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Complyport Limited
60 Cannon Street, London EC4N 6NP
t: +44 (0) 20 7399 4980 f: +44 (0) 20 7629 8002
e: info@complyport.co.uk w: www.complyport.com

Regulatory Roundup
December 2015
Issue 71

In Brief:

EMIR – Mandatory Clearing Regulation & Frontloading: Commission Delegated Regulation comes in to force

Thematic Review – Wealth Management & Suitability : FCA publishes review of wealth management firms and private banks

Thematic Review – Inside Information: Flows of Confidential and Inside Information review published by FCA

AIFMD - Annex IV Reporting: Key reporting date for AIFMs approaches

FAST Act Amendment to Disclosure Requirements: Amendment of the consumer privacy provisions revises the requirement for Financial Institutions to provide an annual privacy disclosure

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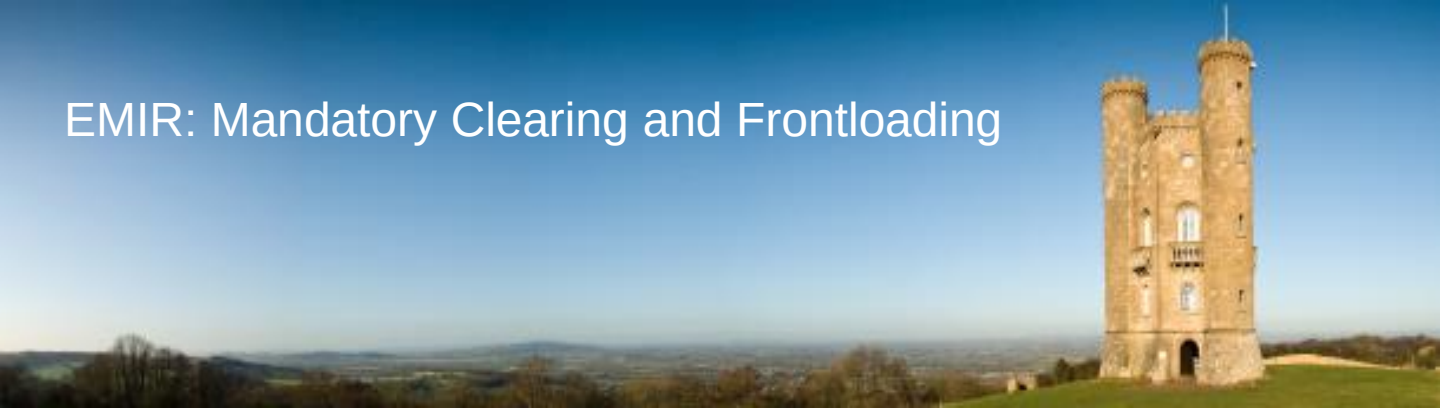
If any of the topics discussed above raise questions or a need for guidance or support, please feel free to contact Peter Carlisle.

EMIR: Mandatory Clearing and Frontloading



Useful links:

[Regulatory Roundup 67]

[Delegated Regulation 2015/2205]

[Official Journal]

[EMIR (648/2012)]

[ESMA Q&A: 2015/1485]

[ESMA List of Authorised CCPs]

The Commission Delegated Regulation (2015/2205) on the **mandatory clearing** of certain OTC derivative contracts through central counterparties (see Regulatory Roundup 67) under Article 4 of EMIR has now been published in the Official Journal of 1 December. As is usual, the Regulation came into force on the **twentieth day** after such publication i.e. **21 December 2015**.

The following classes of contracts denominated in **EUR**, **GBP**, **JPY** and **USD** fall within the scope of the Delegated Regulation (subject to the exclusions in Article 1(2)):

- Basis swaps
- Fixed-to-float interest rate swaps
- Forward Rate Agreements
- Overnight Index swaps.

Please see the tables in the **Annex** to 2015/2205 for further details.

