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Regulatory Roundup
9 August 2010
Issue #19

In Brief:

Dodd-Frank revisited: Further guidance for Advisers

Remuneration Code: Further information on proportionality

Strengthening Capital: CEBS guidelines on exemptions from the large exposure regime

UCIS promotion: FSA findings and report on good and poor practice

Fuzzy matching and financial sanctions: RBS fined for breaches of money laundering rules

In your Complyport Regulatory Roundup:

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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Dodd-Frank revisited

Useful Links:

The DF Act

The IA Act

Goldstein

Reg Roundup #17

Following on from Regulatory Roundup #17 we have had requests for further details on the regulatory developments within the US. As you will know, the 'Dodd Bill' was enacted on 21 July which will have an impact on both certain US investment advisers and non-US investment advisers that have US clients. The full title of the Act was recently renamed the Dodd-Frank Wall Street Reform and Consumer Protection Act ('DF Act'). It is a large Act (848 pages) and covers many areas.

Out of the 1601 sections in the Act, this article provides an overview on sections 401 to 416 ('Title IV – Regulation of Advisers to Hedge Funds and Others'). Based on the linked document provided, the relevant sections start on page 195. What is of interest to us in these sections are the changes to the 'Investment Advisers Act of 1940'.

The SEC refers to the Investment Advisers Act of 1940 ('IA Act') as found at Cornell University Law School as a 'more current version' than others (see link). The IA Act as it currently stands can be found in Subchapter II. Unfortunately there is currently no one document that shows the 'before and after' effect of the DF Act on IA Act.

When quoting legislation in this article a reference to 'Sec' refers to the relevant areas of the DF Act; references to '80a' or '80b' refer to the relevant area of the IA Act.

The definition of an 'investment adviser' (together with a list of exclusions such as 'an engineer or teacher' within that definition) is included (11) among 28 definitions in 80b-2. The DF Act changes will add to the definitions: 'private fund' (29) (which in turn requires reference to 80a-3) and 'foreign private adviser' (30). Corresponding changes are made to 80b-3(b) e.g. the private adviser exemption is removed.

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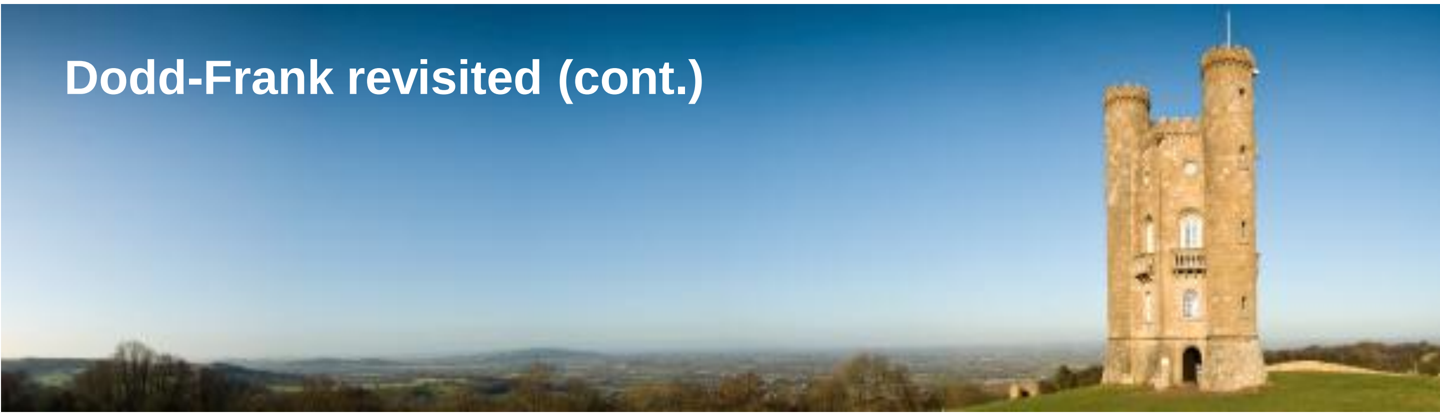
Dodd-Frank revisited (cont.)



