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Regulatory Roundup
31 July 2015
Issue 66

In Brief:

AIFMD Passport and non-EU Jurisdictions: ESMA issues advice of extension of AIFMD passport

Registered Investment Advisers: Personal Account Dealing Guidance: SEC expresses its views on the application of Rule 204A-1

Remuneration Guidelines: UCITS V and AIFMD (and CRD IV): ESMA consultation published

Remuneration: Changes to Handbook: New rules for dual-regulated firms come in to force and revised proportionality guidance issued

Money Laundering: Gold: FATF produces report on gold sector

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In the Complyport Regulatory Roundup:

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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.

AIFMD Passport and non-EU Jurisdictions

Useful Links:

[Regulatory Roundup 60]

[Press Release]

[ESMA Advice 2015/1236]

[ESMA Opinion 2015/1235]

As mentioned in Regulatory Roundup 60, by 22 July 2015 ESMA has to provide an opinion/advice on:

- The functioning of the EU AIFM passport (managing and marketing)
- The **extension** of the passport regime **to non-EEA AIFMs**; and
- The marketing of **non-EEA** AIFs by **EEA AIFMs**

Although ESMA did not make the deadline, it finally published its 'Advice' and 'Opinion' on 30 July.

The '**Advice**' concerns the application of the AIFMD passport to non-EEA AIFMs and AIFs.

Rather than a blanket approach, ESMA has decided to opt for a country-by-country assessment of the possible extension of the AIFMD passport. The **list of the 22 non-EEA countries** to be assessed can be found in s32 of 2015/1236, although ESMA is only in a position to issue advice on: **Hong Kong**, **Singapore**, **US**, **Guernsey**, **Jersey** and **Switzerland**.

The assessments can be found in pages 17 to 52 of the paper, although basically it's a thumbs-up to the application of the AIFMD passport to Guernsey, Jersey and Switzerland (but subject to the enactment of amendments to its Stock Exchanges and Securities Trading Act); a delay in the decision for Hong Kong, Singapore and the US.

The '**Opinion**' concerns the functioning of the AIFMD passport and of the National Private Placement Regimes (NPPR).

Echoing some observations made elsewhere, ESMA comments that:

- There are divergent approaches with respect to the marketing rules (fees charged by competent authorities get a mention);
- The definition of what constitutes a 'professional investor'; and
- Varying interpretations of what activities constitute 'marketing' and 'material changes'.

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AIFMD Passport and non-EU Jurisdictions (continued)

Having made those observations there was insufficient evidence to suggest that the AIFMD EEA passport had raised major issues. As for NPPRs, ESMA sees merit in the preparation of another opinion after a longer period of implementation has passed in all Member States.

ESMA's Opinion can be found in 2.2 (EEA Passport) and 2.3 (NPPR) of 2015/1235, although as each barely extends to half a page there is not really much more added than is captured in the above bullet points. What might be more interesting is the information in the responses received based upon first-hand experiences e.g. fees charged for the passport in Member States can vary between as much as €7,000 in Luxembourg and nothing in the UK, Ireland and Netherlands (s55 to s59). Another respondent had problems with the **definition** of a **professional investor** in Germany and France where the concept of 'professional investors' and '**semi-professional investors**' exists (s71)

Both the 'Advice' and the 'Opinion' represent ESMA's views; it will be down to the European Commission, Parliament and Council to consider them.

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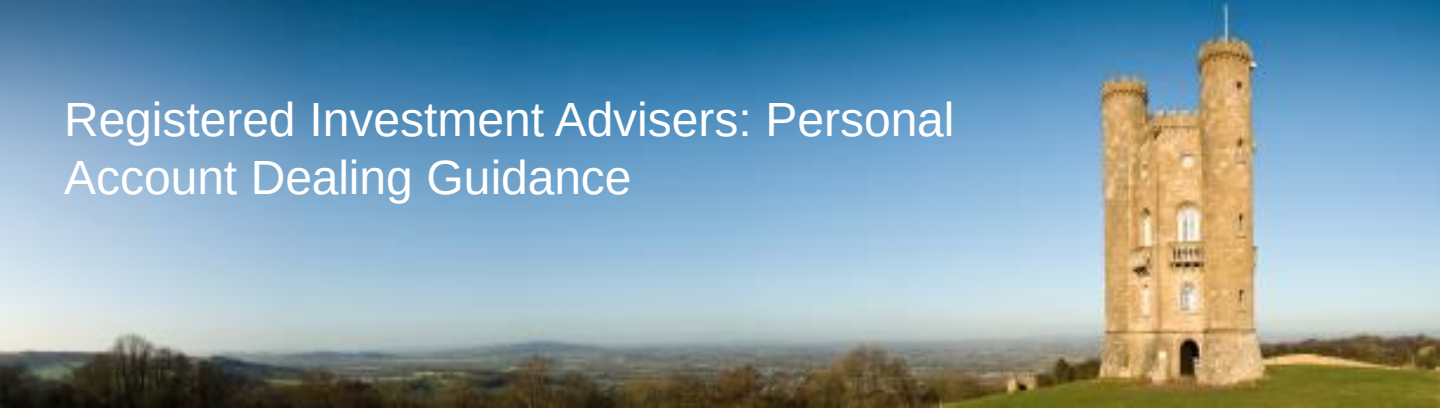

