COMPLYPORT
COMPLIANCE LEADERSHIP

Complyport Limited
4 Cavendish Square, London W1G 0PG
t: +44 (0) 20 7399 4980 f: +44 (0) 20 7629 8002
e: info@complyport.co.uk w: www.complyport.co.uk

Regulatory Roundup – 5 November 2009
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New Liquidity rules come into force on 1 December 2009 – Are you ready?

If your firm is a BIPRU firm then the following should assist in complying with the new liquidity rules coming into force this December.

If your firm is not a BIPRU firm (e.g. an exempt CAD) then this is for information purposes only.

The liquidity requirements contained in the new BIPRU chapter are being introduced in a phased approach. For non-ILAS firms, as of 1 December the relevant parts of BIPRU 12 (see Regulatory Roundup of 8 October 2008) are implemented apart from the overall liquidity adequacy rule ("OLAR"), which comes into force in November 2010. During the intervening period firms are expected to follow the overall financial adequacy rule set out in GENPRU 1.2.26. Although OLAR does not come into force until November 2010, we suggest firms work on the basis that the OLAR is in force. This will ensure that the requirement in GENPRU 1.2.26 will be met during the transitional period whilst reducing the need to make further changes to procedures to meet the November 2010 requirements.

Although at present non-ILAS firms are only required to submit one data form to the FSA (FSA055) containing a systems and controls questionnaire, BIPRU 12 requires such firms to document and report their systems, procedures and review results to their governing body for approval.

The rules require a non-ILAS firm, amongst other matters, to consider its liquidity risk, its tolerance to liquidity risk, the systems and procedures to enable appropriate assessment and approval of these and consideration of matters (both firm specific and market wide) that could impact on its liquidity risk and adequacy. The impact that these matters would have are then quantified through rigorous stress testing and consideration of contingent funding plans that may be necessary to cover periods of liquidity strain.

It is therefore essential that all affected firms are prepared for the new liquidity rules and have considered how they will manage their compliance with BIPRU 12. We will be sending Complyport clients a document summarising what we consider will be the key matters that a non-ILAS firm needs to cover when documenting their compliance with the liquidity rules.

What does it really mean?

All firms will be familiar with assessing the business risks and implementing procedures, systems and controls to document and continually monitor these. For firms who have not been performing stress test and financial scenario calculations the new liquidity rules are likely to pose a challenge. In a nutshell, the liquidity rules go beyond the consideration of risks and controls and require a degree of detailed financial analysis.

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The liquidity rules are underpinned by the OLAR which requires a firm to maintain sufficient liquidity resources to ensure there is no significant risk that it cannot meet its liabilities as they fall due. To do this the firm firstly needs to have appropriate financial projections in place to illustrate the forecast liquidity profile of the firm and to provide a framework to identify the risk tolerance of the firm, periods of strain, the factors which impact on liquidity and hence the matters that may need to be considered when stress testing.

The outcome of the firm's liquidity profile and risk tolerance will undoubtedly impact on the severity to which stress testing and contingent funding plans (for emergency situations) needs to be considered. As such the process is highly bespoke and there are no model answers. Each governing body needs to consider the specific matters that impact on their own liquidity assessment and ensure the systems and controls in place are adequate and appropriate.

It is important to note that the OLAR applies on a solo basis such that each firm must be self sufficient in terms of its own liquidity and as a rule cannot rely on liquidity support from other members in the group.

If retained clients of Complyport wish to discuss the requirements of BIPRU 12 and how they could affect you in more detail please get in touch with your usual Complyport contact who can arrange for one of our liquidity team consultants to contact you. We would also be happy to discuss with you any additional services we can provide in the reviewing of, or assisting in the preparation of, your documentation.

Non retained clients that require assistance with this issue, or for further information on services that Complyport can provide, please contact Diane Gwilliam.

Private Equity & Conflicts of Interest

IOSCO – the International Organization of Securities Commissions – has published a consultation paper on 'Private Equity Conflicts of Interest'. The working group was chaired by Dan Waters, the FSA's Conduct Risk Division Director.

