COMPLIANCE UPDATE

26 February 2018

WELCOME to the very first of our Quarterly publication. We endeavour to summarise relevant regulatory updates from Singapore, UK, Europe and Australia.

The publications are primarily targeted for Capital Market Services Licenced intermediaries dealing, advising on regulated derivatives, including but not limited to FX and CFDs with passporting in the above jurisdictions.

We have selected some latest notable publications from the regulators for your attention.

SINGAPORE

1. **A Guide to Digital Token Offerings**, Nov 2017

MAS stated that if a digital token constitutes a product regulated under the securities laws administered by MAS, the offer or issue of digital tokens must comply with the applicable securities laws.

Offers or issues of digital tokens may be regulated by MAS if the digital tokens are capital markets products[1] under the Securities and Futures Act ("SFA").

MAS will examine the structure and characteristics of, including the rights attached to, a digital token in determining if the digital token is a type of capital markets products under the SFA.

Offers of digital tokens which constitute securities or units in a CIS ("Offers") are subject to the same regulatory regime in Part XIII of the SFA as offers of securities or units in a CIS respectively made through traditional means.

- Prospectus Requirements: Under Part XIII of the SFA, Offers are required to be made in or accompanied by a prospectus that is prepared in accordance with the SFA and is registered with MAS.
- However, Offers can be exempt from the **Prospectus Requirements** pursuant to the following exemptions[2]:

    - the Offer is a "small offer" of securities of an entity, or units in a CIS, that does not exceed S$5 million (or its equivalent in a foreign currency) within any 12-month period, subject to certain conditions;
    - the Offer is a "private placement offer" made to no more than 50 persons within any 12-month period, subject to certain conditions;
    - the Offer is made to "institutional investors" only; or
    - the Offer is made to "accredited investors", subject to certain conditions.

The exemptions are respectively subject to certain conditions which includes advertising restrictions.

In addition, where an offer is made in relation to units in a CIS, the CIS is subject to authorisation or recognition requirements. Under the SFA, an authorised or a recognised CIS must comply with investment restrictions and business conduct requirements.[3]

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[1]Section 2(1) of the SFA: "capital market products" means any securities, futures contracts, contracts or arrangements for the purposes of foreign exchange trading, contracts or arrangements for the purposes of leveraged foreign exchange trading, and such other products as MAS may prescribe as capital markets products.

[2]Section 2.6 of The Guide to Digital Token Offerings, MAS

[3]Securities and Futures (Offers of Investments)(Collective Investment Schemes) Regulations 2005 ("SF(OI)(CIS)R"), the Code on Collective Investment Schemes ("Code on CIS") and the Practitioner's Guide to the CIS Regime under the SFA.

MAS noted that one or more of the following **types of intermediaries facilitating offers or issuing digital tokens**:

1.1 A person who operates a platform on which one or more offerors of digital tokens may make primary offers or issues of digital tokens ("primary platform")
- A person who operates a primary platform in Singapore in relation to digital tokens which constitute any type of capital markets products, may be carrying on business in one or more regulated activities under the SFA.
- Where the person is carrying on business in any regulated activity, or holds himself out as carrying on such business, he must hold a capital markets services license for that regulated activity under the SFA, unless otherwise exempted.

1.2 A person who provides financial advice in respect of any digital tokens
- A person who provides any financial advice in Singapore in respect of any digital token that is an investment product, must be authorised to do so in respect of that type of financial advisory service by a financial adviser's licence, or be an exempt financial adviser, under the Financial Advisers Act ("FAA").

1.3 A person who operates a platform at which digital tokens are traded ("trading platform").
- A person who establishes or operates a trading platform in Singapore in relation to digital tokens which constitute securities or futures contracts, may be establishing or operating a market.
- A person who establishes or operates a market, or holds himself out as operating a market, must be approved by MAS as an approved exchange or recognised by MAS as a recognised market operator under the SFA, unless otherwise exempted.

Cross border consideration: Where a person operates a primary platform, or trading platform, partly in or outside of Singapore, or outside of Singapore, the requirements of the SFA may nevertheless apply extra-territorially to the activities of that person under section 339 of the SFA.[4]

Where a person who is based overseas, engages in any activity or conduct that is intended to or likely to induce the public, or a section of the public, in Singapore to use any financial advisory service provided by the person, the person is deemed to be acting as a financial adviser in Singapore.