Registered Investment Advisers: Personal Account Dealing Guidance

Useful links:

[SEC Guidance Update]

In late June 2015, the United States Securities and Exchange Commission (SEC) Division of Investment Management released Guidance Update No. 2015-03 entitled "**Personal Securities Transactions Reports by Registered Investment Advisers: Securities Held in Accounts Over Which Reporting Persons Had No Influence or Control**." Despite the title, **Exempt Reporting Advisers** should also take note of the Guidance.

Through the Guidance, the SEC expressed its views on the application of **Rule 204A-1** in the context of any trust and third-party discretionary accounts of '**access persons**' (see below). The end result is an increase in an adviser's responsibilities under Rule 204A-1 of the Investment Advisers Act of 1940 (Advisers Act) with regard to administering its Code of Ethics.

Rule 204A-1 and the "Reporting Exception"

Section 204 of the Advisers Act and Rule 204A-1 thereunder compels an investment adviser to establish and enforce a written code of ethics that requires the adviser's directors, officers and partners and its supervised persons who have access to non-public information regarding securities transactions ('**access persons**') to report their personal holdings and transactions. One caveat to Rule 204A-1 comes in the form of Rule 204A-1, subsection (b)(3)(i) (also known as the "**reporting exception**") whereby an exception is made to rule 204A-1 when an access person's securities are held in accounts over which he or she has "no direct or indirect influence or control." **Historically**, advisers and access persons have relied on the reporting exception for trust accounts, managed accounts, and other similar third-party discretionary managed investment accounts.

Guidance Update

In the Guidance, the SEC takes the position that the fact an access person provides a trustee with management authority for which he or she is grantor or beneficiary, or provides a third-party manager discretionary investment authority over his or her personal account, by itself, is insufficient for an adviser to reasonably believe that the access person had no direct or indirect influence or control over the trust or account for purposes of relying on the reporting exception.

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Registered Investment Advisers: Personal Account Dealing Guidance (continued)

The SEC noted that providing a third-party discretionary investment authority would not prevent an access person from:

- Suggesting purchases or sales of investments to the trustee or third-party discretionary manager;
- Directing purchases or sales of investments; or
- Consulting with the trustee or third-party discretionary manager as to the particular allocation of investments to be made in the account.

In the Guidance, the SEC staff state "an access person's discussions with the trustee or third-party discretionary manager concerning account holdings may also, in certain circumstances, reflect direct or indirect control or influence."

The SEC did provide some possible controls an adviser may consider to establish a reasonable belief that an access person has no direct or indirect influence or control (and hence eligible for the reporting exception) including:

- Obtaining information about a trustee or third-party discretionary manager's relationship to the access person (i.e. independent professional versus friend or relative; unaffiliated versus affiliated firm);
- Obtaining periodic certifications by access persons and their trustees or third-party discretionary managers regarding the access persons' influence or control over trusts or accounts;
- Providing access persons with the exact wording of the reporting exception and a clear definition of "no direct or indirect influence or control" that the adviser consistently applies to all access persons; and
- On a sample basis, requesting reports on holdings and/or transactions made in the trust or discretionary account to identify transactions that would have been prohibited pursuant to the adviser's code of ethics, absent reliance on the reporting exception.

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Registered Investment Advisers: Personal Account Dealing Guidance (continued)

In the Guidance, the SEC definitively states a general certification that an access person did not exercise direct or indirect influence or control would, on its own, likely **be insufficient**. The SEC further suggests obtaining more specific certifications from a firm's access persons and/or the third party discretionary manager confirming the access person has not exercised any direct or indirect influence over the account.

Actions

It will be appreciated that the SEC Guidance on such accounts **goes further** than the MiFID-based requirements in COBS – specifically see COBS 11.7.5. Firms that are also Registered Investment Advisers should therefore review their current personal dealing procedures to ensure that they are compliant with both COBS 11.7 and SEC Guidance.

