

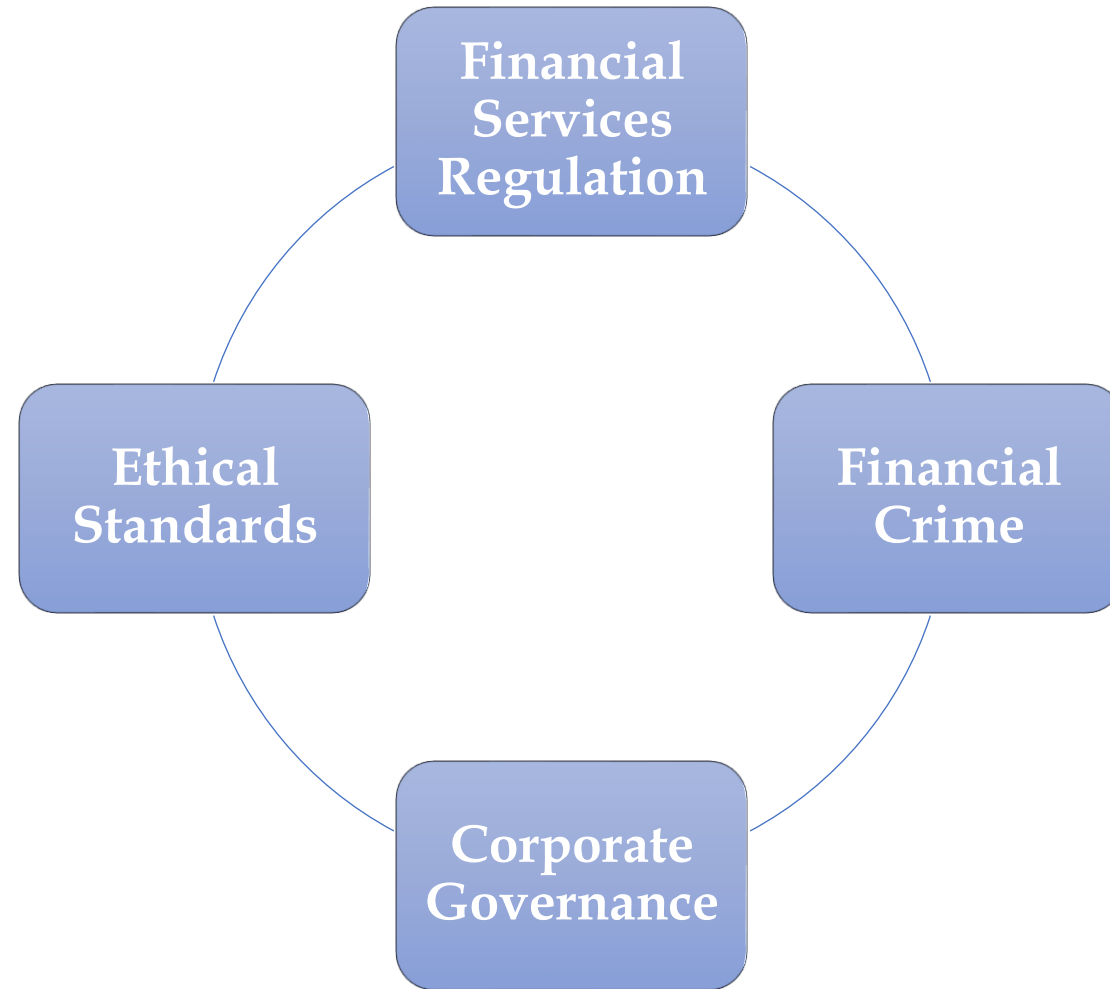


Chapter 2 – Industry Regulation

5 Questions



Chapter 2 Industry Regulation



Securities and Exchange Commission (SEC) - US

- It monitors securities exchanges, brokers, dealers, investment advisers and mutual funds.
- Aims to ensure that market-related information is disclosed to the investment community in a fair and timely manner.
- Enforces laws to prevent investors suffering from unfair trading practices and insider trading.

