



# European Trust & Fiduciary Services

Information Bulletin

October 2012

**J.P.Morgan**

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## Foreword



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David Kane

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Welcome to the October edition of our Client Information Bulletin.

The summer months normally bring some respite in regulatory activity. However, this year, the agenda for change that is being driven by the European regulators continues unabated. Consultation on UCITS VI has already commenced, following hot on the heels of proposals under UCITS V that are not scheduled to reach the rule books of Member States until 2014. The Commission has identified more areas where it believes the credibility and effectiveness of the UCITS brand can be still further improved.

Alongside improved consumer protection measures for UCITS funds, the Commission is also preparing to extend the Key Information Document concept to cover packaged retail investment products ("PRIIPs"), as well as proposing revisions to the Insurance Mediation Directive that regulates selling practices for all insurance products. Therefore, we are now seeing some progress towards the level playing field that has been so long espoused by the fund management industry.

In this edition, we are pleased to include, for the first time, details of regulatory developments in Guernsey. This is the latest location that is covered by J.P. Morgan Trust & Fiduciary Services as we continue to expand our presence across Europe where this aligns with our clients' business strategies.

Please do let us know if there are any points in the attached Bulletin, or more generally with regards to Trust & Fiduciary Services, where we can be of assistance.

A handwritten signature in dark ink, appearing to read 'David', followed by a long horizontal stroke.

David Kane  
Head of Trust & Fiduciary Services

The main aim of this Bulletin is to provide information on various topics relating to the administration / operation of Collective Investment Schemes ("CISs") after the "point of sale". Other topics may be included, where relevant, if they relate to the regulatory "corporate" requirements of an operator of a CIS. We have not set out to recommend any specific actions that arise from the topics covered. However, in some cases, appropriate general suggestions may be offered.

This document is for the information of J.P. Morgan clients only and is designed to make you aware of our views regarding recent regulatory changes. It is not intended as a substitute for your own due diligence as to what action should be taken as a result of the regulatory changes described herein. J.P. Morgan has taken reasonable care in forming its views, however, it cannot be responsible for inaccuracies or misrepresentations in the information furnished hereby.

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## CONTENTS SUMMARY

### A PAN – EUROPE

#### UCITS V

ESMA has published separate Q & As on risk measurement and exchange of information between regulators. (A1)

#### ETFs and Other UCITS Issues

ESMA has published guidelines, together with consultation on repurchase and reverse repurchase arrangements. (A2)

#### UCITS VI

Following swiftly on from UCITS V, the Commission has launched extensive consultation, identifying a number of areas where it believes improvements can be made. Feedback is invited by **18th October 2012**. (A3)

#### Consumer Protection

The Commission has published a package of legislative proposals intended to improve consumer protection in financial services. (A4)

#### Derivatives

The Council has now adopted the regulation aimed at increasing transparency and reducing risk ("EMIR").

This was followed by the Basel Committee on Banking Supervision and IOSCO consulting on high-level principles on margin practices and treatment of collateral. Comments were invited by **28th September 2012**. (A5)

#### MiFID

ESMA has issued separate guidelines covering suitability of investments, responsibilities of the compliance function and pre-trade transparency obligations. (A6)

#### Credit Rating Agencies

The Commission has updated the regulations covering the process for imposing fines on CRAs. (A7)

#### Short Selling

Technical standards have been issued by the Commission and are due to come into force in November. In the meantime, ESMA is consulting on the exemptions covering market making and authorised primary dealers. (A8)

#### Shadow Banking

ESMA has responded to the Commission's Green Paper on shadow banking. (A9)

#### Capital Requirements

The various ESAs have launched consultation on calculation methods in order to support the implementation of CRD IV. The consultation period closes on **5th October 2012**. (A10)

### B BELGIUM

FSMA has introduced a voluntary moratorium on the distribution of particularly complex structured products to retail investors. (B1)

## **C** **CHANNEL ISLANDS**

### **Jersey**

#### **AIFMD**

The Commission is working closely with EU regulators to ensure continued private placement of funds, established in Jersey, until at least 2018. (C1)

#### **Regulatory Legislation Amendments**

The Commission is consulting on a number of miscellaneous amendments arising from an ongoing review of legislation. (C2)

#### **International Agreements**

A MoU has now been agreed with India. (C3)

### **Guernsey**

#### **Corporate Governance**

All companies licensed by the GFSC were required to issue an assurance statement under the Financial Sector Code by 31st July 2012. (C4)

#### **AML**

GFSC has completed consultation on changes to the Regulations and Handbook, (C5), as well as publishing findings from on site inspections. (C6)

#### **Collective Investments Schemes – Class B**

GFSC has sought feedback following changes to the 1990 Rules. (C7)

## **D** **FRANCE**

### **UCITS IV**

Transposition of the Directive into national law has now been completed. (D1)

#### **AIFMD**

AMF has published its final report with recommendations on implementation. (D2)

#### **Market Timing and Late Trading**

AMF has published an updated position paper and Q & A. (D3)

#### **EMIR**

AMF has issued a press release confirming direct application of the regulation passed by the EU Parliament and Council. (D4)

#### **Collective Investment Schemes**

AMF has published two separate guides covering CISs reserved for employees and private equity funds reserved for qualified investors. (D5)

## **E GERMANY**

### **AIFMD**

The Federal Ministry of Finance has issued a discussion draft of a new Act in order to implement the AIFMD. The opportunity has also been taken to consolidate legislation covering all types of funds. (E1)

## **F IRELAND**

### **Leverage**

CBI has responded to the IFIA regarding leverage disclosure for funds utilising VaR. (F1)

### **AML & Terrorist Financing**

IFIA has responded to the Department of Justice and Equality regarding proposed amendments to the Act. (F2)

### **Fitness & Probity**

CBI has responded to Notes issued by IFIA with its opinion on the identity of the party responsible in respect of a Controlled Function. (F3)

### **Connected Party Transactions**

Discussions continue between the IFIA and CBI regarding disclosure requirements. (F4)

## **G LUXEMBOURG**

### **Dormant Funds**

In an initiative aimed at reducing the number of listed funds, CSSF has made a number of proposals regarding un-launched sub funds, sub funds waiting to be reactivated and sub funds in liquidation. (G1)

### **Securitisation**

AMF has issued updated Q & As. (G2)

### **Leverage by UCITS**

CSSF has issued a press release clarifying disclosure requirements. (G3)

### **Risk Management & Conflicts of Interest for SIFs**

CSSF has issued a regulation covering the organisation of risk management for SIFs to ensure proper segregation from the operating units. (G4)

### **AIFMD**

A bill has been submitted to Parliament to harmonise existing national laws in anticipation of implementation of the Directive. (G5)

## **H NETHERLANDS**

### **Property Funds**

AMF has issued a checklist to assist investors in assessing the risks associated with unlisted property funds. (H1)

## I UK

### Short Selling

The FSA Handbook is being updated to reflect the EU Short Selling Regulation which imposes a two stage reporting regime for net short positions in shares and sovereign debt. (I1)

### Client Assets

The FSA is consulting on changes to the classifications system used by firms holding client assets. (I2)

### Financial Services Compensation Scheme

After an extensive review, the FSA is consulting on making a number of changes although it remains to be seen whether these will be sufficient to satisfy its critics. The FSA has considered various alternative approaches but concluded that the existing regime provides the best balance between fairness, affinity and sustainability. Comments are invited by **25th October 2012**. (I3)

### Retail Distribution of Unregulated Funds

The FSA is proposing to limit the promotion of unregulated CISs to sophisticated investors. The consultation period closes on **14th November 2012**. (I4)

### Contractual Schemes Regulations

HM Treasury has issued revised draft rules after feedback from the FSA, trade bodies and other interested parties. (I6)

### Investor Protection

Via a statement on its website, the FSA has drawn attention to the current initiatives being taken by the European Commission; PRIIPs, the Insurance Mediation Directive and updates to the UCITS Directive. (I7)

## DENMARK, FINLAND, NORWAY, SWEDEN AND SWITZERLAND

No significant developments to report since our last edition.