HOW CAN WE HELP?

Complyport has a dedicated US Desk headed up by Ross Goffi, a qualified Lawyer and Consultant in US financial services, regulation and compliance.

To find out more about how we can help with your US Compliance Requirements, please contact your usual consultant or email us at **info@complyport.co.uk**

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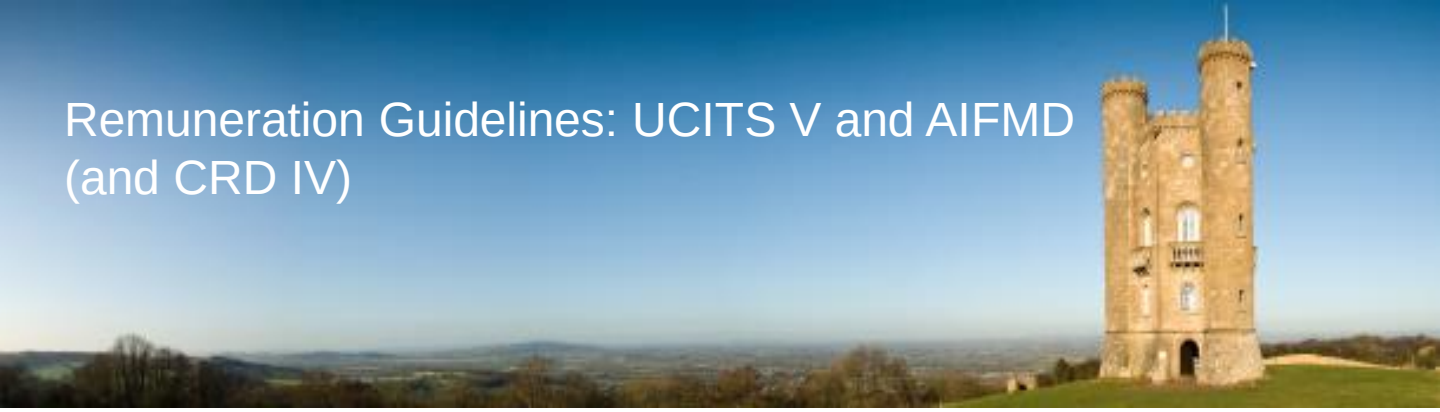
Remuneration Guidelines: UCITS V and AIFMD (and CRD IV)



Useful links:

[Regulatory Roundup 59]

[Regulatory Roundup 65]

[2015/ESMA/1172 (UCITS V)]

[ESMA/2013/232 (AIFMD)]

An article in Regulatory Roundup 59 on **UCITS V** drew attention to the introduction of the concept of **remuneration policies** for UCITS management companies, with ESMA being charged with drawing up guidelines on the application of such UCITS remuneration obligations which were to "be aligned to the extent possible" with those under the AIFMD. The article also contained **links** to both UCITS IV and UCITS V – 'Article 14b' in the latter contains the UCITS remuneration principles.

ESMA has now published a consultation paper (2015/ESMA/1172) on remuneration guidelines relating to UCITS V.

The principle of **proportionality** is maintained in that 'on an exceptional basis' some of the requirements might be disapplied if this is reconcilable with the risk profile of the management company – although see section 7 for the details.

The requirements that might be **disapplied** are the need to have a Remuneration Committee and the 'pay-out process rules' which includes the concepts of:

- the need to have at least 50% of variable remuneration in units of the UCITS concerned;
- the need for the instruments to be subject to an appropriate retention policy;
- deferral of 40% to 60% of variable remuneration over a minimum period of three years; and
- performance adjustment.

The equivalent AIFMD 'pay-out process rules' (and which can also be disapplied on the grounds of proportionality) can be found in SYSC 19B.1.17 to SYSC 19B.1.20.

This is in **contrast** to the recent EBA views on proportionality in the context of **CRD IV** firms in which it was proposed that there was **no scope for disapplication** of **any** of the CRD IV remuneration principles - see Regulatory Roundup 65 for further information.