Useful Links:

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Reg Roundup #17

Before the DF Act, the private adviser exemption meant any adviser that had fewer than 15 clients in the preceding 12 months and who didn't hold themselves out generally to the public as an investment adviser did not need to be registered.

The SEC v Goldstein case of 2006 reaffirmed that the definition of 'clients' as including funds managed and *not* the investors in those funds.

As mentioned above, the Dodd-Frank Act removes the private adviser exemption. The effect for **US advisers** is that is that it is going to require many of them to register, but not necessarily with the SEC (see below).

There is some exemption from SEC registration for **non-US ('Foreign') advisers** provided they (a) have no place of business in the US; (b) have in total fewer that 15 clients and investors in the US in private funds advised by the investment adviser; (c) has aggregate assets under management attributable to clients and investors in the US of less than $25m; and (d) do not hold themselves out generally to the public in the US. Reference should be made to the Act for the precise wordage.

Note that the above exemption now refers to '15 clients *and investors*'. Hence before the DF Act, a hypothetical foreign adviser of one fund with 100 investors would be exempt from SEC registration as, post Goldstein, it would have been deemed to have 'fewer than 15 clients'. However post DF Act the foreign adviser would fail the 'fewer than 15 clients and investors in the US' test and will require SEC registration.

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Dodd-Frank revisited (cont.)

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Currently, under 80b-3a advisers that have assets under management of less than $25m and that are (State) regulated in their home State are not allowed to register with the SEC. Sec 410 of DF Act effectively increases this level to $100m. Note that there are exemptions to this including if adherence to this requirement would mean having to register in 15 or more States. The effect of this is that a (one State) US adviser advising a fund of, say $50m, would not have to register with the SEC whilst a foreign adviser advising a similar sized fund would have to register with the SEC.

Under the DF Act, advisers that only advise Venture Capital Funds (not yet defined) will be exempt from the registration requirements (Sec 407). However they will be subject to record keeping and reporting requirements (yet to be established).

Advisers that only advise ‘private funds’ (see earlier in this paper) will be exempt from registration requirements provided assets under management are less than $150m. However they will be subject to record keeping and reporting requirements (yet to be established).

Family Offices (not yet defined) will be excluded from the definition of ‘investment adviser’ and the need to register.

Those advisers that are required to register with the SEC should refer to Sec 404 ‘Collection of systemic risk data; reports; examinations; disclosures’. Records and reports required include ‘trading practices’ and ‘amount of assets under management and use of leverage, including off-balance-sheet leverage’.

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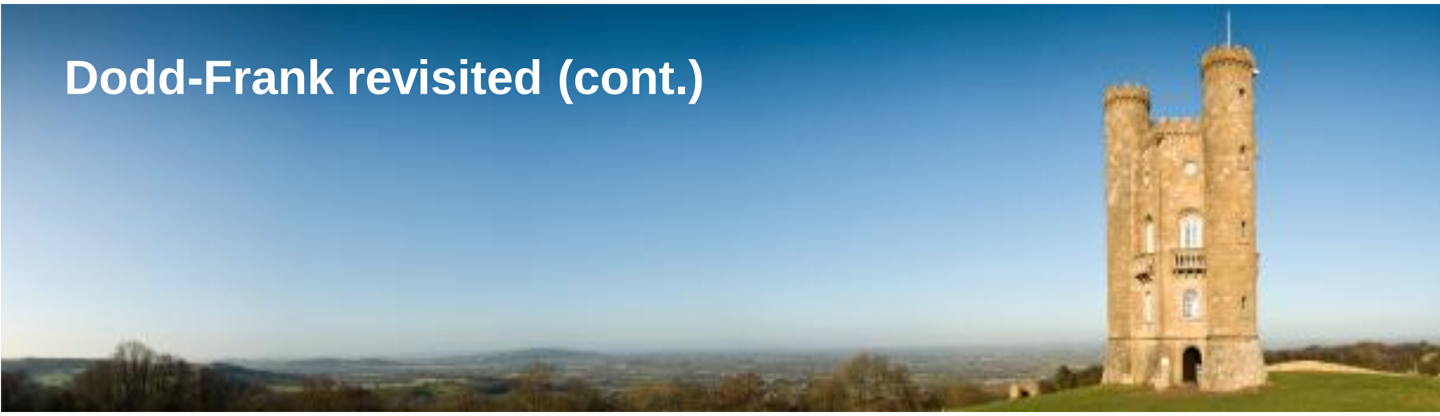
Dodd-Frank revisited (cont.)