MAS highlighted that the following **AML/CFT** may apply:

1. relevant MAS Notices on Prevention of Money Laundering and Countering the Financing of Terrorism ("AML/CFT Requirements");
2. AML/CFT-related obligations from other regulatory authorities, such as the Suspicious Transactions Reporting Office and the Commercial Affairs Department; and
3. Prohibitions from dealing with or providing financial services to designated individuals and entities pursuant to the Terrorism (Suppression of Financing) Act (Cap. 325), and various regulations giving effect to United Nations Security Council Resolutions.
4. MAS' proposed new Payments Services Framework would also include requirements for mitigation of AML/CFT risks.

As part of its FinTech initiatives, MAS invites any firms that are looking to apply technology in an innovative way to provide new financial services that are or are likely to be regulated by MAS, to apply for MAS' **Fintech Regulatory sandbox**. MAS expects that interested firms would have done their due diligence, such as testing the proposed financial service in a laboratory environment and knowing the legal and regulatory requirements for deploying the proposed financial service, prior to applying.

If an application is approved, MAS will provide the appropriate regulatory support by relaxing specific legal and regulatory requirements prescribed by MAS, which the applicant would otherwise be subject to, for the duration of the sandbox.

[4]Guidelines on the Application of Section 339 (Extraterritoriality) of the SFA (Guidelines No. SFA15-G01)

2. **CP I on Draft Notices and Guidelines to the SFA**, Oct 2017

The CP is concerned with CMS Licensees in respect with their OTC derivatives activities for retail investors. MAS proposals:

1. New Notice on Risk Fact Sheet for Contracts for Differences ("CFD Notice") and Guidelines on MAS Notice on Risk Fact Sheet for Contracts for Differences ("CFD Guidelines")
   - The new CFD Notice sets out the requirement for CMS Licensees and Exempt Financial Institutions dealing in CFD with retail investors to provide a risk fact sheet to the retail investors. It also prescribes the format of the risk fact sheet and minimum information that must be included in the risk fact sheet.
   - The accompanying CFD Guidelines provide guidance to assist CMS Licensees and Exempt Financial Institutions in preparing the risk fact sheet.

   These new requirements are proposed to take effect when the Securities and Futures (Amendment) Act 2017 ("SF(A) Act") is put into use, to be further advised in AlbaMD further Updates.

2. Amendments to SFA04-N13 Notice on Risk-Based Capital Adequacy Requirements for Holders of CMS Licences ("RBC Notice")
   - The proposed amendments to the RBC Notice are consequential amendments from the changes to product definitions in the Securities and Futures Act ("SFA") and the Second Schedule of the SFA to extend the capital markets services licensing regime to OTC derivatives.

3. Amendments to MAS Notices 757, 1105, 109, 816, and SFA 04-N04, which relate to the Lending of Singapore Dollar to Non-Resident Financial Institutions ("MAS Notice 757 and Equivalent Notices")
   - MAS is proposing to amend MAS Notice 757 and equivalent Notices to take into account the change in the definition of "securities" in the SF(A) Act.
   - MAS has also proposed to amend the scope of SFA 04-N04 from CMS licensees "regulated to conduct dealing in securities" to "holders of CMS licenses to carry on a business of dealing in capital market products" that are securities, units in a collective investment scheme, or securities-based derivatives contracts.
   - MAS proposed that SFA04-N04 will not apply to a CMS licensee if it did not deal in securities-based derivatives contracts, even if its CMS license permits it to deal in capital markets products that are exchange-traded derivatives contracts or OTC derivatives contracts.

4. New Guidelines on the Interpretation of "Persons Who Commonly Invest" in Division 3 of Part XII of the SFA ("Common Investors Guidelines")
   - The new Guidelines seek to provide interpretive guidance for the statutory definition of the term "Common Investor" and its application in the insider trading provisions.

The Guidelines clarify that the term "Common Investors" can comprise different classes of investors and may differ from product to product depending on the product's investment risk level, complexity, cost of investment, accessibility and any applicable regulatory restrictions.

MAS intends to set out in the Common Investors Guidelines a set of knowledge descriptors and abilities that would describe retail investors, which make up a sizeable proportion of the investing public.

MAS noted that these characteristics could also apply to accredited investors, expert investors and institutional investors.

MAS highlighted that for information to be considered "generally available", the test to be applied is whether the information has been made known in a manner that would, or would be likely to, bring it to the attention of all classes of Common Investors for the relevant product.

The Guidelines also highlighted that information may be taken to have a material impact on the price or value of securities, securities-based derivative contracts or CIS units, if one or more classes of Common Investors might be influenced by the information in deciding whether or not to subscribe for, buy or sell the aforementioned securities, securities-based derivative contracts or CIS units.

