/settlements.

And:

5) Customer Function

Customer-dealing roles giving advice, dealing, arranging deals and managing investments e.g. investment advisor/manager, only carried on from a UK establishment. These are NOT SIFs.

FCA-Required Controlled Functions for FCA & PRA authorised persons:

Apportionment & Oversight (non-MiFID business only, for FCA persons)

Compliance Oversight

CASS Operational Oversight

Money Laundering Reporting

Benchmark Submission & Administration (non-SIF for PRA persons)

PRA-Required Controlled Functions for a PRA-authorized firm:

Actuarial

With-profits Actuary

Lloyd's Actuary

5.3.2 The CASS Oversight Function

Client Assets Sourcebook (CASS) oversight controlled function:

Applies to firms holding client's assets/money, known as **CASS-authorized firms**

Role includes oversight and reporting of firm's compliance with CASS to board and completing/submitting monthly client money and assets return (**CMAR**) to regulator.

6. THE APPROVAL PROCESS FOR FIRMS SUBJECT TO THE SMCR

SMCR introduced in March 2016 (Chapter 1), included:

- i) **Senior Managers Regime** for **Senior Management Functions (SMFs)**
- ii) **Certification Regime** for employees posing significant risk to firm/customers
- iii) **Conduct Rules** for all applicable staff

6.1 SENIOR MANAGEMENT FUNCTION (SMF) HOLDERS

FCA/PRA must approve all individuals seeking to perform SMFs

Some SMFs are FCA functions, others are PRA functions:

Senior Management Functions (SMF) for UK relevant Firms

SMF Functions held by Executives:

FCA Function	PRA Function
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Already covered, to some extent by **Criminal Justice Act (CJA)** for Insider Dealing, and by: **FSA 2012, Sections 89-92** for Misleading Statements and Practices

FSMA Market Abuse regime complements criminal regime for misleading statements & insider dealing

FCA determines whether criminal proceedings or sanctions are more appropriate

FCA will NOT:

Impose sanctions for market abuse if person is being prosecuted for insider dealing & misleading statements or *visa-versa i.e. take two bites of the cherry.*

Market abuse is a civil offence, intention does not need to be proved

FCA Market Conduct Sourcebook (MAR) sets out conduct standards

Includes **Code of Market Conduct (MAR 1)** & **Price Stabilising Rules (MAR 2)**

1.3 REPORTING OF SUSPICIONS

EU Regulations (MAR 16) require firms to have procedures to detect/report suspicious orders & transactions

Includes trading venue operators, investment firms, staff arranging/executing transactions

Any suspicion of insider trading/manipulation or attempt to commit must be reported to FCA immediately

2. INSIDER DEALING

2.1 INSIDE INFORMATION AND INSIDER DEALING

For MAR, Inside Information includes the following:

Non-public data of a precise nature relating directly/indirectly to:

i) A financial instrument:

That, if made public would significantly affect price of instrument or derivative

ii) Commodity derivatives or the spot commodity contract:

That, if made public would significantly affect price of instrument, derivatives or spot contract and:

Where this data is reasonably expected to be/required to be disclosed

iii) For persons executing orders:

It means information of a **precise nature** about an instrument conveyed by a client relating to client's pending order, that, if made public would significantly affect price of instrument or derivatives or spot contract.

Under MAR, Insider Dealing occurs in the following circumstances:

v) The Joint Money Laundering Steering Group (JMLSG) Guidance

Provided by UK Trade Associations e.g. UK Finance, Council of Mortgage Lenders (CML)
Provides guidance on interpretation & implementation of anti-money laundering provisions
NOT mandatory, highlights procedural guidance
Approved by HM Treasury
Adherence to this guidance will be taken into consideration by courts as evidence of compliance

4.1.1 Financial Crime Guide

FCA Handbook published guidance for firms re financial crime:
Not rules, only guidelines, not binding, guidance on reducing financial crime risk, enhance understanding of FCA expectations and assess adequacy of systems and controls

4.1.2 The Criminal Finances Act 2017

Amends the Proceeds of Crime Act 2002 (POCA)

- i) Extra provisions for forfeiture of assets & sharing of information re terrorist property
- ii) Creates Corporate offence for a person with a body corporate/partnership facilitating tax evasion by another person
- iii) Regulated firms under MLR 2017 must make a **Suspicious Activity Report (SAR)** to the **National Crime Agency (NCA)** to avoid offending under POCA.
- iv) NCA can issue **Consent SARs** to allow/consent/refuse person making disclosure to undertake activity involving suspected criminal property.