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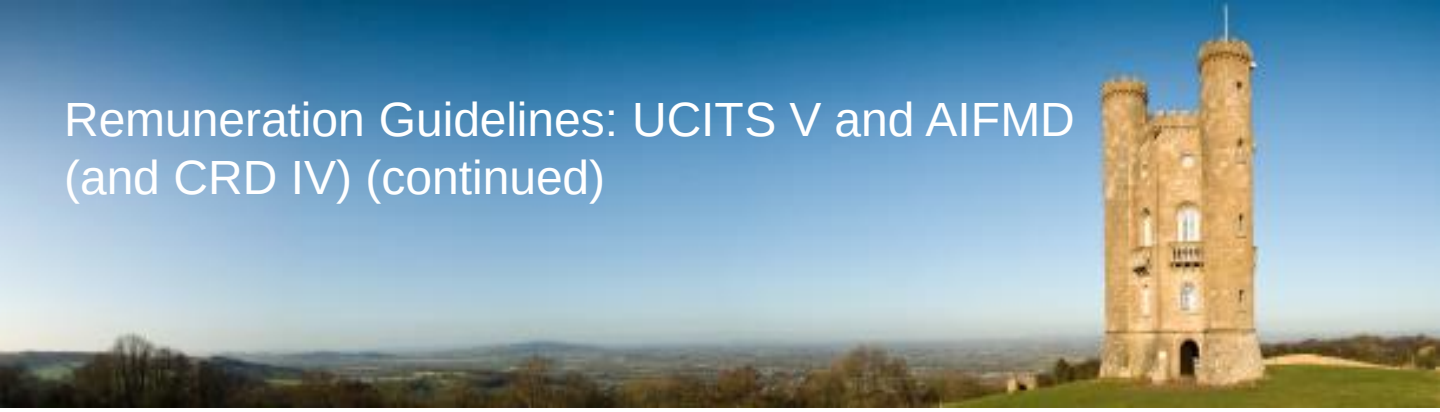

Remuneration Guidelines: UCITS V and AIFMD (and CRD IV) (continued)

Useful links:

Interestingly, and although separate Directives, in arriving at its views on the application of (UCITS) proportionality, ESMA took into account the EBA's reading of the **CRD IV** remuneration provisions. Notwithstanding those views, ESMA was of the opinion that an **alternative legal reading** of the equivalent provisions of the UCITS V Directive could be envisaged with the acceptance of the possibility of the disapplication of some of the remuneration principles.

Firms with mixed business models will be aware that those that are subject to both the AIFMD Remuneration Code (SYSC 19B) and the BIPRU Remuneration Code (SYSC 19C) are not required to demonstrate compliance with the latter provided they are compliant with the former (SYSC 19C.1.1A) – unfortunately no similar provision applies to those firms that find themselves subject to the (CRD IV) IFPRU Remuneration Code. In its Remuneration Guidelines paper ESMA considers how **different sectoral remuneration principles** (CRD IV, AIFMD and UCITS Directive) could be applied. It proposes that firms have the choice of **either** applying remuneration regimes on a pro rata basis based on objective principles **or** simply applying those principles which are "deemed more effective for achieving the outcomes of discouraging excessive risk taking and aligning the interest of the relevant individuals with those of the investors in the funds they manage".

The paper also proposes some **changes** to the **AIFMD Guidelines** (ESMA/2013/232) for AIFMs that are part of a group (page 105).

Elsewhere **Annex I** contains a useful comparison table of UCITS V vs. AIFMD texts on remuneration.

Comments are invited by 23 October 2015.

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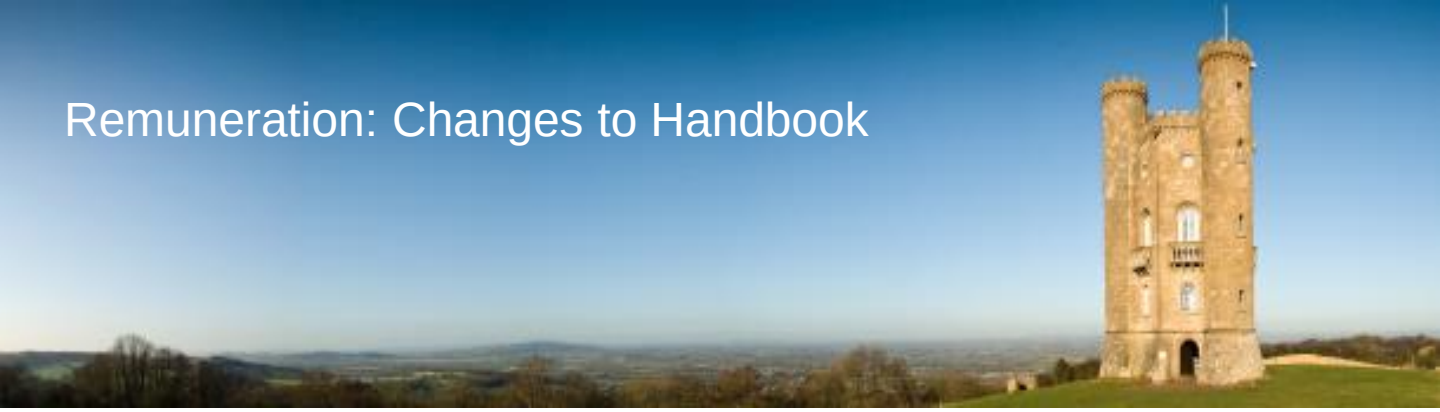
Remuneration: Changes to Handbook