## A PAN – EUROPE



### 1 UCITS: New Q&As

1.1 On 9 July 2012, the European Securities and Markets Authority ("ESMA") published two new question and answer documents ("Q&As") on:

- risk measurement and calculation of global exposure and counterparty risk for UCITS;
- notification of UCITS and exchange of information between competent authorities.

1.2 The purpose of these Q&As is to promote common supervisory approaches and practices in the application of the UCITS Directive and its implementing measures. They provide responses to questions posed by the industry and competent authorities in relation to the practical application of the UCITS framework. The Q&As are intended to be continually edited and updated as and when new questions are received.

1.3 The Q&As on risk measurement and calculation of global exposure and counterparty risk provide clarifications on:

- hedging strategies;
- disclosure of leverage of UCITS;
- concentration rules; and
- calculation of global exposure for fund of funds.

1.4 The Q&As on notification of UCITS and exchange of information between competent authorities provide clarifications on:

- notification of new investment compartments;
- amendments and updates of documents;
- UCITS host Member State's access to documents;
- Part A of the notification letter regarding the details of the contact person at a self-managed SICAV;

- exchange of information between competent authorities in the context of establishment of a branch of a UCITS management company; and
- attestation of payment of notification fees.

1.5 The Q&As can be found at:

<http://www.esma.europa.eu/news/ESMa-publishes-two-QA-UCITS?t=326&o=home>

### 2 Guidelines on ETFs and other UCITS Issues – Consultation on Repurchase and Reverse Repurchase Arrangements

2.1 On 25 July 2012, ESMA published its Guidelines on Exchange Traded Funds ("ETFs") and other UCITS issues ("the Guidelines"), together with a consultation on the treatment of repurchase and reverse repurchase agreements ("the Consultation").

#### Guidelines on ETFs and other UCITS issues

2.2 Amongst other things, the Guidelines cover:

#### *Index-tracking UCITS*

The Prospectus and the key investor information document ("KIID") should include the following information:

- the indices used and the information on their underlying components;
- how the index will be tracked and the implications of the chosen method in terms of a fund's exposure;
- anticipated level of tracking error;
- factors that are likely to affect the tracking of the performances of the indices.

The annual and half-yearly reports should state the size of the tracking error at the end of the period under review.

#### *Index-tracking leveraged UCITS*

An index-tracking leveraged UCITS must comply with the limits and rules on global exposure (commitment approach or the relative Value at Risk ("VaR")).

The prospectus and the KIID should include the following information:

- the leverage policy, how this is achieved, the cost of the leverage and the risks associated with the selected policy;
- the impact of any reverse leverage;
- how the performance of the UCITS may differ significantly.



### *UCITS ETFs – Identifier and specific disclosure*

In all of its statutory and marketing documents, a UCITS ETF should use the identifier “UCITS ETF” which identifies it as an exchange-traded fund. It should disclose clearly in its prospectus, KIID and marketing communications the policy regarding portfolio transparency and where information can be obtained, as well as how the indicative net asset value is calculated, if applicable, and the frequency of the calculation.

### *Actively-managed UCITS ETFs*

An actively-managed UCITS ETF should inform investors of that fact and how it will meet the investment policy.

### *Treatment of secondary market investors of UCITS ETFs*

If the stock exchange value of the UCITS ETF significantly varies from its net asset value, investors who have acquired their units or shares on the secondary market should be allowed to sell them directly back to the UCITS ETF.

### *Efficient portfolio management techniques*

A UCITS should disclose in its prospectus the policy regarding direct and indirect operational costs / fees arising from efficient portfolio management (“EPM”) techniques that may be deducted from the revenue delivered to the UCITS. These costs and fees should not include hidden revenue. The UCITS should disclose the identity of the entities to which the direct and indirect costs and fees are paid and indicate if these are related parties to the management company or the depositary. All the revenues arising from EPM techniques, net of direct and indirect operational costs, should be returned to the UCITS.

A UCITS should ensure that it is able at any time to recall any security that has been lent out or terminate any securities lending agreement into which it has entered.

### *Financial derivative instruments*

Where the counterparty of a financial derivative instrument (“derivative”) has discretion over the composition or management of the UCITS’ investment portfolio or of the underlying of the derivative, the agreement between the UCITS and the counterparty should be considered as an investment management delegation arrangement and should comply with the UCITS requirements on delegation.

### *Management of collateral for over-the-counter (“OTC”) derivatives and EPM techniques*

Where a UCITS enters into OTC derivatives and EPM techniques, all collateral received to reduce counterparty risk exposure should comply with qualitative criteria and specific diversification limits.

A UCITS receiving collateral equal to or exceeding 30% of its assets should have an appropriate stress testing policy in place to assess the liquidity risk attached to the collateral.

### *Financial indices*

A UCITS investing in financial indices will have to ensure that investors are provided with the full calculation methodology of financial indices. A UCITS should only invest in financial indices which respect strict criteria, including the rebalancing frequency and diversification.

A UCITS should not invest in commodity indices that do not consist of different commodities. Sub-categories of the same commodity should be considered as being the same commodity for the calculation of the diversification limits.

An index should not be considered as being an adequate benchmark of a market if it has been created and calculated on the request of one, or a very limited number of, market participant(s) and according to the specifications of those participants.

- 2.3 The final guidelines, which will include the guidelines from the consultation regarding repurchase and reverse repurchase agreements (see 2.4 below), will become effective two months after publication on the ESMA website of the translations into the EU official languages.

### *Consultation on repurchase and reverse repurchase arrangements*

- 2.4 ESMA also launched a consultation on the appropriate treatment of repurchase and reverse repurchase arrangements in the context of the Guidelines.
- 2.5 ESMA proposes a distinct regime for repurchase and reverse repurchase arrangements which, unlike that for securities lending arrangements, would allow a proportion of the assets of the UCITS to be non-recallable at any time at the initiative of the UCITS. It includes safeguards to ensure that the counterparty risk arising from these arrangements is limited and that UCITS entering into such arrangements can continue to execute redemption requests.