This month, The Monetary Authority of Singapore (MAS) issued a consultation paper P005-2018, proposing regulations for trading of over-the-counter (OTC) derivatives on organised markets, main objective being

improving market transparency. This requirement will complete MAS' implementation of the G20 OTC derivatives reforms.

MAS proposes to impose obligations for the most globally-traded OTC derivatives, namely interest rate swaps denominated in US Dollar, Euro and Pound Sterling to be traded on organised markets, i.e. exchanges or other centralised trading facilities. These obligations will apply to banks whose gross notional outstanding OTC derivatives exceed $20 billion. Please click here to view the consultation paper on the proposed regulations on the mandatory trading obligations for OTC derivatives.

UK & EU

With regards to CFD space, there is a valuable video discussion where Robert Taylor, Head of Asset Management Global Strategy and Gunnar Burkhart, a senior adviser give an overview of regulatory concerns. To watch, lease click *here*

The discussion includes an overview of Inherent Risks including:

- Client onboarding
- Appropriateness and Suitability Testing
- Conduct Risk
- Reputational Risk
- Prudential Risk including Counterparty and Liquidity Risks

It gives an insight into FCA toolkits applied if the risks were mismanaged. There are several areas FCA are focusing on:

- prudential requirements: ICAAP, recovery and resolution plans
- client money
- senior managers and certification regime
- financial promotions
- best execution
- anti-money laundering

FCA and ICO publish joint update on GDPR

The FCA and the Information Commissioners Office (ICO) have published and update on the EU General Data Protection Regulation (GDPR), Feb 2018.

The EU General Data Protection Regulation (GDPR) will apply in the UK from 25 May 2018. It is an essential step forward in enhancing the privacy and security of personal data. The GDPR will be regulated and enforced in the UK by the Information Commissioner's Office (ICO). Financial services firms will need to consider how the GDPR will apply to them and ensure that they are ready to comply with the regulations from May 2018.

The requirement to treat customers fairly is also central to both data protection law and the current financial services regulatory framework.

While the ICO will regulate the GDPR, complying with the GDPR requirements is also something the FCA will consider under their rules, for example, the requirements in the Senior Management Arrangements, Systems and Controls (SYSC) module. As part of their obligations under SYSC, firms should establish, maintain and improve appropriate technology and cyber resilience systems and controls.

Office for Professional Body Anti Money Laundering Supervision (OPBAS)

OPBAS has begun its work, under regulations which came into force on 18 January 2018. OPBAS is hosted within the FCA and has responsibility for overseeing the standards of anti-money laundering supervision by the professional body supervisors outlined in Schedule 1 to the MLRs 2017. This is part of a suite of measures by the Government as part of a wider package of reforms to strengthen the UK's AML supervisory regime.

Algorithmic Trading

Firms operating in wholesale markets increasingly use algorithms in their trading activities. The FCA and Prudential Regulation Authority (PRA) have been reviewing firms' algorithmic trading activity and have issued supervisory publications. For firms solo-regulated by the FCA, please refer to published report here.

Automated technology brings significant benefits to investors, including increased execution speed and reduced costs. However, it can also amplify certain risks. It is essential that key oversight functions, including compliance and risk management, keep pace with technological advancements. In the absence of appropriate systems and controls, the increased speed and complexity of financial markets can turn otherwise manageable errors into extreme events with potentially wide-spread implications. As a result, algorithmic trading continues to be an area of focus for the FCA and other regulators across the globe.

While this report highlights key requirements in MiFID II, it will also be of interest to all firms that develop and/or use algorithmic trading strategies. Depending on the nature of a firm's algorithmic trading activity, certain areas of the report may be more relevant than others.

FCA' expectations of providers and brokers of retail contract for difference (CFD) products, which include spread betting and rolling spot foreign exchange (FX), updated Jan 2018, to access, click here.

We all already noted the business shaping publications such as:

1. ***Dear CEO Letter***
2. Latest information on FCA and ESMA's work in relation to the sale of CFDs and binary options to retail clients:

   2.1 ***Statement on ESMA's ongoing work on possible product intervention measures applicable to retail CFD and binary option products***, Dec 2017.

   ESMA is considering measures to:

   - Prohibit the marketing, distribution or sale of binary options to retail clients.
   - Restrict the marketing, distribution or sale to retail clients of CFDs, including rolling spot forex.