The clearing obligation will **take effect** at various times depending on how a counterparty (as defined in Article 2(8) & (9) of EMIR) is **categorised** as follows:

- **Category 1** will include counterparties that are clearing members for at least one of the OTC contracts set out in the Annex, of at least one of the Central Counterparties ("CCPs") authorised or recognised to clear one of those classes.
- **Category 2** will capture counterparties not falling within the above that are financial counterparties (or **AIFs** that are **non**-financial counterparties) which belong to a group whose aggregate month-end average of outstanding gross notional amount of non-centrally cleared derivatives from **January**, **February** and **March** 2016 is above €8bn.
- **Category 3** will be financial counterparties (or **AIFs** that are **non**-financial counterparties) not belonging either of the above categories.
- **Category 4** will consist of **non**-financial counterparties that do not belong to any of the above three categories.

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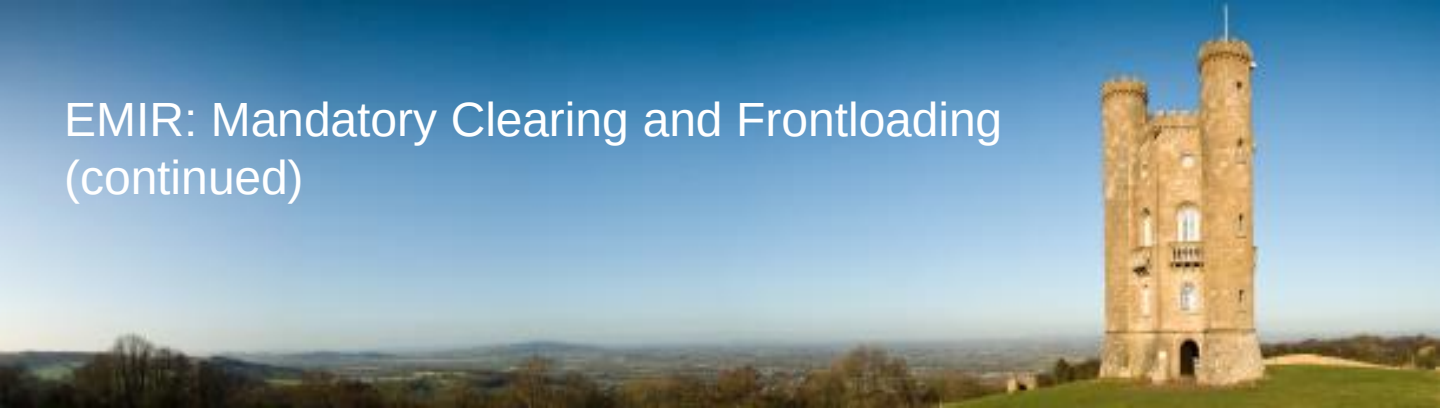
EMIR: Mandatory Clearing and Frontloading (continued)



Where the counterparties are **AIFs** or **UCITS** then the €8bn referred to in Category 2 applies individually at **fund level**.

Once a counterparty has been categorised in accordance with the above then the clearing obligation takes effect on:

- **Category 1**: 21 June 2016
- **Category 2**: 21 December 2016
- **Category 3**: 21 June 2017
- **Category 4**: 21 December 2018

Where a contract is concluded between counterparties included in **different categories** then the clearing obligation will take place from the **later** date.

Although there is now certainty as to when the clearing obligation takes place, a reminder that the **frontloading obligation** set out in EMIR Article 4(1)(b)(ii) will impact many firms.

In essence the frontloading obligation requires **clearing** of certain contracts of a **minimum remaining maturity** to be cleared **before the clearing obligation takes effect**.

Fortunately the frontloading obligations have been rethought (see article 'EMIR and Frontloading' in Regulatory Roundup 67) and will only apply to:

- **Category 1 counterparties** for those contracts entered into or novated two months after the Delegated Regulation comes into force i.e. **21 February 2016**.
- **Category 2 counterparties** for those contracts entered into or novated five months after the Delegated Regulation comes into force i.e. **21 May 2016**.