- 2.6 The Guidelines and the Consultation can be found at:

<http://www.esma.europa.eu/news/ESMA-publishes-ETF-guidelines-and-consults-repo-arrangements?t=326&o=home>

### 3 Consultation on a Future Framework for Investment Funds (UCITS VI Directive)

3.1 On 26 July 2012, the European Commission ("the Commission") launched an in-depth consultation on issues arising in the area of investment funds ("the Consultation").

3.2 The Consultation focuses on the following eight topics:

1. **Eligible assets and the use of derivatives:** evaluation of current practices in UCITS portfolio management and assessment of certain fund investment policies.
2. **Efficient portfolio management technique:** assessment of current rules regarding certain types of transactions and management of collateral.
3. **OTC derivatives:** treatment of OTC derivatives cleared through central counterparties, assessment of the current framework regarding operational risk and conflicts of interest, frequency of calculation of counterparty risk exposure.
4. **Extraordinary liquidity management rules:** assessment of the potential need for uniform guidance in dealing with liquidity issues.
5. **Depository passport:** assessment of whether or not to introduce a cross border passport for the performance of the depository functions set out in the UCITS Directive.
6. **Money market funds ("MMF"):** assessment of the potential need to strengthen the resilience of the MMF market in order to prevent investor runs and systemic risks.
7. **Long term investments:** assessment of the potential need for measures to promote long term investments and the possible form of such measures.
8. **Addressing UCITS IV:** assessment of whether or not the rules, concerning the management company passport, master-feeder structures, fund mergers and notification procedures might require improvements.

3.3 The Consultation is due to close on 18 October 2012.

3.4 The Consultation and the press release can be found at:

[http://ec.europa.eu/internal\\_market/consultations/docs/2012/ucits/ucits\\_consultation\\_en.pdf](http://ec.europa.eu/internal_market/consultations/docs/2012/ucits/ucits_consultation_en.pdf)

<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/12/853&format=HTML&aged=0&language=EN&guiLanguage=en>

### 4 Consumer Protection: Legislative Proposals

4.1 On 3 July 2012, the Commission published a package of legislative proposals intended to improve consumer protection in financial services, which comprises a:

- proposal for a regulation on key information documents for packaged retail investment products ("PRIIPs");
- revision of the Insurance Mediation Directive ("IMD"); and
- proposal to boost protection for those who buy UCITS.

#### 4.2 PRIIPs

The Commission's proposal aims to inform consumers in an easy to understand format, by introducing a new, innovative standard for product information. This document is called the Key Information Document ("KID"). The proposal foresees that every manufacturer of investment products (e.g. investment fund managers, insurers, banks) will have to produce a KID for each investment product.

Each KID will provide information on the product's main features, as well as the risks and costs associated with the investment in that product. It will follow a common standard as regards structure, content and presentation.

The products for which a KID will be required include all types of investment funds, insurance-based investments and retail structured products, in addition to private pensions.

#### 4.3 IMD

The Commission is proposing a revision of the IMD, which currently regulates selling practices for all insurance products. The objective of the proposal is to upgrade consumer protection in the insurance sector by creating common standards across insurance sales and ensuring proper advice. It will improve transparency and establish a level playing field for insurance sales by intermediaries and sales by insurance undertakings.

#### 4.4 UCITS V Directive

In our Bulletin published in July 2012, we considered the third element of the package which proposes a Directive amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to UCITS as regards depository functions, remuneration policies and sanctions. For the sake of completeness, we have also summarised those proposals below.

#### Duties and liabilities of depositaries

The draft proposes the following elements:

- A single depository is appointed for each UCITS fund and the appointment of a depository shall be

evidenced by a written contract. Only credit institutions and investment firms are allowed to act as depositaries;

- There is a uniformed list of oversight duties of depositaries of UCITS established in a contractual or in a corporate form and there are detailed provisions on cash monitoring;
- On the safekeeping side, it introduces a distinction between custody duties relating to financial instruments that can be held in custody by the depositary and verification of the ownership duties relating to the remaining types of assets;
- The conditions in which the depositary's safekeeping duties can be delegated to a sub-custodian;
- It clarifies the UCITS depositary's liability for the loss of a financial instrument that is held in custody. If the financial instrument held is lost, the depositary shall return a financial instrument of the identical type or of the corresponding amount to the UCITS. No further discharge of liability is envisaged, except when the depositary can prove that the loss is due to an external event beyond its reasonable control.

The proposed UCITS provisions applicable to depositaries are broadly in line with the ones proposed under the Alternative Investment Fund Managers Directive ("AIFMD"), with the exception of the possibility to discharge the depositary's liability to a sub-custodian under the AIFMD.

#### Rules on the remuneration of UCITS managers

There are clear rules on the remuneration of UCITS managers; the way they are remunerated should not encourage excessive risk-taking. A remuneration policy should be better linked with the long-term interest of investors and the achievement of the investment objectives of the UCITS.

#### Sanctions and measures

A common approach is defined on how core breaches of the UCITS legal framework are sanctioned, introducing common standards on the levels of administrative fines so as to ensure they always exceed potential benefits derived from the violation of provisions.

- 4.5 The press release and the package of legislative proposals can be found at:

<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/12/736&format=HTML&aged=0&language=EN&guiLanguage=en>

[http://ec.europa.eu/internal\\_market/finances-retail/investment\\_products\\_en.htm](http://ec.europa.eu/internal_market/finances-retail/investment_products_en.htm)

## 5 Derivatives

### Rules on OTC Derivatives and Market Infrastructures ("EMIR")

- 5.1 On 4 July 2012, the EU Council adopted a regulation aimed at increasing transparency in derivatives and reducing risk in the OTC derivatives market ("the Regulation").
- 5.2 The Regulation requires the:
- clearing of standardised OTC derivatives through central counterparties ("CCPs") in order to reduce counterparty risk. A CCP will have to hold a minimum amount of financial resources and it will be required to have a mutualised default fund to which members of the CCP have to contribute;
  - reporting of all derivative contracts to trade repositories. They would have to publish aggregate positions by class of derivatives.
- 5.3 The Regulation became legally binding on 16<sup>th</sup> August. At the end of September, ESMA and EBA published draft technical advice to the European Commission, and the Commission will have three months to decide whether to endorse these Level 2 technical standards. Implementation of the new OTC derivatives clearing and reporting regime will occur during the course of 2013, based on these final, adopted technical standards.
- 5.4 The press release can be found at:

[http://www.consiliium.europa.eu/uedocs/cms\\_Data/docs/pressdata/en/ecofin/131532.pdf](http://www.consiliium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/131532.pdf)

### Requirements for non-centrally-cleared Derivatives

- 5.5 On 6 July 2012, the Basel Committee on Banking Supervision ("BCBS") and the International Organisation of Securities Commissions ("IOSCO") published a consultative paper laying out a set of high-level principles on margin practices and treatment of collateral ("the paper"). The paper proposes margin requirements for non-centrally-cleared derivatives.
- 5.6 These policy proposals seek to ensure that appropriate margining practices will be established for all non-centrally-cleared OTC derivatives transactions. These principles will apply to all transactions that involve either financial firms or systemically important non-financial entities.
- 5.7 Comments on the proposed rules had to be submitted by 28 September 2012.
- 5.8 The press release and consultative paper can be found at:

