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Regulatory Roundup
8th October 2014
Issue 59

In Brief:

Risk Management: Credit Rating Agencies: EU Directive issued to counteract perceived over-reliance on credit ratings

Submission of Annual Accounts (FIN-A): New rules come in to force on December 31st

UCITS V: EU Directive now in force; changes required to remuneration policies

Fixed Overheads: Clarification of methodology provided by the EBA in draft Delegated Regulation

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Risk Management: Credit Rating Agencies Submission of Annual Accounts (FIN-A)

Useful links:

Directive 2013/14/EU

This will be of particular interest to those firms responsible for the management of **AIFs** and **UCITS** (and occupational retirement schemes – IORPS - that are subject to Directive 2003/41/EC).

To counteract a perceived over-reliance on credit ratings when investing in debt instruments, Directive 2013/14/EU will be applicable from **21 December 2014**.

For a Directive it is pleasantly short – three pages – and has the effect of amending relevant Articles in UCITS IV (2009/65/EC: Article 51); AIFMD (2011/61/EU: Article 15); and IORPS (2003/41/EC: Article 18). In essence, when implementing risk-management measures it will **not** be permissible to "**solely or mechanically**" rely on credit ratings issued by credit rating agencies when assessing the creditworthiness of assets.

The Directive's requirements will be incorporated into the Handbook by way of an amendment to COLL 6.12.3 (UCITS) and to FUND 3.7.5 (AIFs). The amendments will simply transpose the relevant wordage in Directive 2013/14/EU – a link is provided to assist firms.

Useful links:

Regulatory Roundup 55

FCA 2014/52

The rules surrounding the need to submit annual report and accounts via GABRIEL using **FIN-A** upload functionality (see Regulatory Roundup 55) will come into force this coming 31 December.

The rules, contained within (new) SUP 16.7A, and FIN-A guidance can be found in Part 2 of Legal Instrument FCA 2014/52.

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UCITS V

Useful links:

[Directive 2014/91/EU (UCITS V)]

[Directive 2009/65/EC (UCITS IV)]

[Regulatory Roundup 53]

Those firms subject to UCITS may want to note on the calendar that **UCITS V** (Directive 2014/91/EU) came into force on **17 September** (see also Regulatory Roundup 53). However there is no immediate panic as Member States have until **18 March 2016** (Article 2) to transpose the Directive into national law so we can expect a consultation paper or two from the FCA in the intervening period.

The good news is that UCITS V only consists of four Articles, although the downside is that Article 1 runs to around 20 pages. The reason for this is that Directive 2014/91/EU does not rewrite UCITS but rather has the effect of amending the current UCITS IV (Directive 2009/65/EC) – with all the amendments being in Article 1. As such, to understand the requirements of UCITS V **both** the Directives have to be read together.

It's worth drawing attention to Article 1(2) of UCITS V as this introduces the need for firms to have in place **remuneration policies** and practices that do not encourage risk taking. As mentioned in the Article, ESMA has been asked to draw up guidelines on the application of UCITS remuneration obligations. At first sight the requirements look similar to those within the AIFMD and indeed the Directive requests ESMA to endeavour to ensure the resultant guidelines "be aligned to the extent possible" with those under the AIFMD. A further area of similarity is the requirement to **disclose** certain details of **remuneration paid** (see Article 1(13)).

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Fixed Overheads
Recovery and Resolution: Simplified Obligations

Useful links:

[Regulatory Roundup 53]

[Draft Delegated Regulation]

[Delegated Regulation 241/2014]

Regulatory Roundup 53 advised that the EBA had published draft **Regulatory Technical Standards (RTS)** relating to the calculation of **own funds** based upon **fixed overheads** required under **CRR Article 97**.

Although possibly of little more than passing interest to BIPRU firms, the RTS is very relevant **to UCITS firms**, **full-scope AIFMs** as well as CRD IV **IFPRU firms**. The reason for this is that whilst UCITS firms and AIFMs may fall under different Directives, their **own funds** are required to be calculated with reference to CRR Article 97. Whilst what does and does not constitute 'fixed overheads' is clear for BIPRU firms (CRD III), unfortunately the same is not true of CRD IV and the EBA, in consultation with ESMA, were requested to draft appropriate technical standards.

