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Regulatory Roundup
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Impact of CRD IV on Investment Firms

Useful links:

[CP13/6]

[CRD]

[CRR]

The FCA has published its 400+ page consultation paper on CRD IV: CP13/6 "CRD IV for investment firms". The CRD comes into effect on 1 January 2014.

The paper advises that there are around 2,400 firms regulated by the FCA which are potentially subject to CRD IV - the table on page 63 of CP13/6 provides an interesting breakdown of the firms both by prudential status and by activity – although perhaps **1,000** or so of these firms may **benefit from a discretion** granted to Competent Authorities (see below).

As is probably known, CRD IV is aimed at banks even though parts of it apply to investment firms. With this in mind it will be reassuring for firms to know that the European Commission is required to **review** the appropriateness of the whole prudential regime for all firms carrying out MiFID investment activities by the **end of 2015**. The FCA is adopting a pragmatic approach in that it intends to "do the legal minimum and, where possible, not seek to change current policy".

CRD IV is actually comprised of a Directive (CRD) and a Regulation (CRR). In keeping with previous approaches, the CP only covers requirements relating to the CRD rather than the CRR (save where it relates to e.g. a national derogation) as the requirements in the latter are directly applicable and take effect in all Member States without the need to transpose into national law. As such the applicable rules and guidance will consist of:

- CRR
- Technical standard from the European Banking Authority
- FCA Handbook

The FCA Handbook will contain a **new prudential sourcebook** for "investment firms" (**IFPRU**) as well as other changes e.g. to SYSC to ensure consistency with CRD IV. IFPRU will **replace** GENPRU and BIPRU for IFPRU investment firms (although, perhaps confusingly, BIPRU 12 'liquidity standards' **will** apply to an IFPRU investment firm).

IFPRU will also apply to a **collective portfolio management investment firm**, a term which includes both a UCITS investment firm and a full-scope UK AIFM that also undertakes permitted additional MiFID type activities under the AIFMD, but generally only to the extent of its designated investment business i.e. excluding managing a UCITS and managing an AIF (however the ICAAP will apply to the whole of its business).

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Impact of CRD IV on Investment Firms (cont.)

The **remuneration provisions** in CRD III, which are reflected in SYSC 19A (Remuneration Code), are largely carried over to CRD IV but with one important change: a 1:1 **limit on bonuses** ("the variable component shall not exceed 100% of the fixed component.."). The use and extent of national discretions, and proportionality, is currently under consideration by the FCA and the Treasury and for now is not being consulted on in CP13/6.

The **definition** of what constitutes an **investment firm** will change. Although the MiFID definition remains as the starting point, **excluded** from the definition are those firms that **do not** provide safekeeping and administration nor hold client money or assets **and** that provide **only** one or more of:

- reception and transmission of orders (RTO);
- investment advice;
- portfolio management; and/or
- execution of client orders.

It will be noted the similarity with the current recast CAD carve-out for **exempt CAD firms** save that **portfolio management** and **execution** has been added to the list. Such firms will **not** be an '**IFPRU investment firm**' and hence the IFPRU prudential sourcebook will not be relevant.

Current **exempt CAD firms** (limited to RTO and investment advice) will continue to be treated as exempt CAD firms which means that a new prudential regime will apply to those firms that undertake only portfolio management and/or execution as they are neither IFPRU investment firms nor exempt CAD firms.

At the risk of causing confusion the FCA has created a new prudential category for such firms; a firm that only executes orders or manages will be a '**BIPRU firm'** and will be subject to the (amended) GENPRU and BIPRU sourcebooks. It is worth reminding ourselves that the changes above, including to what is an 'investment firm', mean that the definition of what is a 'BIPRU firm' has also changed and that most firms currently classified as BIPRU firms will become IFPRU firms. The effect of CRR Article 95 means that the new BIPRU firms will be subject to a 'higher of' own funds requirement that is similar to current Pillar 1 requirements save for a stricter definition of 'own funds'. Another change of note is that the FCA's current 'simplified' approach to calculating credit risk will not be available. The paper tells us that no other parts of the CRD IV requirements would apply.

(cont.)

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Impact of CRD IV on Investment Firms (cont.)

European Long-Term Investment Funds

Tucked away in CRR Article 95(2) is a **discretion** afforded to competent authorities that the new BIPRU firms can follow the own funds requirements that are in force as at 31 December 2013; the FCA proposes to exercise this discretion - and will **extend this** to include current Pillar 2, Pillar 3 and **Remuneration Code** requirements - which will be reflected in the new BIPRU sourcebook.

The FCA invites comments on CP13/6 by 30 September; the intention is to publish final rules before 1 January 2014.

For the avoidance of doubt the PRA is publishing a separate CP on CRD IV as it applies to its authorised firms.

Complyport will be keeping its clients updated on CRD IV progress and implementation.