Useful links:

[Regulatory Roundup 58]

[FCA PS15/16]

Whilst on the subject of remuneration (see previous article) it may be recalled from Regulatory Roundup 58 that a new Remuneration Code was to be introduced into the Handbook: SYSC 19D "Dual-regulated firms Remuneration Code".

The new rules came into force on **1 July** and, as the title implies, is relevant to those firms that are regulated by the PRA and FCA. These are largely building societies and banks but there are a handful of investment firms that are also dual-regulated. The **IFPRU Remuneration Code** (SYSC 19A) has been **amended** to reflect the impact of the creation of SYSC 19D, including the definition of 'Remuneration Code Staff' (SYSC 19A.3.4(1)).

Although the rules are obviously now in the Handbook, it is worth referring to the joint PRA/FCA Policy Statement "Strengthening the alignment of risk and reward: new remuneration rules" (FCA PS15/16) because tucked away in Annex 4 are the latest versions (1 July 2015) of **FCA Proportionality Guidance** for **IFPRU firms** (SYSC 19A) and **BIPRU firms** (SYSC 19C) – which includes Pillar 3 Disclosure - as well as new Guidance for dual-regulated firms.

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Money Laundering: Gold

Useful links:

FATF: Money Laundering and Gold

FATF has produced a report on the gold sector as a result of what is seen as a transition of money laundering and terrorist financing from the formal financial sector and the cash market to the gold market as regulators and law enforcement harden those environments. Various case studies appear in chapters 2 and 3 (and in Appendix B) with chapter 4 containing 'red flag' indicators to assist with the identification of suspicious activities.

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Performance Management

Useful links:

[Performance Management: FG15/10]

The FCA has published Guidance on the risk to customers from performance management at firms (FG15/10) – the paper advises that it will be relevant to **all types of firm** with staff who deal directly with **retail** customers.

In the context of the issued Guidance 'performance management' refers to the process (e.g. appraisals, sales targets etc.) through which organisations manage how people and teams behave to achieve objectives. The concern is that incentives that are misaligned can lead to pressure on staff to sell, or perhaps more appropriately to mis-sell, products.

Despite previous missives from the FCA – including, of course, the concept of Treating Customers Fairly – thanks to a combination of whistleblowers and media articles it believes that in some cases the reward structures remain sales-focussed, even if terminology has changed from 'sales' to 'meeting customer needs'.

The paper is fairly short at 15 pages but manages to pack in some examples of 'good practice' such as senior management actually listening to what frontline staff say about the culture of the firm and maintaining good relationships with staff bodies as well as including a case study.

The Guidance concludes with the requirement that all firms with staff who deal directly with retail customers should read the paper and consider:

- how their approach to performance management may increase the risk of mis-selling;
- whether their governance and controls are adequate, and
- taking action where required to ensure the risks are adequately managed.

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Client Money and Custody Rules

Useful links:

[FCA Report and Accounts 2014/15]

[FCA: CASS web page]

The FCA has recently completed a review of **24** firms for their compliance with **CASS**.

Although the firms reviewed operated in the CFD and spread betting arena, all firms subject to CASS should take on board the findings to compare them with their own internal processes.

The review makes depressing reading in that the visit teams found a range of CASS issues at all of the firms visited. Common themes were:

- CASS resolution packs: Incomplete with missing core contents requirements and records, inadequate frequency of updates and lack of formal approval by the governing body;
- Internal client money reconciliation: Non-compliant or no internal reconciliation using external bank balances only. Lack of adjustment for un-cleared cheques and unidentified receipts. Some firms were giving credit to client accounts before funds had cleared through various payment systems without prefunding. Some firms included negative equity in the client money requirement;
- Acknowledgement letters: Incorrect wording, account names and unsigned letters; and
- Client agreements: some terms did not reflect the practice of how the firms were treating clients.

We are informed that this list was not exhaustive in the issues identified.