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Reg Roundup #17

Note that there is a one year transitional period before the registration provisions come into effect. During this time the SEC will have to issue final rules including those defining certain terms e.g. ‘venture capital fund’.

Summary

Advisers advising **less than $100m** assets under management (‘AUM’) will not be required (or permitted) to register with the SEC and instead will be subject to State registration (unless it would involve having to register with 15 or more States in which case registration with the SEC can be effected).

Advisers advising AUM **more than $100m** that do not qualify for the private funds exemption will have to register with SEC.

Advisers advising solely ‘**private funds**’ with AUM **less than $150m** will not have to register with the SEC.

Family Offices and advisers to Venture Capital Funds will be exempt from registration.

Note that even if an exemption applies the adviser may still be subject to reporting and record keeping requirements.

Advisers that can satisfy *all* the following criteria will not need to register with the SEC: (a) have no place of business in the US; (b) have in total fewer that 15 clients and investors in the US in private funds advised by the investment adviser; (c) has aggregate assets under management attributable to clients and investors in the US of less than $25m; and (d) do not hold themselves out generally to the public in the US. Reference should be made to the Act for the precise wordage.

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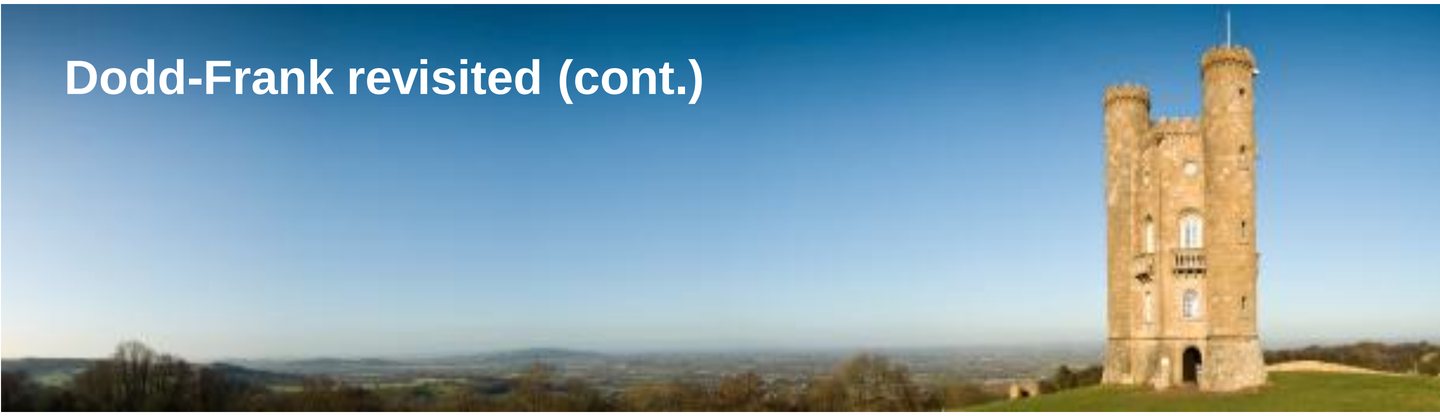

Dodd-Frank revisited (cont.)

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Reg Roundup #17

How Complyport can help

Complyport can assist firms seeking SEC authorisation and, where necessary, can bring in help in association with Ascendant Compliance Management, (“ACM”), a leading US compliance consultancy with which we have a long-standing relationship. Complyport already has a strong track record of helping firms gain SEC authorisation and can draw on ACM’s expertise should firms require assistance with more complex US regulatory queries.

Please contact us at info@complyport.co.uk or call 020 7399 4980 to discuss your requirements.

