



# Regulatory Roundup

## 31 August 2012

### Issue 43



#### In Brief:

**New Restrictions on UCIS:** FSA proposes amendments to COBS 4.12 reducing the categories of investors to whom firms can promote unregulated collective investment schemes

**Short Selling Changes:** New restrictions on uncovered short sales

**Remuneration Code: Changes to Guidance:** Revised approach means firms will be divided into 3 proportionality tiers instead of 4

**Remuneration Code: Change to Templates:** Updated self-assessment templates on FSA website

**CASS Update:** FSA consulting on changes to firm classification and oversight and mandates

**Hedge Funds and Systemic Risk:** FSA report assesses the possible sources of systemic risk from hedge funds

**Capital Instruments: Pre-Issuance Notification:** Reminder for GENPRU firms regarding notification to FSA

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# New Restrictions on UCIS



## Useful links:

[CP12/19](#)

[Regulatory Roundup 39](#)

[UCIS Enforcement Notices](#)

Regular Readers of Regulatory Roundup will be aware of both the FSA's continuing concerns on the promotion of unregulated collective investment schemes (UCIS) and its readiness to take relevant regulatory action against both firms and individuals where transgressions have occurred – see link to UCIS Enforcement Notices for further details.

The FSA's **Conduct Risk Outlook 2012** that was published in **March** (see Regulatory Roundup 39) listed 15 broad risk categories: UCIS were included under 'complexity in retail investment products and services'. Whilst it was acknowledged that the majority of UCIS are designed for institutional investors the Regulator was finding that more of these schemes were being **sold to retail** investors "**for whom this product is unsuitable**". We were put on warning that the Regulator was intending to conduct a review of the rules relating to UCIS to improve consumer protection so the publication of **CP12/19** "Restrictions on the retail distribution of unregulated collective investment schemes and close subjects" will not come as a surprise. Arguably this is an example of the new regulatory approach under which the Regulator will intervene at an earlier stage.

Strictly speaking, and in keeping with the paper's title, CP12/19 concerns itself with the distribution of '**non-mainstream pooled investments**' so **not only** includes **UCIS** but **also** includes **traded life policy investments, securities issued by special purpose vehicles** and **qualified investor schemes**. The latter are, of course, **authorised** funds governed by COLL 8.

The current restrictions on the promotion of UCIS can be found in COBS 4.12. Under this, it is a requirement that a potential investor/scheme participant must fall into one of the eight categories listed therein before a UCIS can be promoted to them. It is proposed to remove three of those categories: category 1 (existing participants in a UCIS); category 2 (where a firm has deemed the UCIS as being suitable for them); and category 8 (where an adequate assessment has been made, written warnings provided and the necessary statement made). The **purpose** of these changes is not to discourage the promotion of UCIS per se but rather to **restrict** their **promotion to 'ordinary retail investors'** (see glossary on page 6 of CP12/19). The remaining five categories in COBS 4.12 continue, including **category 7** which **permits promotion** to persons that are a **professional client** or an eligible counterparty.

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## New Restrictions on UCIS (cont.)



The category 8 exemption was of use to firms that were intending to promote a UCIS to a retail client i.e. an investor that did not fall into category 7. Although this category will be lost, firms can still make use of exemptions in the **CIS Exemptions Order** e.g. certified sophisticated investors (article 23). However it must be remembered that **for MiFID business** a firm **must** still follow the **MiFID communication provisions as implemented in COBS 4** even if COBS 4.12 exemptions are not being used.

**SPVs** are of concern to the FSA as they can be used as a means to pool investments but, because of their structure, would not be subject to the current protections under the UCIS regime: there will be a carve out for investment trusts and covered bonds. The FSA will consider **waiver requests** from providers under certain circumstances – see 3.28 of CP12/19.

In a similar manner to the possible use of the CIS Exemption Order (see above), firms can also consider the use of the **Financial Promotions Order** where the non-mainstream pooled investment is not a UCIS. Note the **obligation** placed upon the **CF10** (COBS 4.11.4) and the need for a firm to **make and retain a record** of why it is satisfied that a particular exemption applies (COBS 4.11.5).