Financial Conduct Authority (FCA) - UK

In 2013 the FSA was replaced by new regulatory agencies known as 'Twin Peaks':

- **Prudential Regulatory Authority (PRA)**
 - Subsidiary of the Bank of England (BoE)
 - Responsible for the prudential supervision of banks, insurance companies and complex investment firms.
 - Focus on stability – ensuring the safety and soundness of deposit-taking firms, insurers and systemically important investment firms.
- **Financial Conduct Authority (FCA)**
 - Prudential supervision of brokers, wealth management companies, financial advisers and investment exchanges.
 - Responsible for the conduct of business rules that all firms must adhere to.
 - Overall ensuring that financial markets work well, so that consumers get a fair deal



European Union (EU)

- Rules and regulations are set by each country.
- Working to bring about a single market in financial services.
- Passed a series of directives aimed at harmonising rules across each country and promoting the cross-border offering of investment services and products.
- The European Securities and Markets Authority (ESMA) works on securities legislation and standard setting in order to contribute to the development of a single rulebook
- Works closely with other European supervisory authorities and the European Systemic Risk Board (ESRB) on potential risks to the financial system.

Securities and Commodities Authority (SCA or ESCA) - UAE

- Is a legal entity, which is financially and administratively independent, reporting directly to the Economy Minister.
- Main objective of the Authority is to supervise and monitor the markets which include:
 - the Dubai Financial Market (DFM)
 - the Abu Dhabi Securities Market (ADSM)
 - the Dubai Gold & Commodities Exchange (DGCE).