<http://www.bis.org/press/p120706.htm>  
<http://www.bis.org/publ/bcbs226.pdf>

## Risk Mitigation Techniques for OTC Derivatives not cleared by CCPs

- 5.9 On 30 July 2012, the Joint Committee of the European Supervisory Authorities ("ESAs") addressed a request to the Commission for a postponement of the deadline for the submission of the joint draft regulatory technical standards ("RTS") on risk mitigation techniques for OTC derivatives not cleared by a CCP.
- 5.10 The rationale behind the request is to enable consistency of the EU rules with the on-going global development of international standards by BCBS and IOSCO, which are expected to be delivered by end 2012.
- 5.11 The current deadline to deliver the joint draft RTS was 30 September 2012. A new deadline should be set by the Commission once the present deadline has expired.
- 5.12 The press release can be found at:

<http://www.esma.europa.eu/news/EMIR-Information-deadline-joint-draft-regulatory-technical-standards-risk-mitigation-techniques?t=326&o=home>

## 6 MiFID

### Guidelines to enhance investors' protection

- 6.1 On 6 July 2012, ESMA published two final sets of guidelines aimed at enhancing the protection of investors in the EU ("the guidelines"). The guidelines relate to the provisions under the Markets in Financial Instruments Directive ("MiFID") relating to the suitability of investment advice and the compliance function.

#### 6.2 *Appropriate arrangements for the suitability assessment*

Investment firms must obtain the necessary information to be able to understand the essential facts about the client in order to assess the suitability of any investment for that client. An investment firm must assess whether the specific transaction to be recommended or entered into in the course of providing portfolio management service is suitable.

The guidelines focus on the need for firms to have in place appropriate arrangements to enable them to meet the suitability requirements on an on-going and consistent basis for any client, and irrespective of the distribution channel used.

#### 6.3 *Responsibilities of the compliance function*

MiFID requires investment firms to implement a series of systems and controls aimed at securing a robust governance framework, with a clear organisational structure and lines of responsibility, and effective risk management and compliance processes. This includes policies and procedures to ensure regulatory compliance

and the establishment of a compliance function.

This second set of guidelines is focused on the responsibilities of the compliance function. The guidelines focus on the:

- responsibilities of the compliance function for monitoring, reporting and advising;
- organisational requirements of the compliance function for the standards of effectiveness, permanence and independence;
- extent of interaction of the compliance function with other functions, and the outsourcing of the tasks of the compliance function; and
- approaches for competent authority review of compliance function requirements.

- 6.4 The guidelines will be translated and published on ESMA's website. Competent authorities will have two months following the publication of the translations to confirm their compliance or intention to comply. They will then apply 60 days after the end of the reporting period for competent authorities.

- 6.5 The press release and the guidelines can be found at:

<http://www.esma.europa.eu/content/ESMA-publishes-MiFID-guidelines-enhance-investor-protection>

<http://www.esma.europa.eu/content/Guidelines-certain-aspects-MiFID-suitability-requirements>

<http://www.esma.europa.eu/content/Guidelines-certain-aspects-MiFID-compliance-function-requirements>

### Updated List of Waivers on Pre-Trade Transparency Obligations

- 6.6 On 8 August 2012, ESMA published a revision of its waiver document which provides information on the pre-trade transparency of trading systems already set up in the EU and informs on the compliance of such systems with MiFID.

- 6.7 Pre-trade transparency waivers are an integral feature of MiFID. In order to ensure the liquidity and efficiency of equity markets, waivers allow, in a limited number of cases, deviation from MiFID's trade transparency requirements.

- 6.8 The updated list can be found at:

<http://www.esma.europa.eu/system/files/2011-241e.pdf>

### Suitability Requirements

- 6.9 On 21 August 2012, ESMA published the official translations of its final guidelines on certain aspects of the MiFID suitability requirements, which focus on the need for firms to have in place appropriate policies and procedures in order to know their clients when recommending suitable investment choices (see 6.2

above).

6.10 The publication triggers a transitional period of two months within which national competent authorities have to declare whether they intend to comply with the guidelines or otherwise explain the reasons for non-compliance.

6.11 The final guidelines can be found at:

<http://www.esma.europa.eu/page/IPISC-documents>

## 7 Credit Rating Agencies

### Rules of Procedures on Fines

7.1 On 12 July 2012, the Commission adopted a delegated regulation supplementing Regulation (EC) 1060/2009 with regard to rules of procedures for fines imposed on credit rating agencies ("CRAs") by ESMA, including rules on the right of defence and temporal provisions.

7.2 The delegated regulation will enter into force on the third day following its publication in the Official Journal.

7.3 The delegated regulation can be found at:

<http://register.consilium.europa.eu/pdf/en/12/st12/st12633.en12.pdf>

### List of registered CRAs

7.4 On 30 July 2012, ESMA published an updated list of registered CRAs in the EU.

7.5 The newest addition is the European Rating Agency, a.s. which has been registered by the National Bank of Slovakia.

7.6 The updated list can be found at:

<http://www.esma.europa.eu/news/ESMA-publishes-updated-list-registered-Credit-Rating-Agencies?t=326&o=home>

## 8 Short Selling

### Technical Standards on Short Selling

8.1 On 29 June 2012, the Commission adopted implementing technical standards ("the Implementing Regulation") on the short selling regulation ("the Regulation") which entered into force on 25 March 2012, to apply from 1 November 2012.

8.2 The Implementing Regulation details rules to ensure a consistent application of the Regulation and covers the following areas:

- Disclosure of significant short positions on a

central web site;

- Borrowing agreements that ensure settlement of shares when due;
- Arrangements and measures to ensure timely settlement of short sales of shares;
- Arrangements with third parties relating to the timely settlement of short sales of sovereign debt;
- The types of third parties and the requirements they must meet to be eligible to enter into arrangements with short sellers to ensure settlement;
- The format for the periodic information on net short positions to be provided to ESMA; and
- The technical rules for ESMA to determine whether the principal trading venue of a share is inside or outside the EU and the exemption for shares whose principal trading venue is outside the EU.

8.3 The Implementing Regulation will enter into force on the day following its publication in the Official Journal of the EU and shall apply from 1 November 2012, except for the provisions on the principal trading venue, which shall apply from the date of entry into force.

8.4 The press release can be found at:

<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/12/727&format=HTML>

### Updated Table of Measures

8.5 On 24 July 2012, ESMA published an updated table of measures taken by its Members in relation to short selling in financial markets.

8.6 This update includes measures taken by Spain and Italy.

8.7 The updated list is available at:

<http://www.esma.europa.eu/news/ESMA-publishes-updated-list-measures-adopted-competent-authorities-short-selling?t=326&o=home>

### Market Maker & Primary Dealer Exemption Notification Procedure

8.8 On 30 August 2012, ESMA published a notice to alert financial market participants of its upcoming consultation on the market making and authorised primary dealer exemption under the EU's Short Selling Regulation ("SSR"), and the procedure to be followed by firms and regulators in dealing with notifications of intention to use the exemption.