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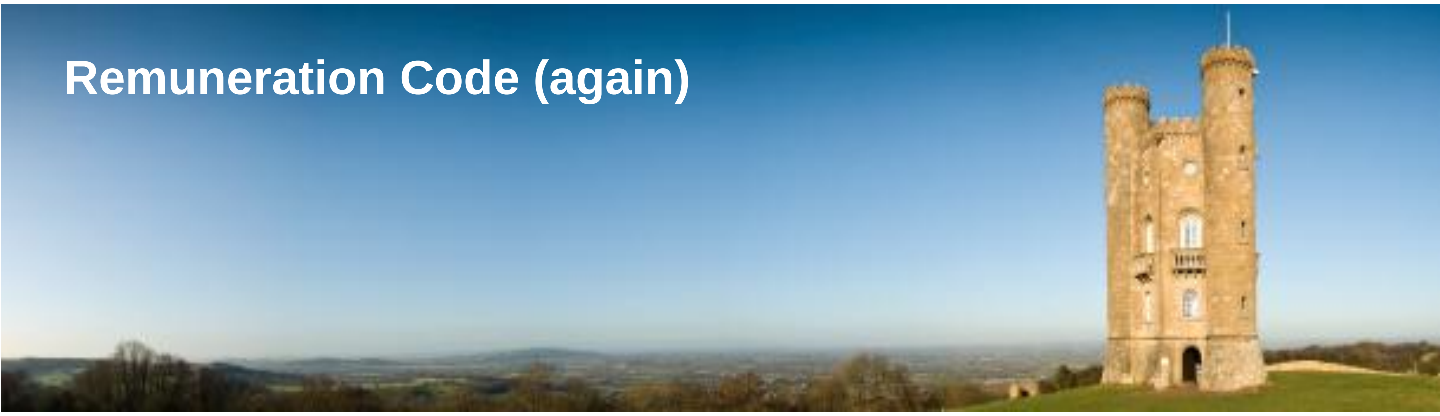
Remuneration Code (again)



Useful Links:

[CP10/19](#)

[Reg Roundup #18](#)

Following Regulatory Roundup #18 – 'Remuneration Code Special' – we would like to take this opportunity to remind firms that a proportionality approach can be adopted and our article advised referring to Annex 5 for those rules *have* to be applied by all firms and those rules which can have *proportionality* applied to them.

The 'must do' elements of the Remuneration Code are set out in Proportionality Table 1 in Annex 5 of CP10/19.

On the other hand Proportionality Table 3 in Annex 5 tells us that a proportional approach can be taken to, and a de minimis concession applied to, some of the proposed rules surrounding 'Principle 12 – Remuneration Structures'. In particular proportionality can be applied to 'guaranteed variable remuneration' (SYSC 19.3.38); to share- based awards [the 'at least 50% in shares' rule] (SYSC 19.3.45); to deferral [the 'at least 40% to be deferred' rule] (SYSC19.3.46); and to performance adjustment (SYSC 19.3.48).

The draft Remuneration Code rules are in Appendix 1 of CP10/19. SYSC 19.3.6 provides guidance on rules that 'the FSA would not generally consider it necessary for a firm to apply' when variable remuneration is no more that 33% of total remuneration *and* where total remuneration is no more than £500,000).

The FSA welcomes comments on the proposals. If you want to make your views known to the Regulator then you can send them via cp10_19@fsa.gov.uk

Note that responses to all comments are available for public inspection unless the respondent requests otherwise.

The consultation period ends 8 October.

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Strengthening Capital

Useful Links:

[CP10/17]

[CEBS Guidelines on the implementation of the revised large exposures regime]

Regulatory Roundup #6 contained an article on CP09/29 – 'Strengthening Capital Standards 3', which contained proposals for implementing changes to the Capital Requirements Directive ('CRD'). Of interest to the majority of CRD firms was news that the large exposure regime set out in BIPRU 10.5 would cease to apply to 'limited activity' or 'limited licence' firms from 1 January 2011 (although the implementation date for all the proposed measures will now be 31 December 2010).

Feedback to CP09/29 – and further consultation – has been published in the form of CP10/17.