Self regulation

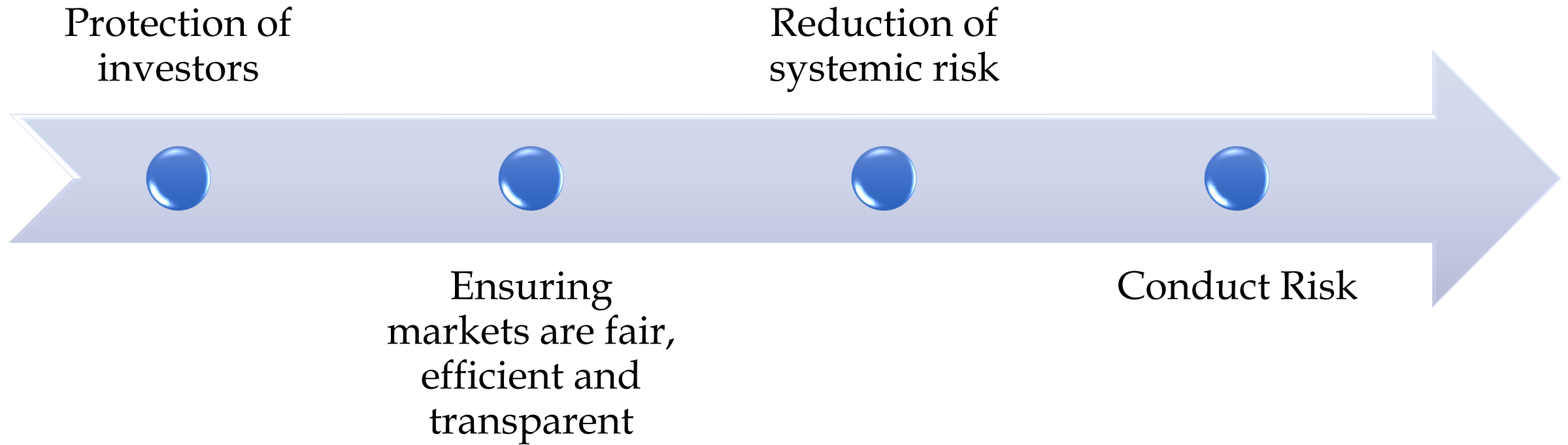
International approach

IOSCO Members objectives

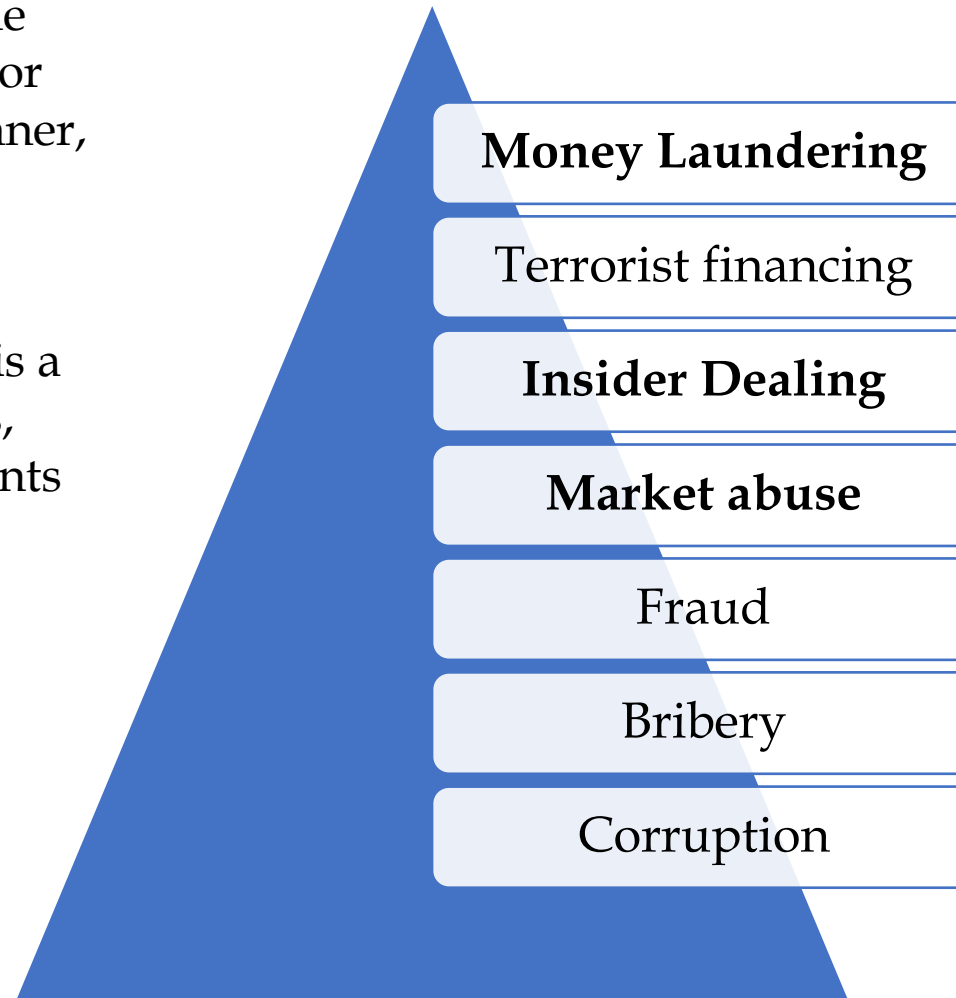
- Cooperate to promote high standards of regulation
- Exchange information to promote development of markets
- Unite their efforts to establish standards and effective surveillance of international securities transactions
- Provide mutual assistance to promote integrity of markets by a rigorous application of standards and by effective enforcement against offences
- Its members regulate more than 90% of the world's securities markets



Objectives and Principles of Regulators (IOSCO)



- Are crimes where someone takes money or property, or uses them in an illicit manner, with the intent to gain a benefit from it.
- Reducing financial crime is a key priority for regulators, authorities and governments globally.



Money Laundering

The process of turning dirty money (i.e. from criminal activities) into money that appears to be legitimate.

Dirty money is difficult to invest or spend and carries the risk of being used as evidence of the initial crime.

M/L disguises the proceeds of illegal activities as legitimate money that can be freely spent.

Anti-money laundering provisions are being seen as the front line against drug dealing, terrorism and organised crime.