8.9 The SSR becomes applicable from 1 November 2012, but allows participants to notify securities regulators of their intention to use the exemption from 1 September 2012.



8.10 ESMA's notice can be found at:

<http://www.esma.europa.eu/news/ESMA-STATEMENT-Short-Selling-Regulation-Update-Market-Maker-Primary-Dealer-Exemption-Notificati?t=326&o=home>

#### Rules on Short Selling and Credit Default Swaps ("CDSs")

8.11 On 5 July, the Commission adopted a Delegated Act which sets out important technical rules needed to ensure the uniform application and enforcement of the short selling regulation ("the Delegated Act").

8.12 The Delegated Act specifies the cases in which sovereign CDSs are considered covered, and therefore not banned in accordance with the Regulation. Other areas addressed in the Delegated Act include technical rules relating to the reporting for short positions in shares and sovereign debt, and the thresholds which can trigger a short term suspension of short selling in illiquid shares and other financial instruments.

8.13 The Delegated Act is subject to a three month objection period and will then enter into force.

8.14 The press release can be found at:

<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/12/746&format=HTML&aged=0&language=EN&guiLanguage=en>

8.15 On 24 July 2012, the Commission published an impact assessment on the Delegated Act supplementing the enforcement of the regulation on short selling and certain aspects of CDS with regards to:

- definitions;
- the calculation of net short positions;
- covered sovereign CDSs;
- notification thresholds;
- liquidity thresholds for suspending restrictions;
- significant falls in the value of financial instruments and adverse events.

8.16 The executive summary of the impact assessment can be found at:

[http://ec.europa.eu/governance/impact/ia\\_carried\\_out/docs/ia\\_2012/swd\\_2012\\_0197\\_en.pdf](http://ec.europa.eu/governance/impact/ia_carried_out/docs/ia_2012/swd_2012_0197_en.pdf)

## 9 Shadow Banking

9.1 On 24 July 2012, ESMA replied to the Commission's Green paper on Shadow Banking.

9.2 In its reply, ESMA confirmed its strong interest in issues surrounding the shadow banking system ("the system") as it is the relevant ESA for some of the entities identified by the Commission as possible components of the system; such as money market funds and exchange-

traded funds.

9.3 ESMA has already started working on issues raised by the system, indirectly through guidelines on UCITS and through contributions to ongoing work by the European Systemic Risk Board ("ESRB"), but also directly through preliminary work.

9.4 ESMA's reply can be found at:

<http://www.esma.europa.eu/news/ESMA-publishes-response-European-Commission-Green-Paper-shadow-banking?t=326&o=home>

## 10 Capital Requirements

10.1 On 31 August 2012, the various ESAs launched a consultation on Draft Regulatory Technical Standards ("RTS") for the calculation methods under Article 6.2 of the Financial Conglomerates Directive ("FICOD") ("the consultation").

10.2 The proposed draft RTS set out specifications for institutions in a financial conglomerate to ensure uniform conditions of application of the calculation methods for determining the amount of capital required at the level of the financial conglomerate.

10.3 The consultation is based on the draft Capital Requirements Regulation ("CRR") and Capital Requirements Directive ("CRD IV"). The proposal might be subject to further changes following this consultation and the final adoption of CRR and CRD IV. The RTS must be submitted to the Commission by 1 January 2013.

10.4 The Consultation period ends on 5 October 2012.

10.5 The Consultation and press release can be found at:

<http://www.esma.europa.eu/news/ESAs-consult-application-capital-calculation-methods-financial-conglomerates?t=326&o=home>

## 11 EFAMA Releases

### Quarterly International Statistical Release

11.1 The worldwide asset management industry had the following highlights to report for Q1 2012:

- Investment fund assets increased by 4.4 percent during the first quarter to stand at EUR 20.85 trillion at end March 2012;
- Net cash flows recorded an increase totalling EUR 193 billion, up from EUR 83 billion in the previous quarter;
- Long-term funds experienced a jump in net inflows during the quarter to EUR 248 billion;
- Money market funds experienced net outflows of EUR 55 billion;

- At the end of the first quarter 2012, assets of equity funds represented 38 percent and bond funds represented 22 percent of all investment fund assets.

11.2 EFAMA's press release can be found at:

[http://www.efama.org/Publications/Statistics/International/Quarterly%20International/120705\\_International%20Statistical%20Release%202012%20Q1.pdf](http://www.efama.org/Publications/Statistics/International/Quarterly%20International/120705_International%20Statistical%20Release%202012%20Q1.pdf)

### Monthly Statistical Releases

11.3 On 12 July 2012, EFAMA published its monthly statistical release for May 2012.

11.4 The main developments in May 2012 can be summarised as follows:

- UCITS experienced increased net sales totalling EUR 22 billion;
- Money market funds recorded net inflows of EUR 13 billion;
- Total net sales of non-UCITS amounted to EUR 8 billion;
- Total assets of UCITS fell by 0.8 percent to stand at EUR 5,849 billion, whilst total assets of non-UCITS increased by 0.7 percent to EUR 2,323 billion at month end.

11.5 EFAMA's press release can be found at:

<http://www.efama.org/Pages/Press-Release-Monthly-Fact-Sheet-May-2012.aspx>

11.6 On 23 August 2012, EFAMA published its monthly statistical release for June 2012.

11.7 The main developments in June 2012 can be summarised as follows:

- Net sales of UCITS registered net outflows of EUR 33 billion;
- Long-term UCITS (excluding money market funds) registered net outflows in June of EUR 9 billion;
- Total net sales of non-UCITS increased in June to EUR 11 billion, from EUR 8 billion in May;
- Total net assets of UCITS increased by 0.3% to EUR 5,865 billion, whilst non-UCITS net assets increased 2.2% to stand at EUR 2,375 billion

11.8 EFAMA's press release can be found at:

[http://www.efama.org/Pages/Monthly%20Fact%20Industry%20Fact%20Sheet%20\(June%202012\).aspx](http://www.efama.org/Pages/Monthly%20Fact%20Industry%20Fact%20Sheet%20(June%202012).aspx)



## B BELGIUM

### 1 Regulatory Framework for the Distribution of Structured Products

1.1 On 20 June 2011, the Financial Services and Markets Authority ("FSMA") announced a moratorium on the distribution of particularly complex structured products to retail investors. Distributors of financial products, including investment funds, can voluntarily sign up to the moratorium. By doing so, they commit themselves not to distribute any structured products that are deemed particularly complex.

1.2 The moratorium came into effect on 1 August 2011. The vast majority of the Belgian distributors of structured products signed up to the moratorium.