Chapter 5 confirms that limited activity/licence firms will indeed be exempted from the large exposure regime 'at the start of 31 December 2010'. Firms that remain subject to the large exposure regime should note that the requirement to notify the FSA when a firm exceeds (or becomes aware of exceeding) the limit in BIPRU 10.5.6 (the '25% exposures' rule) will be been moved from BIPRU 10.5.9 to SUP 15.3.11 (f).

The paper references CEBS guidelines relating to exemptions from the large exposure rules for certain short-term exposures such as custody activities and generally advises firms to have due regard to the CEBS guidelines until the FSA publishes further guidance.

This is a large CP (300+ pages) and covers areas ranging from Hybrid capital to Operational risk. As such it may be easier for firms to turn to Annexes B & C in Appendix 1 to see which of the rules in GENPRU and BIPRU the CP will impact upon. Note that the proposed changes to the large exposures regime are in Appendix 2. Despite its title this Appendix covers various rules in both BIPRU and GENPRU.

The consultation period end 23 October, except for the credit risk amendments for intra-group exposures in Chapter 14 where the period ends 23 August.

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Unregulated Collective Investment Schemes

Useful Links:

FSA UCIS: Project Findings

FSA UCIS: Good and poor practice report

Reg Roundup #3

Regulatory Roundup #3 advised that the FSA was looking at the promotion of unregulated collective investment schemes ('UCIS'). The Regulator has now published its findings alongside a separate document on good and poor practice.

The FSA sent out questionnaires to 185 firms and eventually narrowed the list down to 14 firms which were subject to a full review. All the firms were IFAs but some, if not all, of the findings will be relevant to any firm that may be involved in the promotion of UCIS.

All 14 firms had some cases of non-compliance with regulatory requirements on promotion and only two of them appeared to adequately understand the rules surrounding UCIS. The FSA notes that it was disappointed to see that some consultancy firms were also unaware of the regulatory requirements surrounding UCIS (Complyport clients will have this important, and sometimes complex, subject and the COBS 4.12 Rules included in both their compliance manuals and in their compliance monitoring programmes. As is always, should you have concerns on this, or any other issue, then please do speak to your usual Complyport contact). There was a general unawareness that a 'financial promotion' didn't simply refer to e.g. marketing literature but also covered areas such as a firm's website (members of the public should not have casual access to details of any UCIS on a website) and seminars/presentations (firms should take steps to ensure that the intended audience is suitable). Firms may wish to read e.g. section 3.6 in the 'findings' paper and section 3.1 in the 'good practice' paper for examples of what is a financial promotion.

The Executive Summary advises us that currently six firms that have been promoting UCIS are being investigated by the FSA's Enforcement and Financial Crime Division.

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Fuzzy matching and financial sanctions

Useful Links:

RBS Group Decision Notice

FSA: Financial services firms' approach to UK financial sanctions

Money Laundering Regulations 2007

HM T financial sanctions list

US Office for Foreign Assets Control

JMLSG guidance

The big fine imposed on Royal Bank of Scotland (£5.6m) by the FSA for breaches of Money Laundering Regulations 2007 hit the headlines earlier this week. Apart from issues with systems and controls, the bank had problems with its 'fuzzy matching' (if you're unsure, 4.21 of the Decision Notice clarifies fuzzy matching).

Few authorised firms will be of the size of RBS (although there are probably more such firms now than there were a couple of years ago) but the theme running through the Notice – inadequate checking against persons on HMT's financial sanctions list - will be relevant to all authorised firms.

The Notice reminds us that as part of its appropriate due diligence of clients, a firm should make recourse to the consolidated list of designated persons maintained by HMT.

The links with this article will provide access to the list as well as providing access to the Money Laundering Regulations 2007 and to the guidance issued by the Joint Money Laundering Steering Group. Mention is made in the Notice to the sanctions list of OFAC (the US Office for Foreign Assets Control). We also provide a link to the relevant area for those with US interests.

Following a review by the FSA on firms' approach to UK financial sanctions the Regulator published its findings last year. The document included examples of good and poor practice. Firms, and in particular MLROs, may find it useful to revisit the findings.

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

For details of any other of Complyport's services, please contact [Philip Chapman]

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