International Approach to Combating Money Laundering

Financial Action Task Force (FATF) set up in 1989 by G7 Summit

- Sets standards for national anti-money laundering and counter-terrorist financing programmes
- Evaluates how effectively member countries have implemented the standards
- Identifies money laundering and terrorist financing methods and trends

Other Countries

- **US Patriot Act** - includes extensive regulatory requirements for financial institutions including client identification programme and to screen transactions and clients for risk on a routine basis.
- **UK Proceeds of Crime Act 2002 (POCA)** - earlier legislation had moved AML on to a statutory basis. Made disclosure of income sources compulsory and enabled the seizing of assets earned from illegal activities.
- **EU Money Laundering Directives** - extended the range of activities considered to be financial crimes

Wolfsberg Group: An association of 11 global banks which aims to develop financial services industry standards and related products for know your customer (KYC), AML and counter-terrorist financing policies.



Offences

- Concealing
- Arrangements
- Acquisition, use and possession
- Failure to disclose
- Tipping off

Obligations on Firms

- Appropriate internal controls to recognise and deal with suspicious transactions
- Carry out identification procedures
- Implement internal reporting of suspicions
- Keep records
- Train staff
- Appoint MLRO



Stages of Money Laundering

Placement

- The first stage and typically involves placing the criminally derived cash into some form of bank or building society account

Layering

- The second stage and involves moving the money around in order to make it difficult for the authorities to link the placed funds with the ultimate beneficiary of the money. Disguising the original source of the funds might involve buying and selling foreign currencies, shares or bonds.

Integration

- The third and final stage. At this stage, the layering has been successful and the ultimate beneficiary appears to be holding legitimate funds (clean money rather than dirty money). The money is integrated back into the financial system and dealt with as if it were legitimate.



CDD measures that must be carried out

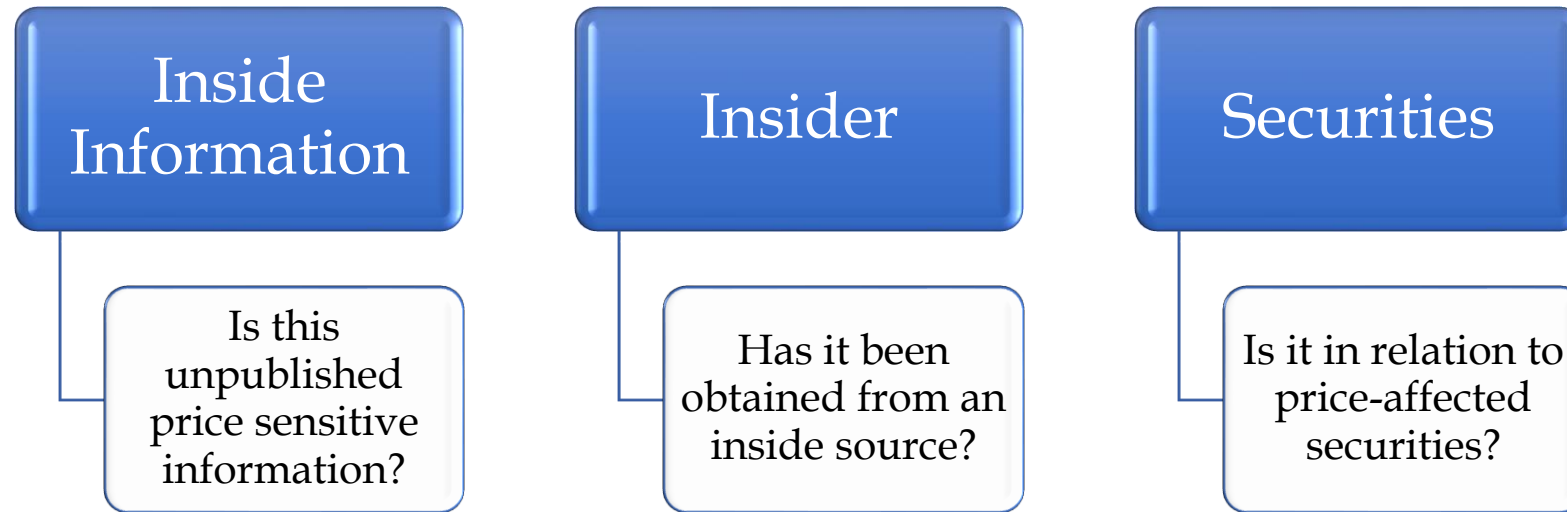
- Identification and verification of the customer
- Identification and verification of the beneficial owner
- Nature and purpose of proposed business relationship
- Source of wealth and source of funds

Enhanced Due Diligence

- Required for scenarios judged as presenting higher risk
- Politically Exposed Persons



Insider Dealing



When directors or employees of a listed company buy or sell shares in that company, and have Information that is not known to the general public, there is a possibility that they are committing a **criminal act - insider dealing**.