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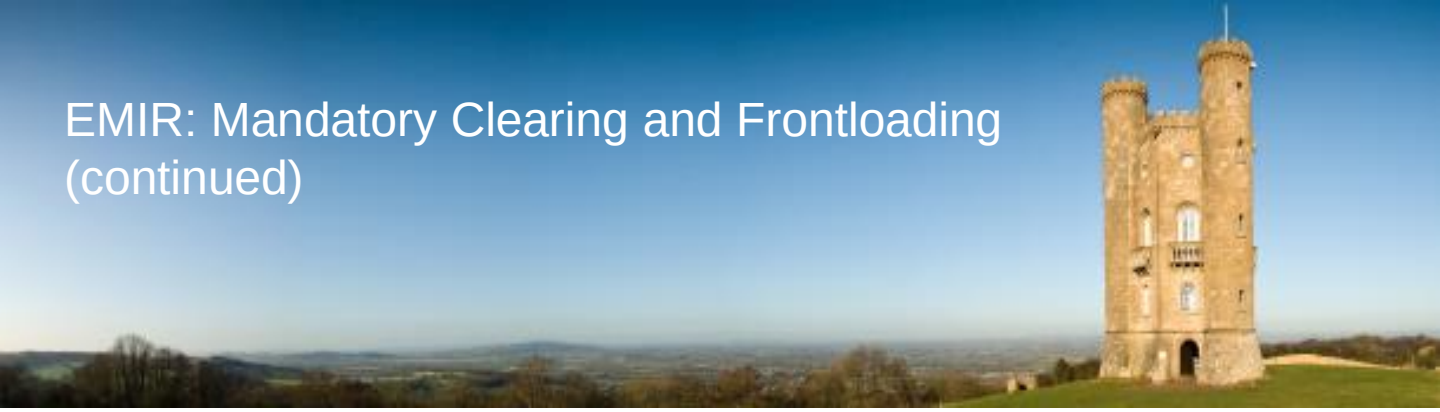
EMIR: Mandatory Clearing and Frontloading (continued)



This means that Category 1 firms will have a four-month frontloading period whilst Category 2 firms will have a seven-month frontloading period.

Please see Article 4 of 2015/2205 for the relevant minimum maturity dates and for the process when counterparties fall into different categories.

There is no frontloading requirement for Category 3 or Category 4 counterparties nor for any non-financial counterparties.

ESMA has recently updated its Q&As on EMIR (2015/1485) which may be useful.

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Thematic Review: Wealth Management and Suitability

Useful links:

TR15/12

Regulatory Roundup 31

Regulatory Roundup 44

Assessing Suitability

The FCA has published its thematic review of **wealth management firms and private banks** and the **suitability** of investment portfolios (TR15/12).

This is not the first time the regulator has reviewed the suitability of client portfolios – the FSA expressed its concerns in a 'Dear CEO' letter in June 2011 and this was touched upon in a speech by Clive Adamson at the FSA Asset Management Conference in September 2012 (see Regulatory Roundup 31 and 44). The purpose of the thematic review was to determine whether asset management firms had acted on the previous concerns expressed.

The thematic review assessed **150 files** from **15 firms**, with follow-up visits to a number of them.

Some improvement was identified but there was also a wide variation in the performance of firms sampled and "many still need to raise their standards – in some cases substantially…".

This is best illustrated by the finding that whilst one-third of firms sampled raised no substantial concerns, the remaining **two-thirds** either **fell substantially short** of expected standards or required some improvements. In terms of the 150 customer files reviewed, around 59% were either deemed to indicate a **high risk of unsuitability** or were unclear (as in insufficient information to make an assessment or where information presented was inconsistent or confusing). By way of comparison, the previous work undertaken indicated that 79% of files fell within the high risk/unclear category.

Customers' risk appetite is a recurring theme and the review comments that in a significant number of firms, a customer's attitude to risk was not recorded on the client file. In other cases, examples were found of customers who gave conflicting or inconsistent responses on their risk appetite and capacity for loss.

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Thematic Review: Wealth Management and Suitability (continued)

The publication makes it clear that:

- **Firms** should take note of the findings and ensure that they are able to demonstrate how the portfolios they manage are suitable
- **Senior management** are expected to consider whether any of the concerns raised are reflected in their own firms' practices and to **take any necessary action.**

With the above in mind, Annex 2 of TR15/12 provides a table of 'good' and 'poor' practices found which firms may find of interest. Areas include effective monitoring, governance and controls and, of course, risk appetite and the matching of the customers' portfolios.