4.1.3 Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLR 2017)

MLR 2017 updated previous **Money Laundering Directive 3MLD (now 4MLD)**, including:

i) Risk Assessments

Now required at EU, national (UK), regulator and firm levels.
Firms must link their risk assessment with national risk assessment

ii) Policies, Controls and Procedures to Mitigate and Manage Risk

Must be written and include:
Risk management practices, Internal Controls, **Customer Due diligence (CDD)**
Reporting and record-keeping, Monitoring and Internal Communication
Board member must be appointed as an **Officer of Compliance**

iii) Customer Due Diligence (CDD) (see Section 4.4.3 for CDD, EDD, PEPs and SDD)

Firms must identify and verify ID and authority of anyone representing the customer.
Where the **Beneficial Owner** cannot be identified, the Senior person responsible for managing the customer is treated as the beneficial owner.

iv) Enhanced Due Diligence (EDD)

Enhanced Due Diligence (EDD) must be applied in higher-risk situations including **Politically Exposed Persons (PEPs)**

v) Politically Exposed Persons (PEPs) (see also section 4.4.3)

All PEPs are subject to a case-by-case proportionate EDD approach

vi) Simplified Due Diligence (SDD)

Eligibility for SDD (lower risk transaction etc.) assessed on a case-by-case basis

vii) Reliance

Reliance on another party to apply due diligence unchanged in 4MLD

Ultimately, failure to apply measures remains with the **relying party**

Reliance on high-risk country entities is prohibited, ID must be through relied upon party

Written procedures required to enable ID material to be available within 2 working days

4MLD new criminal offence: recklessly making false/misleading statement in context of ML, punishable by fine and/or up to 2 years in jail.

4.2 THE STAGES OF MONEY LAUNDERING

Three stages to ML:

i) **Placement:** Depositing money/assets into the financial system via bank, building society, bureau de change etc.

ii) **Layering:** Moving money/assets around financial system to prevent linking of funds to ultimate beneficiary
e.g. through buying/selling foreign currencies, shares, bonds, CISs, insurance products, cross country borders etc.

iii) **Integration:** After successful layering process, ultimate beneficiary holds legitimate Clean money.

Anti-ML provisions aimed at identifying customers at the placement/layering stages and preventing integration.

4.3 THE OFFENCES

4.3.1 Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLR 2017)

MLR 2017: firms must take appropriate measures and maintain records to ensure relevant employees are:

Aware of anti-ML and TF laws and requirements of protection

Trained regularly on recognizing/dealing with transactions/other related to ML/TF

2.4 DISCLOSURE OF COSTS

Firms must provide costs & charges to Retail, Professional and ECPs of services, instruments and ancillary services as follows:

Total price including all fees, charges, expenses, taxes
Basis for these costs if total cost cannot be indicated yet
Costs charged by the firm, itemized separately
Conversion rates of any foreign currencies used
Any additional costs not charged by the firm must be stated
How costs will be paid
Information about compensation schemes

2.4.1 Timing and Medium of Disclosure

Client information must be provided BEFORE provision of firm's services unless:

Client requests agreement concluded via distance communication, and
Firm complies with rules relating to voice communications

Disclosures must be made in durable medium or via firm's website.