The document outlines the key conflict of interest risks through the life cycle of a typical private equity fund: Fund Raising; Investment; Management; and Exit. Chapter 5 sets out 8 principles for the effective mitigation of conflicts of interest although most, if not all, will be matters that such FSA regulated firms already consider in accordance with the requirements in SYSC 10.1. Annex 1 is interesting in that it provides an outline of typical private equity fund structures in various jurisdictions.

Comments to IOSCO are invited by 1 February 2010.

http://www.iosco.org/library/pubdocs/pdf/IOSCOPD309.pdf

Sukuk and see

HM Treasury and FSA have issued a joint document on 'alternative finance investment bonds' ('AFIBs'). These are a subset of the sukuk market, which in turn are financial instruments that conform to the principles of Islamic law (Shariah). The structure of some sukuk instruments means that they will be regarded as collective investment schemes. This was felt to place an additional regulatory burden on AFIBs when compared to conventional bonds or asset backed securities. In order to remove this issue there are proposed changes to various Statutory Instruments including the Regulated Activities Order and FSMA 2000 (Collective Investment Schemes) Order 2001. The report stresses that in doing so the

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Government is not extending special favours to the Islamic finance sector but rather ensuring that economically equivalent financial instruments are afforded equivalent regulatory treatment. Although there has already been one consultation period, the paper welcomes further comments by 6th November. It is intended that the legislation and the necessary changes to the FSA handbook will come into force by early 2010.

http://www.fsa.gov.uk/pubs/cp/afibs_sukuk.pdf

Financial Action Task Force report ('FATF')

FATF has released a report on Money Laundering and Terrorist Financing in the Securities Sector. The document is based upon a mixture of questionnaire results and workshops/consultations. Comment is made that suspicious transaction reports ('STR') in the securities industry are relatively low, although the theories on why this may be so range from a lack of understanding of STR requirements to the more prosaic inconsistency in the definition of 'security'. Appendix B, in the document linked below, lists a series of 'suspicious indicators' which firms may find useful for training purposes although it may seem fairly common sense, for instance, a customer refusing to provide adequate information or being 'unusually concerned' about a firm's AML/CFT policies. There are also various real life case studies scattered throughout the document e.g. case study 14 on the failure to identify beneficial owners of offshore trust accounts.

http://www.fatf-gafi.org/dataoecd/32/31/43948586.pdf

Fine time

UBS (AG) has been fined £8m for failures in systems and controls that enabled four employees to carry out unauthorised transactions involving customer money 'on at least 39 accounts'. As is the norm, the fine would have been larger (£10m) but for UBS agreeing to settle at an early stage. Although fairly eye-watering, the fine is only the third largest ever - beaten by Shell in 2004 with a fine of £17m for market abuse and by Citigroup in 2005 with a fine of £13.9m (the FSA maintains a 'Fines table' which can be accessed using the link below). In addition to the fine UBS has paid compensation in excess of US$42.4m to affected customers. The thrust of the FSA case against UBS (and in the Citigroup case) was based upon breaches of Principle 2 ("A firm must conduct its business with due skill, care and diligence") and of Principle 3 ("A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems"). Specific failings are referenced in sections 4.27 and 4.30 of the Final Notice – see link below – including inadequate training; failure to have clear ownership of responsibilities; lack of, or inadequate, documented procedures; and recommendations from internal reviews not being acted upon. If any of that sounds familiar that might be because the Final Notice relating to the recent Barclays case, concerning failures in transaction reporting, referred to the same failings. Whilst the two firms were involved in completely different activities that gave rise to the respective Enforcement cases, the Notices illustrate areas of weakness that can be common to any firm.

http://www.fsa.gov.uk/Pages/About/Media/Facts/Fines/index.shtml

http://www.fsa.gov.uk/pubs/final/ubs_ag.pdf

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If any of the topics discussed above raise questions or a need for guidance or support, please feel free to contact Peter Carlisle at peter.carlisle@complyport.co.uk

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