Useful links:

[Regulatory Roundup 48]

[Regulatory Roundup 47]

[ELTIF Proposal]

Following on from the proposals for European VenCap and Social Entrepreneurship funds (EuVECA & EuSEF - see Regulatory Roundups 47 & 48), Europe is proposing a further type of collective label, a European Long-term Investment Fund (ELTIF).

They are designed to be long term investments (as in investors will be locked in for whatever the fixed term is) to provide monies for long term projects, such as infrastructure, so investment is largely (at least 70%, although this level of investment can be phased in over a period of up to five years) restricted to unlisted companies and real assets plus EuVECA and EuSEF. It will be available to **retail investors** as well as the usual institutions etc. The balance of up to 30% can be invested in assets that would be eligible for a UCITS fund and which will act as a buffer, affording the fund a degree of flexibility regarding when to sell assets or replace them with new ones.

The fund will be an AIF and subject to the AIFMD so ELTIF managers will need to be **authorised as an AIFM**. An ELTIF will be classified as an authorised closed-ended fund (so will be subject to prospectus requirements) and an ELTIF marketing passport will be available.

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FCA Supervision Approach

Useful links:

[Speech]

At an APCIMS conference Clive Adamson, FCA Director of Supervision, outlined the FCA's approach to supervision. Although the emphasis was upon the Wealth Management and Private Banking sector, firms as a whole will have an interest in the approach adopted by the new Regulator.

Mr Adamson commenced by summing up three characteristics of the FCA's approach as:

- **judgement based** (with the FCA requiring a deeper understanding of the sectors it regulates);
- **forward looking** (using more data and intelligence to head off risks before they crystallise); and
- **outcome-focussed** (concentrating on outcomes being achieved for customers rather than whether a firm complies with FCA rules).

From a more practical point of view we can possibly expect to see more **thematic reviews** as they are now recognised as the most effective way of delivering conduct priorities. **Additional resource** has been added to this area.

Firm risk assessments will **move away** from the traditional approach of focussing on **controls** and instead look at how a firm runs itself and so will look at **business models**, **strategy**, **culture** and **front-line processes**.

One big change is the FCA setting up a new **Wealth Management and Private Banking Department** which will directly supervise such firms; although the biggest wealth managers, which are nearly all part of wider banking groups, will continue to be supervised by their group supervisors (with support from the new Department), with smaller firms being handled via the Firm Contact Centre.

We are promised **further thematic work** in this sector. The speech sets out **key areas** and it may be wise for firms to review these areas now rather than leaving it until later. The areas include AML and anti-bribery, conflicts of interest and oversight arrangements; firms should refer to the speech for further details.

Transaction Reporting Problems
European Market Infrastructure Regulation (EMIR): Reporting Update

Useful links:

[Final Notice]

Transaction reporting (SUP 17) continues to be a problem area for firms.

RBS is the latest big name to be fined (£5.6m after a discount for early settlement, otherwise it would have been £8m) for transaction reporting failures. Previous firms fined for similar failings include Barclays (£2.45m), SocGen (£1.575m) and Credit Suisse (£1.75m).

RBS failed to report over **800,000** transactions, and inaccurately reported **44.8 million** transactions, over a 5-6 year period.

As a common source of regulatory issues is when a firm expands too quickly, it will be no surprise to learn that many of the problems arose from inadequate oversight by senior management following the takeover by RBS of ABN Amro.

Useful links:

Regulatory Roundup 46

The timeline for reporting under EMIR has slipped giving everyone a bit more breathing space.

Until the slippage the probable start date for reporting to a Trade Repository (TR) in respect of interest rate and credit derivatives (OTC and exchange traded) was this September, and 1 January 2014 for reporting of all other asset classes of derivatives.

As there are not yet any TRs to report to (ESMA's best guess is that the first approval of a TR is "not likely to take place before 24 September 2013"), the reporting start date for interest rate and credit derivatives is now 1 January 2014. Note that the start date for all other asset classes remains 1 January 2014.

Although EMIR is now in force, unlike, say, the AIFMD "start date" of 22 July 2013, the above dates are not fixed in stone but are best estimates (the EMIR Regulation was drafted so that reporting is supposed to start 90 calendar days after a TR for that asset class has been approved/registered).

A brief summary of EMIR's requirements and what firms should be doing in anticipation can be found in Regulatory Roundup 46.

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AIFMD Follow-Up

Useful links:

[AIFMD Register]

[HMRC CP]

The AIFMD came into force on 22 July. It would seem that most AIFMs are taking advantage of the one year transitional period, or there is a backlog at the FCA, as the AIFMD Register maintained by the FCA shows, at the time of this article, a total of three firms with permission to manage an AIF.

On a related note, **HMRC** has issued a consultation document concerning offshore funds that are managed from within the UK. The intention is to extend legislation so that e.g. a Cayman based AIF which now has a UK AIFM will not be regarded as UK resident and will remain ‘offshore’ for tax purposes.

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Please note that there is a small time-delay between the publication of the latest Regulatory Roundup and its availability in the searchable archive.

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[Peter Carlisle]

Or for details of any other of Complyport's services, please contact [Jon Wedgbury]

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