   The restrictions on CFDs currently under review are:

   - leverage limits on the opening of a position between 30:1 and 5:1, whose limit will vary according to the volatility of the underlying asset
   - a margin close-out rule
   - negative balance protection to provide a guaranteed limit on client losses
   - a restriction on benefits incentivising trading, and
   - a standardised risk warning

   2.2 ***Statement on contract for difference products and CP16/40***, 29 June 2017

   Given progress in ESMA's own consideration of the use of its product intervention powers in this area, the FCA has decided to delay making final conduct rules for UK firms providing CFDs to retail clients, pending the outcome of ESMA's discussions. However, FCA is reinforcing its recommendation for firms to reinforce its expectations of customer appropriateness assessments concerning distribution of CFDs to retail clients, please click *here*. Furthermore FCA encourages firms to assess their systems and practices in view of pending obligations under the Markets in Financial Instruments Directive II (MiFID II), which takes effect (for firms) on 3 January 2018.

AUSTRALIA

1. **Australian Parliament passed the Bill to establish the Australian Financial Complaints Authority (AFCA)**:

finally agreed and passed by both houses on 14 Feb 2018. Higher monetary limits and compensation caps, including for primary production businesses, will give more consumers and small businesses access to a free and independent forum to resolve their complaints.

- AFCA will start accepting complaints no later than 1 November 2018
- The operator of the scheme will be authorised by the Minister, and the scheme will be subject to ongoing oversight by ASIC.

ASIC' Consultation Paper could be accessed *here*.

2. **The Australian Securities and Investments Commission (ASIC) has taken an interest in the mobile app market.**

The targets of ASIC's recent investigations have been the residents of the darker corners of the app stores, which facilitate a pseudo-investment subculture that seeks to operate outside the usual regulatory environment. Citing concerns about unlicensed financial services activity and associated consumer protection risks, ASIC cracked down on web and mobile based OTC derivative providers in July 2016, and, in March 2017, it requested the removal from the Apple and Google stores of more than 330 apps that facilitated binary options trading (BOT apps).

ASIC also raised concerns over unlicensed retail OTC derivatives providers and increased activity among licensed brokers, providing a range of financial services, including for trading in margin FX contracts, CFDs and binary options.

However, no updates superseding ASIC 2016' compliance review were published recently. In its Report 482 ASIC guides on major 7 Risks, affecting AFS Licensees and its appointed representatives, namely:

- Failure to comply with net tangible assets (NTA) requirement
- Failure to comply with notification requirements for changes of control and issues around new ownership compliance
- Failure to comply with client money provisions
- Poor, misleading or deceptive Product Disclosure Statements (PDS) and website disclosure
- Failure to comply with financial reporting obligations
- Failure to supervise authorised representatives and noncompliance by authorised representatives
- Claims that no financial services are being provided under the AFS licence

3. **Cyber security**

There is no current legal obligation under the Privacy Act to notify either the Privacy Commissioner or affected individuals where you suffer a data breach. However, mandatory data breach notification laws took effect in Australia on 22 February 2018 and applies to all Australian companies that are currently subject to the Privacy Act.

Where an entity is aware that there are reasonable grounds to believe that there has been an 'eligible data breach' of the entity it must notify the Privacy Commissioner and affected individuals. An 'eligible data breach' occurs where there is unauthorised access to, disclosure of or loss of personal information, which is likely to result in serious harm to affected individuals.

Depending on the circumstances, there are three options for notification to individuals to whom an eligible data breach relates:

- Option 1: notifying each of the individuals to whom the relevant information relates.
- Option 2: notifying only those individuals at risk of serious harm from the eligible data breach.
- Option 3: where neither options 1 or 2 are practicable, the entity must publish a copy of the prescribed matters on their website and take reasonable steps to publicise the contents of those statements.

A key exception to the notification obligation is where effective 'remedial action' has been taken before the breach causes serious harm.

Important takeaways:

- Updating internal processes: Review and implement your data breach response plans. The OAIC will release additional guidance over the next few months to help businesses and agencies prepare for changes.
- Third party providers: Businesses will need to consider the implications of the notification regime in relation to outsourcing or other arrangements with third parties who hold personal information for the organisation.

Other publications to note:

- ***Bank of England Staff Working Paper No 1711*:** first holistic paper published about the "Judgement Day" or "Black Thursday", discussing algorithmic trading around the Swiss franc cap removal, Feb 2018

- Updated ***FX Global Code***, Dec 2017

Conducting business in accordance with regulatory Principles, Codes, Guidances, Acts, Notices could prove a challenge, especially if your business is also subject to cross border rules.

Avoid the trap of treating compliance as a burden. Here in AlbaMD we are dedicated for you to meet set industry and regulatory standards. We are open to mutually beneficial collaborations, broadening our professional excellence and your success.

Looking forward to a brighter future, in joint efforts.

Yours Sincerely,

Ina Mackinnon, *CEO & Founder*