1.3 On 10 July 2012, FSMA launched a consultation seeking views from interested parties on the rules to be adopted regarding the introduction of a regulatory framework for the distribution of structured products to retail investors ("the consultation"). The consultation addresses the objectives of the forthcoming regulation, which are as follows:

- The scope: defining the distribution, distributor, structured product and retail investors;
- The internal product approval by the distributor;
- Some aspects of transparency: costs, building blocks, risks, expected value, investment rationale and underlying;
- Accessibility of the underlying on which the return of the structured product depends must be accessible to the retail investor;
- The strategy of the structured product must be sufficiently comprehensible to retail investors;
- The calculation formula: the number of calculation mechanisms should be limited;
- Follow-up after distribution: the value of the product should remain traceable for customers after acquisition as well;
- Consequences of non-compliance: approaches when a distributor that is considering distributing a structured product does not meet the requirements of the forthcoming regulation; and
- A number of additional transparency requirements regarding marketing materials (costs, components and risk diversification).

1.4 The consultation expires on 15 October 2012.

1.5 The press release and the consultation note can be found at:

[http://www.fsma.be/en/Doormat/Consultations/Cons\\_clotu re/Article/press/div/2011-08-12\\_consult.aspx](http://www.fsma.be/en/Doormat/Consultations/Cons_clotu re/Article/press/div/2011-08-12_consult.aspx)

[http://www.fsma.be/en/Doormat/Consultations/-/media/Fil es/fsmafiles/consultaties/en/consultation\\_moratorium.ashx](http://www.fsma.be/en/Doormat/Consultations/-/media/Fil es/fsmafiles/consultaties/en/consultation_moratorium.ashx)



## C CHANNEL ISLANDS

### JERSEY

#### 1 Alternative Investment Fund Managers Directive ("AIFMD")

- 1.1 Jersey Financial Services Commission ("the Commission") is working closely with ESMA and Member State regulators to ensure that necessary arrangements are in place by June 2013 for the continued private placement of funds established or managed in Jersey to professional investors in the EU until at least 2018.
- 1.2 Jersey is also committed to creating a regime that is fully compliant with the AIFMD and obtaining an EU-wide passport by 2015, or as soon as is possible for 'third countries' to do so.



#### 2 Consultation on Miscellaneous Amendments to Regulatory Legislation

- 2.1 The Commission issued a consultation paper on 16 July that contains proposals for legislative changes on a variety of topics. These have been identified as a result of continuous review of the regulatory process undertaken by the Commission.
- 2.2 While some amendments affect only one law, a secondary objective is to enhance consistency in legislation across all sectors of the industry. Therefore, the opportunity has been taken to amend, as appropriate, the corresponding provisions in other laws.
- 2.3 Amendments to a range of laws and subordinate legislation will be introduced in the form of two statutes:
- The Financial Regulation (Miscellaneous Provisions No 2) (Jersey) Law 201-; to make amendments to legislation including the Collective Investment Funds (Jersey) Law 1988; and
  - The Financial Regulation (Miscellaneous Provisions) (Jersey) Order 201; to make amendments to Orders including the Collective Investment Funds

(Appointment of Manager) (Jersey) Order 2008.

- 2.4 Responses should be sent to the Commission by 31 October. The consultation paper can be viewed on the Commissions website:

[http://www.jerseyfsc.org/pdf/Consultation\\_Paper\\_No\\_4\\_2012\\_Miscellaneous\\_Amendments.pdf](http://www.jerseyfsc.org/pdf/Consultation_Paper_No_4_2012_Miscellaneous_Amendments.pdf)

### 3 International Agreements

- 3.1 A Memorandum of Understanding ("MoU") was executed on 16 July between the Commission and India's banking regulator, the Reserve Bank of India.
- 3.2 Memoranda contribute to the protection of investors and cover regulatory assistance to be given in the context of:
- new applications for licensing by financial institutions;
  - investigations into regulatory offences such as insider dealing; and
  - general enquiries that are relevant to the fitness and properness of registered institutions.
- 3.3 The Commission now has MoUs with regulators in over 70 countries.

### GUERNSEY

#### 4 Finance Sector Code of Corporate Governance & Assurance Statement

- 4.1 All companies which hold a licence from the Guernsey Financial Services Commission ("GFSC") under the regulatory laws, or are registered or authorised as collective investment schemes ("funds") under the Protection of Investors (Bailiwick of Guernsey) Law, 1987, had to submit an assurance statement under the Finance Sector Code of Corporate Governance ("the Code") to the Commission by no later than 31 July 2012. This was introduced this year and is now an annual requirement.
- 4.2 The Code does not cover entities licensed under the above Laws which are Guernsey branches of foreign domiciled companies or which are partnerships, and the Code does not apply to any underlying SPVs or investment holding companies of funds.
- 4.3 Further detail is available at:

<http://www.gfsc.gg/The-Commission/News/Pages/Code-of-Corporate-Governance-Assurance-Statement.aspx>

## 5 Consultation on Changes to AML / CFT Regulations and Handbooks

5.1 The GFSC wrote to all financial services businesses in June, seeking comments on:

- proposed changes to the Criminal Justice (Proceeds of Crime) (Financial Services Businesses) (Bailiwick of Guernsey) Regulations, 2007 (the "Regulations");
- the Handbook for Financial Services Businesses on Countering Financial Crime and Terrorist Financing (the "Handbook");
- schedules 1 and 2 to the Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Law, 1999 (the "1999 Law"); and
- schedule 1 to the Registration of Non-Regulated Financial Services Businesses (Bailiwick of Guernsey) Law, 2008 (the "2008 Law").

5.2 The consultation period closed on 13 July 2012 and no comments have yet been published by the GFSC. The consultation documents can be located at:

<http://www.gfsc.gg/AML-CFT/News/Pages/Consultation-on-Changes-to-AMLCFT-Regulations-and-Handbooks.aspx>



## 6 AML Visit feedback

6.1 The GFSC has recently issued the following feedback document to provide the industry with a summary of findings from their on-site inspections, which may prove useful to businesses when identifying and managing risks and in considering their AML / CFT policies, procedures and controls.

<http://www.gfsc.gg/The-Commission/Policy%20and%20Legislation/Feedback-on-AML-CFT-onsite-visits.pdf>

## 7 Consultation on the Draft of the Authorised Collective Investment Schemes (Class B) Rules 2012

7.1 The Collective Investment Schemes (Class B) Rules 1990 ("the 1990 Rules") came into operation on 1 October 1990. Whilst the 1990 Rules have been subject to various amendments they have not previously been the subject of a detailed review. In light of amendments made to the rules relating to Class A open-ended collective investment schemes and the introduction of rules covering authorised closed-ended investment schemes and registered collective investment schemes, it was considered appropriate to conduct such a review of the 1990 Rules.

7.2 The GFSC has produced revised rules and sought written feedback from Investment licensees on the proposals. The consultation period closed on 5 April 2012 and the GFSC has not yet published its findings.