The EC has now published draft Delegated Regulation, based upon the EBA recommendations, on the methodology of calculating 'fixed overheads'. The effect of the draft is to add an additional chapter to current Delegated Regulation 241/2014 which concerns technical standards for own funds requirements. The Regulation will come into force 20 days after being published in the Official Journal so until that time both documents will need to be read together.

Useful links:

[EBA Consultative Guidelines]

[EBA Draft ITS]

[Regulatory Roundup 58]

[CP14/15]

Regulatory Roundup 58 included an article on the **Recovery and Resolution Directive** (RRD) which will impact upon 'institutions', a term which covers both credit institutions and investment firms (an **IFPRU 730K firm** – see Regulatory Roundup 58 for how the RRD redefines the latter). It is intended that proportionality be adopted ("simplified obligations") as set out in Article 4 of the RRD.

The EBA has recently published draft guidelines on the application of simplified obligations together with draft Implementing Technical Standards (ITS). The FCA has, of course, issued its own Consultation Paper (CP14/15) in which it is proposed that the simplified obligations will apply to a firm that is not a 'significant IFPRU firm' as defined in IFPRU 1.2.3.

The EBA consultations end 3 January 2015.

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Changes to Companies Act
Corporate Governance

Useful links:

[Small Business, Enterprise and Employment Bill]

The 'Small Business, Enterprise and Employment Bill' is progressing through Parliament. Aside from topics ranging from zero hours contracts to public houses code via childcare and schools, some **changes** to the **Companies Act 2006** are proposed.

Part 7 proposes:

- All UK companies (unless a DTR 5 **issuer** or as specified by the Secretary of State) will be required to keep a **register** of persons ('PSC register') who have a significant control over the company (more than 25% or has right to appoint/remove directors) (s70 & Schedule 3)
- All company directors will need to be natural persons i.e. **no corporate directors** (s76)
- A change to the definition of 'shadow director' (s79)

As mentioned above the Bill is going through the parliamentary process with the Government expecting it to become law by May of next year (the general election being timetabled for 7 May 2015).

Useful links:

[Corporate Governance Code 2014]

[Corporate Governance Code 2012]

The Financial Reporting Council ('FRC') has updated the UK Corporate Governance Code ('Code').

Although all companies can use the Code as a source of reference in establishing their corporate governance arrangements, compliance with the Code is a **regulatory requirement** for listed companies. By way of example, in the Handbook LR 9.8.6 requires statements to appear within a firm's annual financial report on how it has complied with the Main Principles and whether or not it has complied with all relevant provisions in the Code – and if not then an explanation must be provided.

The FRC advise that companies with reporting periods beginning before 1 October 2014 should continue to report against the previous edition of the Code (2012), although they are encouraged to consider whether it would be beneficial to adopt some or all of the new provisions in the revised Code.

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AIFM Prudential Requirements

Now that the transitional period under the AIFMD has passed, more firms will be getting to grips with the obligations of IPRU(INV) 11 which addresses the prudential requirements of both **Collective Portfolio Management Firms** (CPM) and **Collective Portfolio Management Investment Firms** (CPMI). As a reminder the former is a **full-scope UK AIFM** (or UCITS management company) that does not have Part 4A permission to undertake any of the permitted MiFID-type activities (as under AIFMD Article 6(4) or under UCITS Article 6(3) as relevant) whilst the latter type of entity does.

For the avoidance of doubt, IPRU(INV) 11 is **not** relevant to **small AIFMs**; they will either be under IPRU(INV) 5 if they only undertake 'managing an AIF' but if they undertake any MiFID activities outside of this then they will be a MiFID firm and so fall under GENPRU/BIPRU or IFPRU as applicable.

Some of the requirements under IPRU(INV) 11 are based upon either the **"funds under management"** (the 'funds under management requirement' of IPRU(INV) 11.3.2) or the **"value of the portfolio of AIFs managed"** (for 'professional liability risks' as per IPRU(INV) 11.3.14 or 11.3.15).

The "funds under management" figure for the calculation **includes** AIFs & UCITS which the firm is the appointed AIFM/UCITS firm (so will include those funds where it has delegated the portfolio management) but **excludes** any third-party funds it is managing as a delegate.

On the other hand the "value of the portfolios of AIFs managed" will not only **include** those AIFs for which the firm is the AIFM but will **also include** the portfolio management of third-party AIFs. Unlike 'funds under management', the calculations only involve AIFs; there is no mention of the value of UCITS or other third-party portfolios that are not AIFs. The prudential requirements of the AIFMD were modelled on UCITS IV so both Directives have a funds under management requirement of 0.02% of the amount by which FUM exceed €250m; in contrast only the AIFMD has a professional liability requirement.