The review ends with the promise that **more short notice visits** will be carried out in the future and that "our expectations will be raised in terms of compliance". Looking at the wider picture, the recently published FCA Report and Accounts for 2014/15 reveal (page 55) that a total of **159 firms** were subject to CASS-related visits during the year, with the FCA taking **action** against **28 firms** and **27 individuals** for CASS failings and imposed **43 penalties** totalling **£1.4bn**.

The FCA web site maintains pages devoted to CASS – see link – which may be a useful reference source and which also provides access to a recording of a FCA CASS briefing held in January.

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Complaints

Useful links:

[Regulatory Roundup 65]

[PS15/19]

The previous Regulatory Roundup (issue 65) drew attention to changes to the 'complaints rules' in **DISP** which had the effect of classifying **certain professional clients** as **eligible complainants** and hence affording them the same complaints handling requirements – including the right to refer to the FOS – as was previously enjoyed by retail clients.

Further changes to DISP will come into being following the publication of Policy Statement PS15/19 "Improving complaints handling, feedback on CP14/30 and final rules".

Currently DISP 1.5 permits firms in receipt of complaints from eligible complainants to disapply some of the 'complaints rules' e.g. the complaints reporting rules (DISP 1.10) **if** the complaint is resolved by close of the next business day following its receipt. From **30 June 2016** the period will be **extended** to close of business on the **third** business day **following** the day on which it was received.

On the face of it, this would seem to ease the burden for firms e.g. this could reduce the number of complaints being carried over to the more formal eight week period. However there are a couple of downsides.

Firstly any complaints falling within DISP 1.5 will now have to be **included** when reporting complaints to the FCA and will be **subject to** the complaints record rule.

Secondly, any firm resolving a complaint under the revised DISP 1.5 must send the complainant a '**summary resolution communication**' – see (new) DISP 1.5.4 and associated guidance for what must be included in such a communication.

On the matter of complaints reporting, the returns are being amended to provide greater transparency; there will be **different returns** to be completed depending upon whether a firm has received less than 500 complaints or received 500 or more complaints in the reporting period.

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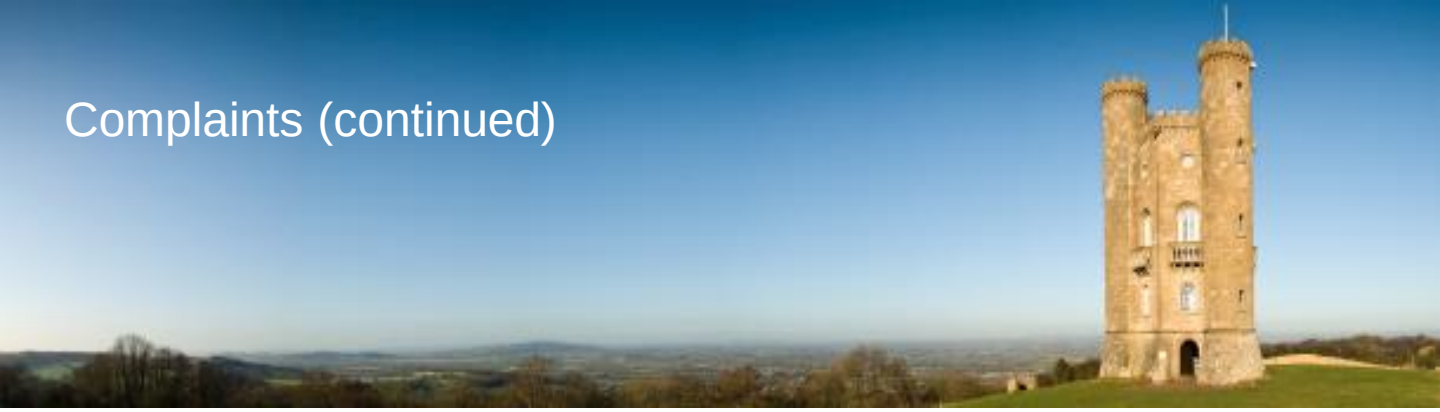
Complaints (continued)



DISP 1.3 ('complaints handling rules') will impose requirements upon firms operating a **telephone line** for the purpose of enabling eligible complainants to submit a complaint to ensure that such complainants will not pay more than the basic rate i.e. no premium rate numbers will be permitted.

Note that **GEN** will have a new chapter added on similar lines concerning charging consumers for telephone calls **other than** for complaints (although it will not apply in respect of contracts relating to the **MiFID business** of a firm).

There is no one date when the revisions come into force – for some it is 1 or 26 October this year whilst for others, including the enhanced complaints reporting requirements, it is 30 June 2016 – so impacted firms should take the opportunity to familiarise themselves with the changes set out in Appendix 1 of PS15/19 in order that their processes remain compliant. In particular such firms should also review the examples of the new complaints returns, and guidance, to ensure that their systems can provide the enhanced granularity demanded by them.

