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Regulatory Roundup

November 2016
Issue 82

In Brief

PRIIPs: Implementation Delay Confirmed - European Commission proposes 1 year extension of PRIIPs Regulation implementation

FCA Asset Management Market Study: Interim Report – FCA publishes interim report on asset management market study

Investment Firms: New Prudential Regime Discussion Paper - EBA publishes Discussion Paper on design of new prudential regime

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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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PRIIPs: Implementation Delay Confirmed

Useful Links:

[Regulatory Roundup 80]

[PRIIPs Delay: Press Release]

Of relevance to:

Most firms providing investments or investment services to retail investors, including AIFMs, UCITS Management Companies and the Authorised Fund Managers of NURS

As advised in Regulatory Roundup 80, the European Parliament rejected a proposed Delegated Regulation which was a key part of the **Packaged Retail and Insurance-based Investment Products Regulation** ("PRIIPs").

The core provision behind PRIIPs - which applies to both PRIIP '**manufacturers**' and to those that **advise** on or **sell** such products – is the need provide a **Key information Document** ("KID") "before a PRIIP is made available to retail investors".

The regulatory technical standards ("RTS") on the content, presentation etc. of the KID were contained in the (rejected) Delegated Regulation and its associated Annexes. Given that PRIIPs applies from **31 December 2016** the rejection of the Delegated Regulation so late in the day causes obvious problems for firms. Whilst PRIIPs on its own is clear, the RTS is essential for consistency in the format and methodology used to compile the KID.

Fortunately the European Commission has proposed an **extension to the date of application** of the PRIIPs Regulation by one year.

The European Commission **press release** informs us that "the revised PRIIPs framework should be in place during the first half of 2017 and **apply as of 1 January 2018**".

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FCA Asset Management Market Study: Interim Report

Useful Links:

[Regulatory Roundup 70]

[Regulatory Roundup 75]

[Market Study: Terms of Reference]

[Market Study: Interim Report]

Of relevance to:

The asset management sector

In November 2015 the FCA published its **terms of reference** in relation to the intention to undertake a **market study** into **asset management** - see Regulatory Roundup 70 "Asset Management: Under the Microscope".

The intention to conduct such a market study was set out in the FCA's Business Plan for 2015/16 with the terms of reference having identified three main topics to be explored:

- how asset managers compete to deliver value;
- whether asset managers are willing and able to control costs and quality along the value chain; and
- the effect of investment consultants and other advisers on competition for institutional management.

The FCA has published an **interim report** on the market study taking in various areas including the impact of intermediaries and fund governance bodies on competition between asset managers and the control of costs and performance. The latter is often an emotional subject and there are probably no surprises in learning that:

- active funds, on average, underperformed benchmarks after charges;
- institutional active products, on average, provided no significant return over the benchmark after charges;
- there is little evidence of persistence in outperformance, but there is some evidence of persistence of relatively poor performance;
- annual management charge 'price clustering' for active equity funds around the 1% and 0.75% region.

The study also looked at the role of **investment consultants**.

Cont...

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Amongst the findings is that, on average, investment consultants are **not** able to identify managers that offer **better returns to investors, nor** do they appear to drive significant **price competition** between asset managers.

The report also comments that there is a strong culture of **gifts and hospitality** in the investment consultancy sector, with a review by the FCA showing "a statistically significant **positive relationship** between the number of high ratings given to an asset manager and the number of gifts and hospitality items recorded by the consultants in a year" (the FCA reviewed the logs for 2015). Whilst the FCA acknowledges that there may be other factors to consider, at this stage the regulator is not ruling out the possibility that consultants may well have been influenced by the acceptance of gifts and hospitality and it is the intention to examine this area more fully.

The interim report concludes with a variety of **proposed remedies** including:

- recommending that HM Treasury considers bringing the provision of 'institutional investment advice' (as in strategic asset allocation and manager selection) within the regulatory perimeter;
- introducing an all-in fee so that investors in funds can easily see what is being taken from the fund;
- helping retail investors identify the best fund for them by providing tools to identify persistent underperformance;
- requiring increased transparency and standardisation of costs and charges information for institutional investors;
- consulting on whether to make a market investigation reference to the Competition and Markets Authority on the institutional investment advice market.

The FCA invites **comments** (to be sent to: assetmanagementmarketstudy@fca.org.uk) on the report by **20 February 2017.** The final report will be published later in 2017 setting out the FCA's findings and conclusions – which may include a consultation on any proposed actions ("we will continue to develop our thinking on whether we should intervene in this market, and what interventions would be most effective …").

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Investment Firms: New Prudential Regime Discussion Paper

Useful Links:

[Regulatory Roundup 72]

[EBA Discussion Paper 2016/02]

[EBA Opinion]

Of relevance to:

MiFID investment firms, UCITS management companies and AIFMs that conduct permissible MiFID activities, particularly those subject to CRD IV

In December 2015 a joint ESMA/EBA report was published on the suitability, or otherwise, of the prudential regime for **investment firms**.

The paper recommended a new categorisation of investment firm which distinguishes between systemic and 'bank-like' investment firms (to which the full CRD IV framework would apply) and those which are non-systemic for which there would be a more limited set of prudential requirements - see Regulatory Roundup 72 and "EBA: Report on Investment Firms and Prudential Requirements".

The EBA backed-up this recommendation by declaring that it "stands ready to complete" the necessary data collection in order to calibrate this new regime.

One 'Call for Advice' later, the EBA has published a **Discussion Paper** (EBA/DP/2016/02) on the design of a new prudential regime for investment firms. Although the paper is aimed at MiFID investment firms it will also be relevant to UCITS management companies and AIFMs that conduct permissible MiFID activities.

Aside from the handful of investment firms that fall within the EBA's earlier Opinion, and so would be subject to the full CRD (see below), the Discussion Paper proposes a prudential regime focusing on the risks to customers and markets and risks to the firm itself (what is referred to as the **K-factor** approach).

These K-factors can be attributed to 'risk to customers' ("**RtC**") and 'risk to market access, liquidity or integrity' ("**RtM**") which would need to be accompanied by appropriate scalars – with acknowledgement of the extent such risks are amplified by the risk to the firm itself ("**RtF**").

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Possible RtC and RtM K-factors identified so far include, but are not limited to, Assets Under Management, Client Money held and (number of) Customer Orders Handled. As an alternative to creating specific K-factors for RtF the use of an 'uplift' is considered i.e. a firm's capital requirement would be the sum of the RtC and RtM K-factors as above multiplied by an appropriate 'uplift factor'.

The Discussion Paper also gives consideration to a different prudential regime, based mainly upon the fixed overheads requirement for "very small and non-interconnected" firms (referred to as "**Class 3**" investment firms).

Whilst the paper effectively proposes designing a tailored regime for investment firms – and so reflects the EBA's preferred approach – it also acknowledges that there is also the alternative option of applying the current prudential regime to such firms, but in a more proportionate and targeted manner.

The Discussion Paper follows on from a short (four page) EBA **Opinion** paper published in October which concentrated on the identification of those investment firms for which CRD IV **is** appropriate and which rules should apply. In brief, the recommendation was that the **full CRD and CRR** should apply to those investment firms that meet the identification standards and guidelines applicable to Global Systemically Important Institutions ("**G-SIIs**") and Other Systemically Important Institutions ("**O-SIIs**") – although the Opinion advises that there are only eight such firms in the EU.

Comments on the Discussion Paper are invited by 2 February 2017 with a view to the EBA submitting an Opinion to the European Commission by 30 June 2017.

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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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