HOW CAN WE HELP?

Complyport offers a complete range of services to wealth management firms. Our service provides you with independent guidance, ongoing support and the appropriate level of oversight to ensure your firm has the knowledge to maintain compliance and keep abreast of regulatory developments. Complyport does not simply provide pro forma documentation to firms and leave them to it, all service offerings are bespoke to your firm's individual requirements.

When choosing Complyport, firms will benefit from:

Initial Assessment

Your firm will be appointed designated experts who will carry out an assessment. This involves a review of current arrangements, identifying gaps or areas where procedures may be improved. We will report our findings and help you build a framework that will meet regulatory requirements. If necessary, we can tailor all supporting manuals, policies and procedures. Alternatively, for firms that require less support, our service can be light touch.

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Thematic Review: Wealth Management and Suitability (continued)

ComplyTracker

As an option, ComplyTracker is our proprietary compliance management system designed to reduce the administrative burden that inevitably falls upon busy staff. The single system caters for firms' in-house compliance needs and allows processes to be streamlined. Managed efficiently and simply accessed to demonstrate clear audit trails, the system reduces paperwork and provides a secure storage facility within a controlled compliance environment which reduces the chance of documentary loss or monitoring oversight.

Monitoring Programme

Complyport is well versed in implementing bespoke compliance monitoring programmes that fit with the regulatory obligations relevant to the firm. Whether a firm decides to complete their monitoring on ComplyTracker or use a paper-based monitoring programme, we will help you build a compliance monitoring programme that is appropriate to the nature and scale of your business. We can also provide an independent written assessment of your compliance with your monitoring programme and procedures and evidential records at a frequency agreed with you.

Expertise

Depending upon your own resources and expertise you may ask us to:

- Assist with liquidity, capital and other prudential obligations
- Review corporate governance and supervision arrangements
- Help with file reviews
- Provide registration and filing solutions
- Review your CASS procedures
- Review your TCF procedures
- Help with complaints monitoring or handling
- Review Anti-Money Laundering procedures
- Provide training support
- Review financial promotions
- Support with CRD IV obligations
- Provide a level of regular helpdesk support.

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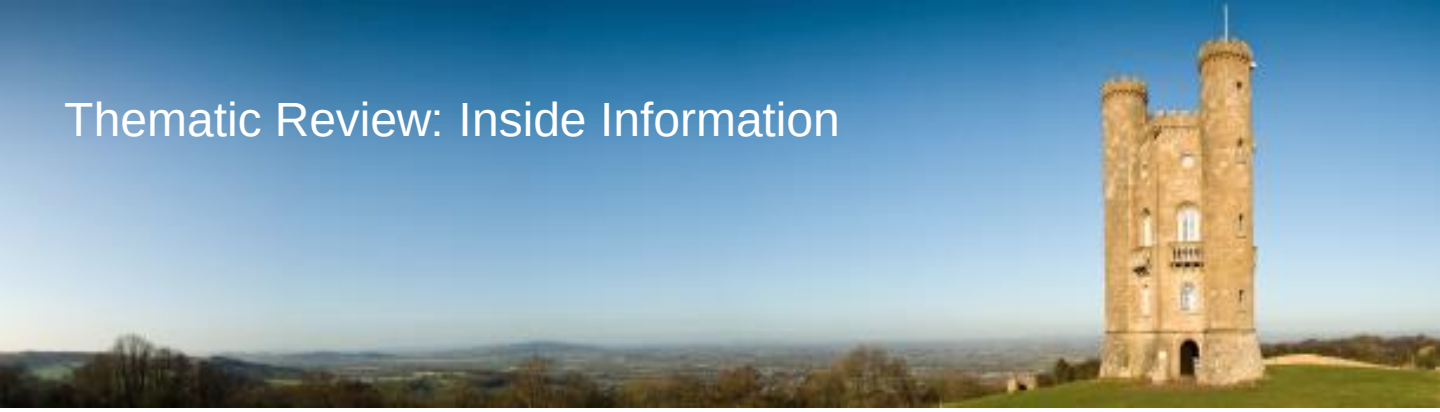
Thematic Review: Inside Information



Useful links:

[TR15/13]

[Regulatory Roundup 70]

The FCA has published its findings on yet another thematic review - this time looking at '**Flows of Confidential and Inside Information**' (TR15/13).