For the avoidance of doubt, the table in **COBS 4.12.1** that we are all currently familiar with still relates to the promotion of **UCIS**. Restrictions on the promotion to retail clients of other investments, apart from UCIS, that will be classified as **non-mainstream pooled investments**, will be addressed by way of **expansion of COBS 4.12**. The guidance on the classification of investors as ‘sophisticated’ or ‘high net worth’ can be read as **a warning** to firms that such classification must be done with due care and even then to carefully consider whether such a promotion would be appropriate – note the use of “the firm should consider” and “for example” in (2) in each of COBS 4.12.7G to COBS 4.12.9G inclusive. For good measure firms are also reminded of their obligations under the Principles and the ‘client’s best interest rule’ (COBS 2.1.1).

The proposed changes to the Handbook, including enhanced record keeping requirements (COBS 4.11); the restrictions on the promotion of UCIS and non-mainstream pooled investments (COBS 4.12); and suitability guidance (COBS 9.3) can be found in Appendix 1 of CP12/19.

The consultation period finishes on 14 November 2012 and, interestingly, the FSA invites feedback from overseas regulators, the EU Commission and any other interested regulatory bodies.

# Short Selling Changes



## Useful links:

[EU 236/2012](#)

[Regulatory Roundup 21](#)

[Market Watch 42](#)

[Delegated Regulation - fields](#)

[Delegated Regulation - sovereign debt thresholds](#)

**As will be known - e.g. see Regulatory Roundup 21 – the European Commission has the goal of harmonising short selling rules. EU 236/2012, being a Regulation ‘on short selling and certain aspects of credit default swaps’, will come into effect on 1 November 2012. Being a ‘regulation’ rather than a ‘directive’ means that it will have direct effect in UK law with no need for implementing measures in domestic legislation.**

The current FSA rules on short selling are, of course, in FINMAR and basically require disclosure of short positions – 0.25% or more - in UK financial sector companies (ongoing disclosure obligation) or securities which are subject to a rights issue, but please see FINMAR 2.2 for the precise details.

The changes to the short selling regime mean that **restrictions** will be placed on **uncovered** short sales in: **sovereign debt** (see Article 13(1) with limited exemption set out in Article 13(2)); **shares** admitted to trading on a trading venue (Article 12); and **sovereign CDS** (Article 14(1)).

Article 2 provides **definitions** of terms e.g. ‘trading venue’ will include regulated markets and MTFs as per MiFID.

**Reporting obligations** are set out in Articles 5 and 6 (shares) and Article 7 (sovereign debt).

From the same date, **public disclosures** of net short positions in shares (public disclosure will be required at the 0.5% level) through a **Regulatory Information Service** e.g. RNS will **no longer be required – instead** disclosures will be published on the **FSA website**; further details of this web-based solution are awaited. Market Watch 42 (MW42) informs us that those making disclosures will be required to do so using the fields set out in Table 2 of Annex I of Commission Delegated Regulation (see link).

Apart from public disclosure, **net short positions** in shares of 0.2% and above need to **be notified to the Regulator** and again the FSA is working on a web-based solution. Disclosure to the Regulator will also apply to short positions in **sovereign debt** (either at the 0.1% or 0.5% levels – see Chapter VI, Article 21 of Delegated Regulation for details).

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# Short Selling Changes (cont.)



## Useful links:

[CP12/21](#)

Under a transitional provision existing national short selling measures can continue in parallel with EU regulation until 1 July 2013. However MW42 informs us that the FSA will be consulting on proposals to remove the current FINMAR short selling rules with effect from this coming 1 November and indeed CP12/21 - "Short selling regulation – Handbook changes" – followed on the heels of MW42.

The proposed changes to the Handbook can be found in Appendix 1. Basically FINMAR 2.2 to 2.4 inclusive are deleted in their entirety

The majority of the proposals within CP12/21 are based upon anticipated UK legislation as a result of the change to the short selling regime – changes to FSMA and related legislation – so, depending upon how that turns out, there may be need for a few last minute changes to what is proposed in CP12/21.

Comments on CP12/21 are invited by 20 September.

The FSA will not be producing FAQs regarding the new regulations – that will be left to ESMA – although they will respond to specific questions; see page 3 of MW42 for the FSA link.

Firms should now be giving thought to what procedural and system changes may need to be put in place to ensure compliance with the new regime from 1 November.



# Remuneration Code: Changes to Guidance

## Remuneration Code: Change to Templates



### Useful links:

[Remuneration Code; Proportionality](#)

**The FSA has issued amended consultative guidance on proportionality in relation to the Remuneration Code (the current guidance was issued last December).**

At present the FSA's guidance provides for the division of Remuneration Code firms into one of four proportionality tiers based on capital resources.

The revised approach will divide such firms into one of three proportionality tiers based upon 'relevant total assets'. The latter, for BIPRU firms, will be the average of the firm's total assets on the firm's last three accounting reference dates.