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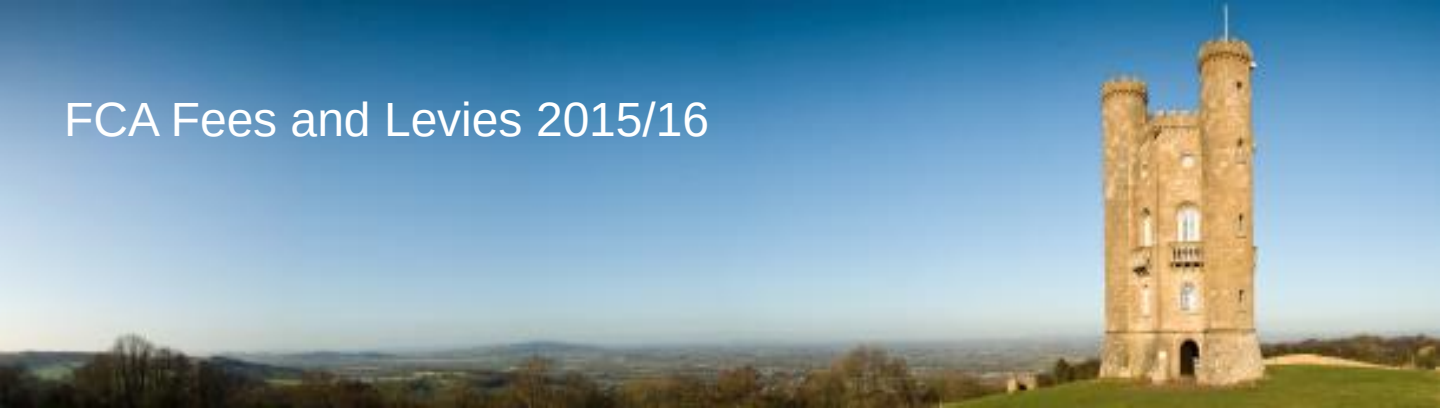
FCA Fees and Levies 2015/16



Useful links:

[Regulatory Roundup 64]

[PS15/15]

[Fee Calculator 2015/16 - Final Rates]

The FCA has published PS15/15 "FCA regulated fees and levies 2015/16" which includes feedback on its March Consultation Paper; Regulatory Roundup 64 provides details of the latter.

All respondents to the consultation raised concerns about the **7.9% increase** in the 'annual funding requirement' (AFR) to **£481.6m** - although PS15/15 reveals that the final AFR remains unchanged.

The **final rates** have now been uploaded to the FCA's '**Fee Calculator**' and, if not already received, firms should be receiving FCA invoices very shortly.

The annual 'fee' payable by a firm includes not only the FCA's periodic fee but also various levies such as the FSCS levy. Some firms, including 'portfolio managers' (fee-block A.7), 'advisors, arrangers, dealers or brokers' (A.13) and 'managers and depositaries of investment funds, and operators of collective investment schemes or pension schemes' (A.9) will note that a new levy appears – the '**Pensions Guidance Service**' levy. This levy recovers the costs of the pension reforms under which people are entitled to free impartial guidance at retirement to help them make the most of their pensions.

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Private Equity: Limited Partnership Reforms

Useful Links:

[HMT Consultation: LPs]

[Draft Legislative Reform Order]

HM Treasury has issued a consultation on changes to the Limited Partnership Act 1907.

For the avoidance of doubt the proposals are applicable **only** to those UK LPs that are **collective investment schemes** that are **not authorised** by the FCA i.e. the typical fund structure for **private equity** and **venture capital funds**. The aim of the amendments is to ensure that the UK limited partnership remains the market standard structure for such funds and other types of private fund.

An LP which is a private fund limited partnership (**PFLP**) will be appropriately **designated** at the point of registration – **existing LPs** will have the **option** to become designated as private fund LPs **within the first year** of the changes coming into effect.