The review sample consisted of 16 mostly **small to medium-sized** wholesale firms which the paper describes as 'investment banking firms' (however the accompanying article on the FCA website, as well as the document itself, makes it clear that the review is relevant to **all firms** that handle confidential and/or inside information). The sample firms provided their policies and related documentation and the FCA made full-day visits to 10 of them.

Key findings can be summarised under the following three headings:

Circumstances Posing Heightened Risk

The need for regular assessment of conduct risks in the light of changing circumstances should not be overlooked e.g. changes to business model or rapid growth.

Conduct, Culture and Responsibility

Recognition that all staff members across the three lines of defence (internal controls, Compliance and Risk Management, Internal Audit/independent assurance) have a role to play, albeit that ultimate responsibility sits with senior management.

Firm Systems, Procedures and Infrastructure

Robust systems, procedures and infrastructure underpin the effective management of flows of confidential and inside information in firms.

Chapter 3 of TR15/13 sets out the detailed findings, and an expansion of the above three headings, including examples of good practice and poor practice. It's certainly worth a read, as much for the poor practice as for the good practice. Examples of the former include findings of **non-UK headquartered firms** failing to make any reference to the UK regulatory regime in their policies and procedures and the remoteness of Compliance (to the extent that, in one instance, the function was based in a different city).

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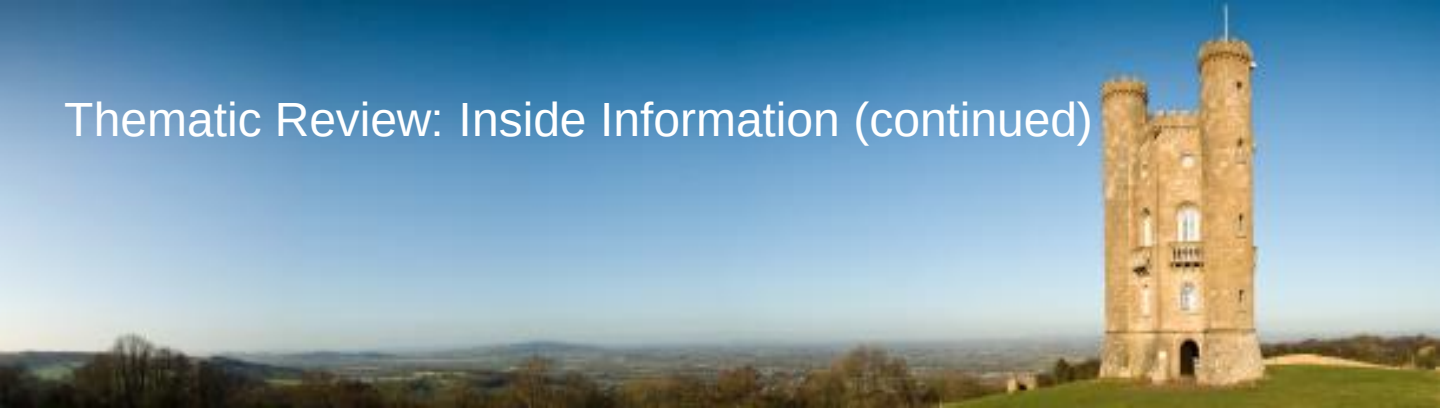

Oddly enough, cases where Compliance was **too strong** also fell under the 'poor practice' banner. Although this initially would seem to confound logic, the concern was that over-reliance on Compliance could, over time, lead to it operating as part of the first line of defence, meaning that Compliance, as the second line of defence, would end up monitoring its own work.