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AIFMD and Safe Custody

Useful links:

CP14/18

As part of the implementation of the AIFMD, changes were made to the Regulated Activities Order (RAO) so that firms that were managers of UCITS and AIFs were deemed not to carry on any specified activity other than '**managing a UCITS**' or '**managing an AIF**' as appropriate. As a result, such firms would **not** require any other regulated activities such as 'managing investments' etc. on their Part 4A Permission (although, of course, if such firms also carried out permitted MiFID-type activities **outside** of managing a UCITS or AIF then they would need the appropriate activities added).

A consequence of this is that AIFMs are not deemed to be carrying on the activity of 'safeguarding and administering investments' (which for Permission purposes is sub-divided into 'arranging' and 'without arranging'). On the face of it this should not be an issue because the AIFMD requires a Depositary to be appointed to hold the AIFs' assets. However this created a loop-hole because **small AIFMs** are not required to appoint a Depositary so we currently have a situation where a small AIFM can hold the assets of an AIF and yet not be subject to the regulatory requirements of CASS 6 ('Custody Rules').

The FCA proposes amending the Handbook to include a new definition: "excluded custody activities". This will be activities that would have amounted to 'safeguarding and administering investments' **if** it was not for the exclusion arising from the amendment to the RAO. Following this, CASS 6 (and CASS 10 – "CASS resolution pack") will be amended so that it captures a small AIFM carrying on 'excluded custody activities' and so closing the loop-hole.

The Handbook changes can be found in Appendix 4 of Quarterly Consultation CP14/18.

The consultation period ends 5 November.

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AIFMD Reporting Timetable

Useful links:

SUP 16.18

ESMA Guidelines 2014/869

FCA: AIFMD Reporting Q&As

Alert

Those AIFMs that have been authorised under the AIFMD for some time will probably have gotten used to the AIFMD reporting requirements set out in SUP 16.18.

However for those AIFMs that have only recently been authorised a reminder that the **reporting period** is based upon the **calendar year** and is not based upon a firm's accounting year. As such January 2015 will be a busy time as the **31 December 2014** is a reporting period applicable to **all** AIFMs, with a requirement to provide the information no later than **one month** after the period end.

Small AIFMs have to report annually to 31 December each calendar year whilst larger AIFMs have to report either half-yearly (to 30 June and 31 December) or quarterly (as half-yearly plus 31 March and 30 September) – see the table in SUP 16.18.4 for further details.

The procedure for **first time reporting** is set out in ESMA Guidelines. AIFMs should start reporting as from the first day of the **following quarter day** until the end of the **first reporting period**. By way of example, a small AIFM authorised on 22 July 2014 (i.e. in Q3) would start reporting information as from 1 October 2014 to 31 December 2014; thereafter the firm would revert to annual reporting.

Please see our 'Alert' for further details, including the use of new forms **AIF001** and **AIF002**.

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COBS and CoCos

Useful links:

COBS 22

FCA Restriction Notification August 2014

A new chapter in COBS came into force on 1 October – **COBS 22** "Restrictions on distribution of contingent convertible instruments". The provisions are effectively a copy of the short-lived COBS 4.14 (and which is now deleted) which was brought in as **temporary product intervention** rules. Under COBS 22.1.1(4) the rules will still cease to have effect on 1 October 2015.

These instruments ('CoCos') - basically convertible bonds whose conversion rights are contingent upon a particular event such as, if issued by a Bank, the Bank's tier one capital ratio falling below a set threshold - are regarded by the FCA as higher risk and unsuitable for retail investors.

Under COBS 22.1.1 a firm is **not** permitted to **sell** a CoCo to a **retail client** in the **EEA** or do anything that might result in such a retail client either buying or having a beneficial interest in such an instrument – unless 'reasonable steps' are taken to ensure that one or more of the exemptions in COBS 22.1.2 applies. For the purposes of this chapter note the broad definition of 'retail client' in COBS 22.1.1(3).

The table in COBS 22.1.2 is similar in concept, but not in content, to that in COBS 4.12 which concerns the promotion of non-mainstream pooled investments. By way of example, a retail client that meets the **self-certified sophisticated investor** requirements set out in **COBS 4.12.8** will meet a permitted exemption under COBS 22.1.1(2).

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Peter Carlisle

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