Points of note include (references in brackets relate to the draft Legislative Reform (Limited Partnerships) Order 2015):

- Limited partners will **not** be under any obligation to **contribute any capital** or property to the PFLP (Article 2, paragraph (3))
- Under certain circumstances a limited partner can wind up a dissolved PFLP (Article 2, paragraph (4))
- Limited partners will be **permitted to undertake certain activities** ('white list') without being regarded as taking part "in the management of the partnership business" - which would ordinarily make that partner liable for all the debts and obligations of the LP incurred whilst taking part in the management of the business. The 'white list' will include activities such as taking part in a decision about whether to allow a particular investment by the partnership or whether the general nature of the partnership business should change (Article 2, paragraph (5))
- Partnerships that wish to register as a PFLP will need to include in the application a **certificate signed by a solicitor** to confirm that the LP conforms to the PFLP conditions (Article 2, paragraph (6))
- A similar signed certificate will be required for those **existing** LPs applying to be designated as a PFLP (Article 3)
- The registrar will be able to strike PFLPs off the register (Article 2, paragraph 11)

Comments are invited (lp.consultation@HMTreasury.gsi.gov.uk) by **5 October 2015**.

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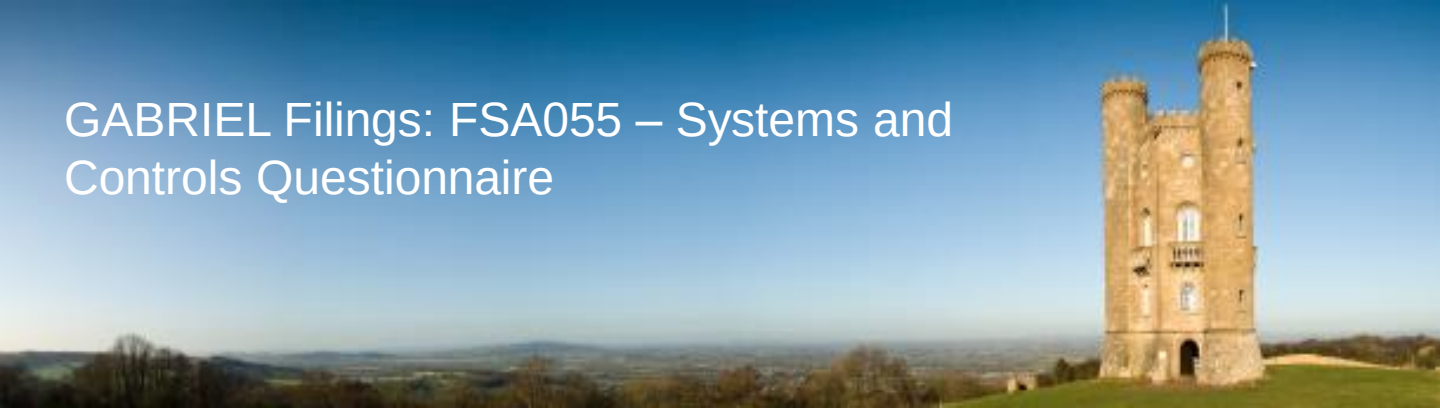
GABRIEL Filings: FSA055 – Systems and Controls Questionnaire



Non-ILAS BIPRU firms, a term which also captures IFPRU limited-licence and limited activity firms, will be familiar with the **FSA055** Systems and Controls Questionnaire which is required to be submitted to the FCA on an annual basis and within 15 business days of the calendar year end, regardless of the financial year end of the firm. This return focuses on a firm's ability to monitor and manage its liquidity risk. This is defined as "the risk that a firm, although solvent, either does not have available sufficient financial resources to enable it to meet its obligations as they fall due, or can secure such resources only at excessive cost".

Firms are reminded that they must have in place an adequate liquidity risk management framework that meets the rules and guidance outlined in BIPRU 12.3 ('liquidity risk management') and 12.4 ('stress testing and contingent funding'). IFPRU and BIPRU firms, both ILAS BIPRU and non-ILAS BIPRU, are required to ensure that all risks within BIPRU 12.3 have been considered as appropriate.

Specific risks listed within section 6 of FSA055 (which is only relevant to non-ILAS BIPRU firms) include (Q16 – Q20):

- Pricing liquidity risk;
- Intra-day management of liquidity;
- Management of liquidity across legal entities, business lines and currencies;
- Funding diversification and market access; and
- Management of collateral.

We understand that some firms that have answered "**no**" to these questions – because whilst such risks were considered they were not deemed to be relevant - have subsequently been **contacted by the FCA** with concerns about the adequacy of the liquidity risk management framework in place. In order to demonstrate to the FCA that these risks **have** been considered it is important that firms respond "**yes**" to the questions concerned, **even** if some or all of them are regarded as not being applicable.

HOW CAN WE HELP?

Complyport has experience in the preparation and submission of FCA GABRIEL filings. To find out more about how we can help with your Regulatory Reporting Requirements, please contact your usual consultant or e-mail us at info@Complyport.co.uk

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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

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