The FCA advises us that all UK-based and FCA-regulated firms need to consider whether their own arrangements are fit for purpose and meet the standards set out in the report. The paper informs the reader that "This is **not** a one-off exercise". Given this, firms' **senior management** are required to pay heed to the findings and messages outlined and take the steps necessary to identify and resolve any outstanding issues.

The thematic review serves as a reminder of the changes that will take place to 'market abuse' as a whole next July as a result of the Market Abuse Regulation (596/2014) – see Regulatory Roundup 70 for further details.

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AIFMD: Annex IV Reporting

A reminder that the **31 December 2015** is a key reporting date for AIFMs:

- both **small registered AIFMs** and **small authorised AIFMs** are required to report annually with the reporting period ending 31 December in each calendar year;
- depending upon the value of AIFs under management, **full-scope AIFMs** will need to report either quarterly, half-yearly or annually based upon the calendar year which means that all full-scope AIFMs will need to report for the period ending 31 December.

Further details can be found in SUP 16.18.

HOW CAN WE HELP?

Responding to demand from our clients, Complyport recognises that the complexity of the data that firms will have to report via GABRIEL can be a challenge and that many firms are unprepared for this task. To complement its financial returns review service, Complyport also offers a standalone AIFMD Annex IV Reporting Service on a 'per submission' fee basis that covers:

- Advice on AIFMD Annex IV data sourcing;
- Advice on the reporting frequency;
- Customised Excel templates for data collection;
- Advice on data items and Excel template completion;
- Advice and assistance on direct submission to the FCA via GABRIEL; and
- Instruction and help on final submission procedures.

Alternatively, we can undertake reviews and 'reasonableness-checks' of a firm's draft returns on an hourly rate basis, rather than the above package.

To find out more please contact us on 020 7399 4980 or email us at info@complyport.co.uk

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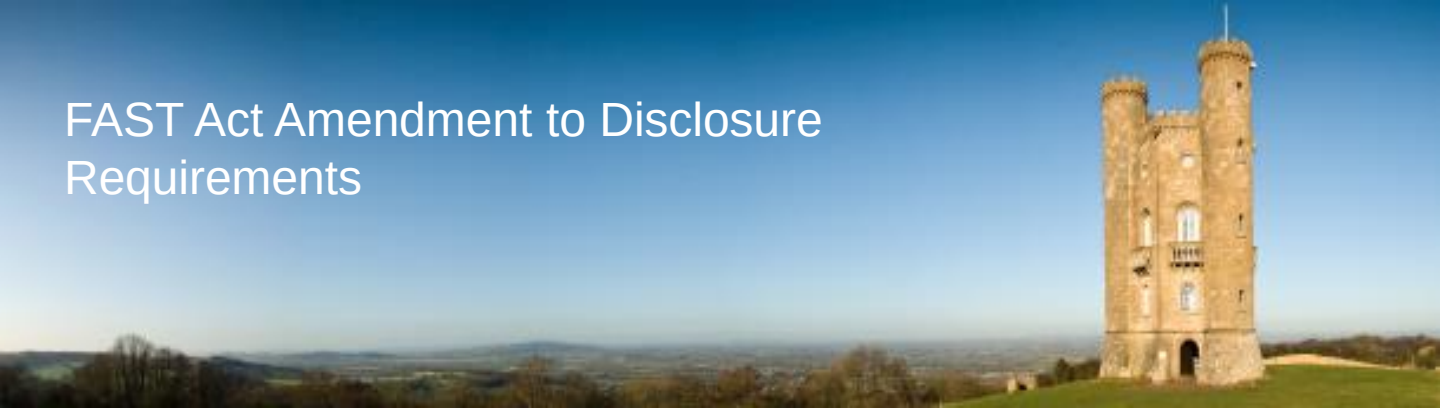
FAST Act Amendment to Disclosure Requirements



The President of the United States, Barack Obama, signed into law the Fixing America's Surface Transportation ("**FAST**") Act on 4 December 2015. The FAST Act included an **amendment** of the consumer privacy provisions of the Gramm-Leach-Biley ("GLB") Act revising the requirement for Financial Institutions to provide an annual privacy disclosure. Investment companies, registered and private fund advisors and broker-dealers, among others, are considered Financial Institutions for GLB Act purposes.