7.3 Further details are available at:

[http://www.gfsc.gg/The-Commission/News/Pages/Consultation-on-the-Draft-of-the-Authorised-Collective-Investment-Schemes-\(Class-B\)-Rules-2012.aspx](http://www.gfsc.gg/The-Commission/News/Pages/Consultation-on-the-Draft-of-the-Authorised-Collective-Investment-Schemes-(Class-B)-Rules-2012.aspx)

## D FRANCE

### 1 UCITS IV Transposition

1.1 Finalising transposition of the UCITS IV directive, the AMF ("Autorité des Marchés Financiers") published on 5 July 2012 instruction N° 2012-06 on the reporting arrangements, changes, the drafting of a prospectus and the periodic disclosure of UCITS sold to certain investors ("the instruction").

1.2 The instruction results from a merger of the five following existing instructions:

- Instruction N° 2005-3 on the procedures of contractual UCITS;
- Instruction N° 2005-4 relating to the prospectuses of contractual UCITS;
- Instruction N° 2009-4 on the procedures of venture capital funds ("FCPRs") with a lighter authorisation procedure and contractual FCPRs;
- Instruction N° 2009-6 relating to the prospectuses of FCPRs with lighter authorisation procedure;
- Instruction N° 2009-9 relating to the prospectus of contractual FCPRs.

1.3 The press release and the instruction are available in French only at:

[http://www.amf-france.org/documents/general/10477\\_1.pdf](http://www.amf-france.org/documents/general/10477_1.pdf)

[http://www.amf-france.org/documents/general/10476\\_1.pdf](http://www.amf-france.org/documents/general/10476_1.pdf)

1.4 On 6 August 2012, the AMF published the update of Instruction n° 2008-03 on procedures and conditions of approval, the activity program and internal organisational requirements for portfolio management companies and investment service providers delivering third party portfolio management or investment advice.

1.5 The main changes concern the updating of statutory and regulatory references, in particular relating to the transposition of the UCITS IV directive.

1.6 The press release and the instruction are available in French only at:

[http://www.amf-france.org/documents/general/10535\\_1.pdf](http://www.amf-france.org/documents/general/10535_1.pdf)

[http://www.amf-france.org/documents/general/9208\\_1.pdf](http://www.amf-france.org/documents/general/9208_1.pdf)

### 2 Implementation of the AIFMD

2.1 In our Bulletin published in July 2012, we considered the AMF consultation on the transposition of the AIFMD. A specific AMF committee ("the committee") issued twenty five recommendations for the implementation of the AIFMD through its draft report entitled *"Implementation of*

*the AIFMD and development of innovative management in France"* ("the report").

2.2 The report highlights the substantial advance of the French fund management industry in terms of compliance with the directive's requirements and the role that some funds, such as private equity funds, play in financing the French economy.

2.3 On 26 July 2012, the AMF published its final report, which is available at:

[http://www.amf-france.org/documents/general/10529\\_1.pdf](http://www.amf-france.org/documents/general/10529_1.pdf)



### 3 Market Timing and Late Trading Practices

3.1 On 1 August 2012, the AMF published its updated Position n° 2004-07 on market timing and late trading practices ("the position paper").

3.2 The purpose of the position paper is to provide clarifications and examples through a Q&A document relating to market timing and late trading practices.

**Market timing** is to be understood as an arbitrage method through which an investor systematically subscribes and redeems within a short time period, by taking advantage of time differences or deficiencies in the method of determination of the NAV of the UCI.

**Late Trading** is to be understood as the acceptance of a subscription, conversion or redemption order after the time limit fixed for accepting orders (cut-off time) on the relevant day and the execution of such order at the price based on the net asset value applicable to that same day.

3.3 The position paper provides the industry with protective measures and rules to be adopted by undertakings for collective investment and certain service providers.

3.4 The position paper can be found, in French only, at:

[http://www.amf-france.org/documents/general/5420\\_1.pdf](http://www.amf-france.org/documents/general/5420_1.pdf)

## 4 Publication of EMIR

4.1 On 7 August 2012, the AMF drew attention to the publication of Regulation n° 648/2012 of the EU Parliament and the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ("EMIR") which was published on 27 July 2012 and came into force on 16 August 2012.

4.2 The AMF advised parties concerned that all these texts will be directly applicable in France.

4.3 The press release can be found at:

[http://www.amf-france.org/documents/general/10550\\_1.pdf](http://www.amf-france.org/documents/general/10550_1.pdf)

## 5 Guides on Collective Investment Schemes

5.1 On 8 August 2012, the AMF published two guides on collective investment schemes ("CIS").

5.2 The first guide covers CISs reserved for employees (fonds communs de placement d'entreprise – FCPEs) and sets out:

- procedures regarding the implementation of capital increases reserved for employees using temporary relay funds;
- FCPEs invested in company shares that are not admitted to trading on a regulated market;
- leveraged employee investment funds; and
- due diligence to be carried out in the absence of investment schemes for employees in a company.

5.3 The second guide covers private equity funds reserved for qualified investors. It defines contractual private equity funds and clarifies their investment scope and sets out the liquidation procedure for private equity funds.

5.4 The guides are available in French only at:

[http://www.amf-france.org/documents/general/10541\\_1.pdf](http://www.amf-france.org/documents/general/10541_1.pdf)



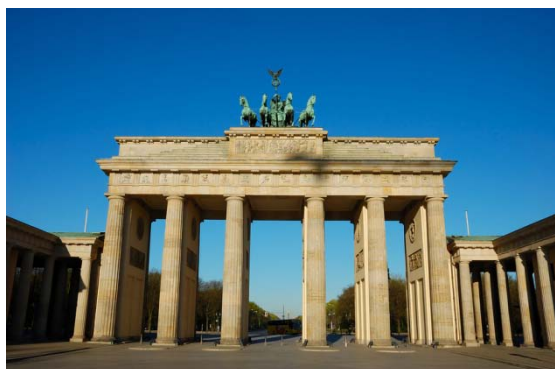
## E GERMANY

### 1 AIFMD

- 1.1 On July 20, 2012 the Federal Ministry of Finance (Bundesministerium der Finanzen) published a discussion draft (Diskussionsentwurf) of the Act implementing the Directive 2011/61/EU on Alternative Investment Fund Managers ("AIFMD") (AIFM-Umsetzungsgesetz). Further detail is available at:

<http://www.bundesfinanzministerium.de/Content/DE/Gesetzestexte/Referentenentwurfe/2012-07-20-aifm.html>

- 1.2 This Act will enter into force on July 22, 2013 and thus implement AIFMD on time. However, the Act goes far beyond a mere adoption of AIFMD and the draft Level-2-Ordinance - in certain areas it "gold plates" AIFMD.
- 1.3 The core section is the so-called "Capital Investment Code" (Kapitalanlagegesetzbuch, KAGB) which regulates all fund types comprehensively (i.e. UCITS Funds and Alternative Investment Funds) and is applicable to all types of funds whether mutual, special, open-ended or closed ended. The current German Investment Act will be fully replaced by the KAGB which will result in the widest change of German investment law since the entry into force of the German Investment Act in 2003.