2.4.4 Compensation Information

For MiFID business:

Firms must make compensation scheme available/alternative arrangement to client

Must include amount and scope of cover of compensation scheme
Any rules of other EEA state compensation schemes
If client requests, the conditions governing compensation and formalities to be completed
Provided in a durable medium or via website

2.4.5 Advisor Charging

FCA's Retail Distribution Review (RDR) implemented January 2013

FCA seeking to:

Improve clarity of description of firm's services to consumers
Address potential detrimental effect of adviser remuneration on investment outcomes
Increase advisers' professional standards

RDR requirements only apply to advised sales of defined retail products

(NOT non-advised business e.g. execution only and Discretionary management, unless advice is provided)

Adviser Charging rules:

A firm holding itself out as acting **independent** must provide comprehensive & fair analysis, and be unbiased & unrestricted in making personal recommendations

For MiFID investment advice or portfolio management MiFID II requires firm to:

Establish and take into account the client's:

Knowledge and experience of the investment type

Financial standing and ability to bear losses

Investment objectives and risk appetite

MiFID II covers all trades e.g. buy, sell, hold etc.

Discretionary portfolio management services will be under a client mandate, a suitability assessment is required to alter that mandate

Firms should gather enough information about client so that the service/transaction:

Has investment risk level that client can bear financially

Has risk that client will have knowledge and experience of

If firm does NOT obtain sufficient information for suitability assessment then it must NOT make a personal recommendation or decision to trade to client.

4.2.4 Assessing Suitability – Professional Clients

For MiFID or equivalent 3rd country business, a firm can assume that a **professional client** has the necessary experience, knowledge and capacity to bear any related investment risks.

4.3 THE APPLICATION OF THE RULES ON APPROPRIATENESS (NON-ADVISED SALES)

Non-advised Sales rules apply to MiFID and some non-MiFID investment services NOT involving advice or discretionary portfolio management.

They apply to firms:

- i) Providing MiFID services, other than personal recommendations and managing investments (already covered by suitability rules)
- ii) Arranging deals/dealing in warrants and derivatives for retail clients where firm is aware that client's application is from a direct offer financial promotion
- iii) That assess appropriateness on behalf of other firms

Appropriateness test provides degree of protection for non-advised transactions

4.3.1 The Obligation to Assess Appropriateness (Non-Advised Sales)

For above services, firm must ask client for knowledge and experience relating to the product/service.

To assess appropriateness, the firm:

Must determine if client has knowledge and experience to understand risks involved

Firms preparing/distributing research recommendations must comply with detailed presentation and disclosure requirements, these are to:

Ensure recommendation is fairly presented

Disclose firm's interests in or any COI concerning the investments

Give name of firm and its regulator

Give identity & job title of person preparing the recommendation

Ensure sources are reliable and any doubts indicated

Ensure facts are clearly distinguished from estimates, opinion and interpretation

Ensure projections/price targets are clearly labelled and include main assumptions

Ensure recommendation can be considered reasonable if requested by FCA

Firms disseminating 3rd party research recommendations must:

i) Identify firm and regulator

ii) Ensure summaries of 3rd party recommendations are fair, clear and not misleading

iii) Identify source recommendation and where 3rd party's disclosures are accessible

iv) Ensure disclosures above are made as if producing the recommendation itself

6.3 INDUCEMENTS AND PAYMENT FOR RESEARCH

6.3.1 Inducements

Inducement rules are payment rules; prohibit any payment unless expressly permitted

Applies to firms carrying on designated investment business, MiFID and non-MiFID

Applies only to professional and retail clients

Therefore, firms undertaking ECP business not subject to these provisions

Also applies to Independent & restricted advice, and portfolio management to a retail client

Although minor non-monetary benefits are allowed

Firms providing independent advice or portfolio management services to retail clients outside the UK or to professional clients are prohibited from receiving:

Any fees, commissions or monetary benefits (other than minor non-monetary)

If received from 3rd parties, must be returned and client advised

A minor non-monetary benefit is:

1) Clearly disclosed prior to provision of the service to client

2) Is capable of enhancing quality of service to client

3) Scale & nature is not sufficient to impair firm's compliance to act fair and honestly

4) Is reasonable & proportionate, unlikely to influence firm's behavior in a way that is detrimental to client and consists of:

i) Information/documentation relating to financial instrument/investment service, generic or personalised to individual client

ii) 3rd party written material commissioned by corporate issuer to promote a new issuance