The table of proportionality tiers can be found on page 7 of the guidance. BIPRU limited licence and BIPRU limited activity firms will remain in the lowest tier, so in practical terms there will no impact on such firms. This tier will now also contain **UK Banks and Building Societies**, where relevant assets do not exceed £15bn, and full scope firms not falling into tiers one or two.

The proposed approach will allow the FSA to focus its resources on the most significant firms who pose risks to financial stability.

Any comments on the changes need to be made by 6 September.

### Useful links:

[Remuneration Code](#)

**The FSA has taken the opportunity to update the self-assessment templates and code staff tables that can be found on its website.**

Use of a template in the drafting of a firm's Remuneration Policy Statement is not compulsory, although it can be a useful tool in ensuring that all the required information has been included.





## Useful links:

[CP12/15](#)

**The FSA is consulting (CP12/15) on changes in two areas of CASS: firm classification and oversight (CASS 1A) and mandates (CASS 8).**

The changes to CASS 1A will include clarification on the CASS firm type effective date.

Identified technical issues will result in some minor changes to the **CMAR**.

The paper advises that the Regulator has identified a large degree of **inconsistency in understanding** among firms and their auditors on the scope of the **mandate rules**. The proposed changes to CASS 8 seek to clarify matters for all concerned – including what is, and is not, ‘a mandate’.

The consultation period ends 30 September. The final rules are planned to come into force on 1 January 2013.

The proposed changes to CASS 1A and CASS 8, together with associated changes to other areas including CMAR, can be found in **Appendix 1** of CP12/15.

Appendix 2 concerns the **designation** of the FSA Handbook provisions within this CP which will create a **FCA Handbook** and a **PRA Handbook**. As will be seen, the provisions of SUP 16 have not yet been designated.



# Hedge Funds and Systemic Risk

## Capital Instruments: Pre-Issuance Notification



### Useful links:

[Survey August 2012](#)

[Regulatory Roundup 33](#)

The FSA has published its latest report (see e.g. Regulatory Roundup 33 for details of the 2011 report) following the results of the Hedge Fund Survey (HFS) and Hedge Fund as Counterparty Survey (HFACS) conducted in March and April of this year respectively.

The surveys are conducted every six months to assess the systemic risk posed by hedge funds. Although, as the report acknowledges, hedge funds did not play a major role in the financial crisis it is felt that they have the potential to pose systemic risks to financial stability if they are very large or leveraged.

Key findings include: an increase in AuM through a mixture of positive returns and positive net subscriptions; leverage remains largely unchanged and modest for most funds; and, in aggregate, hedge funds report that they are able to liquidate their assets in a shorter timeframe than the period after which their liabilities would fall due.

The report should be viewed as a snapshot given that the HFS is voluntary, with the sample (around 50 FSA-authorized investment managers participated) being selected by the FSA. Similarly the HFACS, (14 FSA-authorized banks and branches participated), is based upon each participant's top 20 hedge fund credit exposures so all the data collected cover global exposures to the hedge fund industry.

The HFS will be repeated in September and the HFACS in October.

### Useful links:

[Notification re issuance](#)

[FAQs](#)

**Firms that are subject to GENPRU are reminded that they must notify the FSA before issuing any capital instrument that they wish to include as regulatory capital. The rules, and guidance, are in GENPRU 2.2.61A and on.**

The notice period ranges from one month prior to issue to no later than the date of issue depending upon the type of instrument in question.

The FSA has produced a useful FAQs fact sheet on the matter and which also includes details of the email address to send such notifications to.



# Soliciting in the US



## Useful links:

[Schapiro Statement](#)

[Fact Sheet](#)

**In a statement made by Mary Schapiro, Chairman of the SEC, the possibility of removing the current prohibition against general solicitation and general advertising in certain securities offerings was raised.**

The proposal stems from the Jumpstart Our Business Startups Act ('JOBS Act'), the aim of which is to increase the ability of small businesses and startups to raise capital.

The statement explains that the JOBS Act directs the SEC to lift certain prohibitions. As such, the Commission is seeking public comment on the proposed rules for 30 days, after which time the Commission will consider whether to adopt the proposed rules. However it shouldn't result in a free for all as it will be a requirement for an issuer to take 'reasonable steps' to verify that the purchasers of the securities are accredited investors (Rule 506 refers) or qualified institutional buyers (Rule 144A refers).

The SEC has produced a fact sheet which can be accessed via the link provided.



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