Inside information refers to company information that:

- is specific or precise;
- has not been made public;
- if it were made public, would be likely to have a significant effect on the price of the securities

A person may have price sensitive information:

- Through being a director, employee or shareholder of an issuer of securities.
- Gained access to the information by virtue of his employment



Instruments covered by Insider Trading Rules

Usually broadly described as 'securities', which include:

Shares

Bonds (issued by a company or a public sector body)

Warrants

Depository Receipts

Options

Futures

Contracts for difference (based on securities, interest rates or share indices)

Note that the definition of securities does not embrace:

- Commodities
- Derivatives on commodities (such as options and futures on agricultural products, metals or energy products)
- units/shares in open-ended collective investment schemes



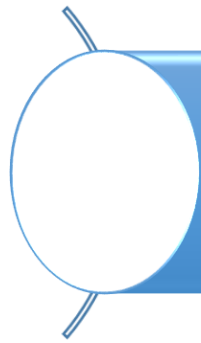
Market abuse

Refers to behaviour –

- Based on information not generally available to public
- Likely to give false or misleading impression
- Likely to distort the market

In all three cases the behaviour is judged on the basis of what a regular user of the market would view as a failure to observe the standards of behaviour normally expected in the market





Concerned with the creation of shareholder value through the transparent disclosure of a company's activities to its shareholders, director accountability and two way communication between the board and the company's shareholders.

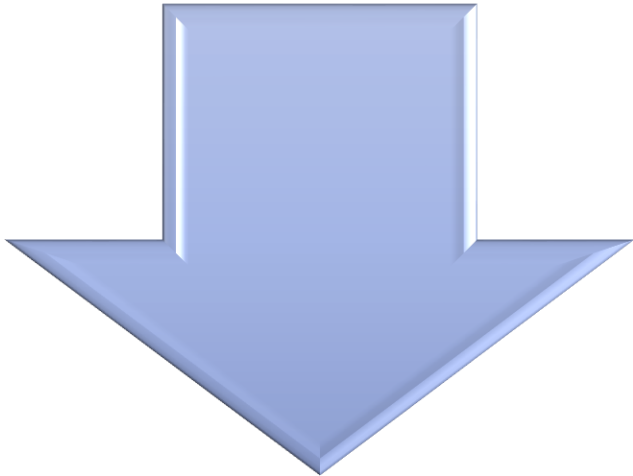
1980s saw an increase in shareholder involvement in companies, especially institutional shareholders, i.e. institutions would buy into the well-run companies and sell out of the badly run companies. As a result, institutional shareholders started paying much closer attention to the way companies were being run, as opposed to just the profitability for the company.





Internal examples

- Independent board of directors
- Separation of responsibilities between the chairman and chief executive
- Appointment of independent non-executive directors
- Specialist committees



External examples -

- Legal duties imposed on directors
- Stock Exchange Listing Rules
- Reporting of financial performance
- Independent audit of financial and other statements



Lessons from the financial crisis

- Corporate governance
- Risk management
- Remuneration systems
- Ratings agencies
- Regulatory framework

OECD Principles of
Corporate Governance have
become an international
benchmark



Ethical Standards - CISI Code of Conduct

Act honestly and fairly at all times

Act with integrity

Observe applicable law, regulations and professional conduct standards

Observe the standards of market integrity, good practice and conduct, and confidentiality required by, or expected of, participants in that market.

Manage fairly and effectively and to the best of your ability, any relevant conflict of interest

Actively maintain a level of professional competence appropriate to your responsibilities and commit to continued learning and development of others.

Uphold the highest personal and professional standards