Under the GLB Act amendment, Financial Institutions will **not** need to provide an **annual privacy disclosure** if certain conditions are satisfied.

Currently, Regulation S-P and Regulation P require Financial Institutions to provide an **initial** notice to consumers that describes the Financial Institutions' privacy policy and practices, including a description of the circumstances in which the Financial Institution may disclose non-public personal information of a consumer to third parties. Regulation S-P and Regulation P further required Financial Institutions to provide an **annual** privacy disclosure describing a Financial Institution's privacy policy and practices.

The GLB Act amendment eliminates a Financial Institution's obligation to comply with the annual privacy disclosure requirement, as long as the Financial Institution satisfies **two conditions**:

- The Financial Institution does not disclose non-public personal information of consumers to third parties, other than disclosure permitted by an exemption e.g. information-sharing that is necessary for processing or administering a financial transaction requested or authorized by a consumer or information-sharing, including disclosures for the purposes of preventing fraud, responding to judicial process or a subpoena, or complying with federal, state, or local laws; and

- The Financial Institution has not changed its policies and practices with regard to disclosing non-public personal information from the policies and practices that were disclosed in the most recent disclosure sent to consumers.

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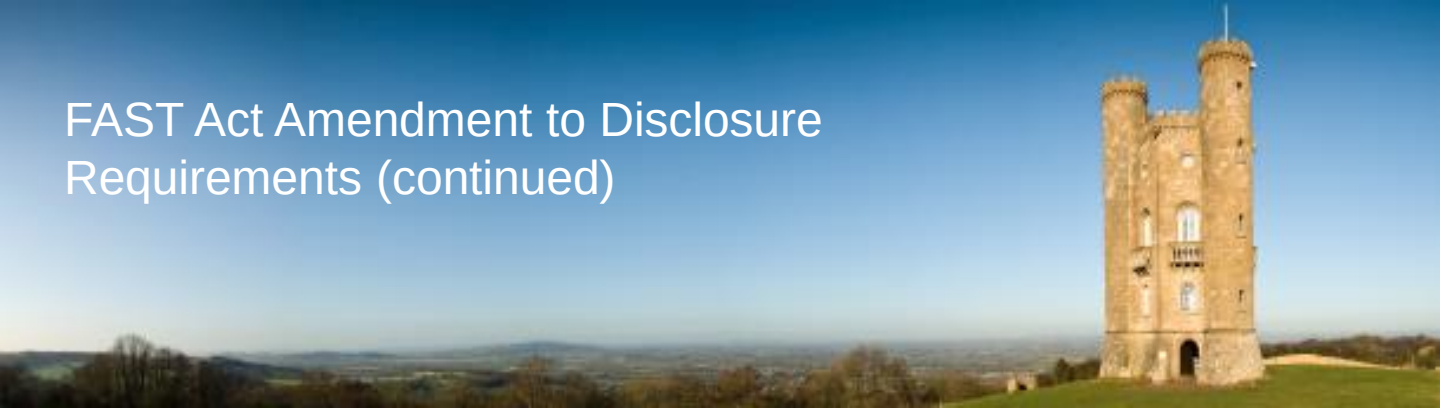
FAST Act Amendment to Disclosure Requirements (continued)



The GLB Act amendment does not mean that Financial Institutions no longer need to provide any privacy notice. Financial Institutions are **still required** to provide an initial privacy notice to consumers (for example, an investment adviser would still be required to provide a privacy notice to individual separately managed account clients and private funds would still be required to provide a privacy notice to investors as part of its standard set of fund offering documents).

The amendments to the GLB Act became effective upon the President's 4 December signing and therefore may have an impact on investment adviser's and private fund's disclosure practices for the fiscal year ending 31 December.

HOW CAN WE HELP?

Complyport has a dedicated US Desk headed up by Ross Goffi, who has extensive experience working in SEC and CFTC-regulated financial services firms, specialising in 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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Peter Carlisle

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Complyport is always interested to receive feedback and general comments on either the Regulatory Roundup or the Complyport website. Comments can be sent to info@complyport.co.uk

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