- 1.4 Some of the key points are:

- From a formal perspective, the KAGB introduces a number of new terms and definitions. For example the term "Kapitalanlagegesellschaft (KAG)" for investment management companies is replaced by "Kapitalverwaltungsgesellschaften (KVGen)", whether the management company is an AIFM ("AIF-KVG") or a UCITS management company ("UCITS-KVG");
- From a material perspective, open-ended real estate funds, structured as mutual funds or special funds, are not considered any more. This part of the draft Act has already been subject to criticism and was part of the industry associations' comments which

were sent to the Federal Ministry of Finance by the due date of August 17, 2012;

- The category of closed-ended alternative investment funds ("AIF") is introduced for the first time and their managers are made subject to specific license and other detailed requirements. Generally speaking, this category includes those products which currently fall under the definition of closed-ended funds pursuant to the Asset Investment Act and have, up to now, been subject only to partial regulation;
- With regard to the depositary function, the option under AIFMD that certain closed-end AIFs may also appoint other entities than depositaries (depositaries generally being credit institutions, investment firms and other entities determined by the Members States under UCITS IV) regarding safekeeping, is not considered within the KAGB.

- 1.5 We will provide more details in the next Bulletin.

## F IRELAND



## 1 Leverage disclosure for funds utilising VaR

- 1.1 The Central Bank of Ireland ("CBI") has responded to a recent submission made by the Irish Funds Industry Association ("IFIA") on the subject of leverage. The IFIA submission highlighted industry concerns with leverage calculations based on the sum of notionals and noted that, in some cases, this may be misleading for investors in terms of overall risk profile of a UCITS. Other matters raised in the submission included the nature of disclosure of leverage in the prospectus and the recently introduced CBI requirement of imposing minimum subscriptions on UCITS with 500% or greater leverage.
- 1.2 In its response the CBI refers to the recently published ESMA Q&A document with regard to CESR's guidelines on risk measurement and calculation of Global Exposure and Counterparty Risk for UCITS. The CBI welcomes the clarification that UCITS which use VaR to calculate global exposure must calculate leverage for disclosure purposes using the sum of the notionals. However, such UCITS may, in addition, disclose leverage using the commitment approach. However, the CBI committed to raising the issue of the limitations of the sum of notionals as a measure of a UCITS' risk profile with ESMA, for further discussion. Furthermore, the CBI confirmed that it requires leverage disclosure – expected and the possibility of higher levels – to be located with investment objectives and policies of the UCITS. Finally, the CBI reversed its previous position and confirmed it would no longer impose minimum subscription requirement or limits on the level of leverage on UCITS.
- 1.3 Further details on the correspondence and issues raised therein can be obtained from your Dublin Trust & Fiduciary contact.

## 2 General Scheme of Criminal Justice Money Laundering and Terrorist Financing Amendment Bill 2012 ("Amendment Bill")

- 2.1 As mentioned in our July Bulletin, the Department of Justice and Equality sought comments on the Heads of the Amendment Bill refining the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (the "Act").
- 2.2 The IFIA responded on behalf of the funds industry and highlighted the following points:
  - The Act should be amended to allow designated bodies to rely on third parties in countries and territories outside the list designated by the Minister under Section 31 of the 2010 Act;
  - This list should reference the FATF membership list or Common Understanding between Member States on third country equivalence, rather than require the Minister to determine the prescribed country, which can lead to delays and anomalies;
  - 'Source of Funds' should be defined with the Act;
  - 'Large' transactions should not be a sole determinate for increased scrutiny of a transaction, since large transactions are the norm for institutional investors;
  - The proposed obligation to check whether existing investors have become politically exposed persons and to keep due diligence documents up to date are significant changes and will place a huge administrative burden on funds and administrators.
- 2.3 We will keep you up to date in future publications of the Bulletin on the progression and development of this important piece of legislation.

## 3 Fitness and Probity

- 3.1 The IFIA prepared revised industry Information Notes ('Notes') on Fitness and Probity in July, which were submitted to the CBI. The CBI did not respond with detailed comments on the Notes, but noted the following:
  - While the Notes may be helpful guidance for industry, it is still the responsibility of the service providers to determine whether or not an individual is performing a Controlled Function role;
  - It is the CBI view that, in the case of company secretaries which are corporate entities, the Fitness and Probity regime should apply to the person actually performing the Controlled Function, rather than the Director or Head of that function.
- 3.2 The IFIA Notes can be found in the members section of the IFIA website. However, further details can be obtained from your Dublin Trust & Fiduciary contact.



## 4 Connected Party Transactions Disclosure Requirement

4.1 During the course of the year the IFIA has been actively engaged in discussions with the CBI on how related party transactions should be disclosed in order to comply with the requirements of UCITS Notice 14 (paragraph 4) and Non UCITS Notice 2 (paragraph 4). The CBI advised the industry in March of this year that its view was that the scope of disclosure under these provisions is different to that required under FRS 8. The CBI advised that it anticipates that the following transactions should be disclosed in the annual and interim reports:

- Fee payments;
- Dealings in units;
- Foreign exchange transactions;
- Deposits;
- OTC transactions; and
- Securities lending and repos.

4.2 Over the course of the last few months, the IFIA, on behalf of the industry, has advised the CBI of implications and challenges arising from these requirements and determined the expectations of the CBI. The disclosure requirements were to apply to funds whose financial year commenced 1 July 2011. However, while discussions continue and until a solution can be reached the CBI has decided to waive the requirement for current reporting periods.

4.3 Further details can be obtained from your Dublin Trust & Fiduciary contact.

## G LUXEMBOURG



### 1 Un-launched sub-funds, sub-funds to be reactivated and sub-funds in liquidation

- 1.1 On 9 July 2012, the Commission de Surveillance du Secteur Financier ("the CSSF") issued Circular 12/540 on un-launched sub-funds, sub-funds waiting to be reactivated and sub-funds in liquidation ("the Circular").
- 1.2 The Circular is applicable to undertakings for collective investment ("UCIs"), subject to the law of 17 December 2010 and specialised investment funds ("SIFs"), subject to the law of 13 February 2007.
- 1.3 The purpose of the Circular is to provide clarifications on sub-funds which have been authorised by the CSSF, but have not yet been launched after their authorisation, have become inactive after their launch or are in liquidation.

An un-launched sub-fund or a sub-fund waiting to be reactivated will have **eighteen months**:

- (i) from the date of the CSSF's authorisation letter regarding the sub-fund to be launched; or
- (ii) from the date on which it has become inactive in order to be reactivated.

The existing sub-funds on the date of publication of the Circular also have eighteen months from the date of the publication to activate or reactivate a relevant sub-fund.

In case the situation remains unchanged for the sub-fund after the eighteen months period, the two following scenarios are foreseen:

If the sub-fund does not appear in the current prospectus / issue document of the UCI or SIF, the CSSF will consider the project to launch this sub-fund as being abandoned. If it appears in the current prospectus / issue document of the UCI or SIF, it has to be removed from the relevant document at the next update (at the latest within six months after the deadline).

Liquidated sub-funds must be removed from the prospectus / issue document at its next update, which must be done, at the latest, within six months after the effective date of the liquidation.

- 1.4 In order to allow the CSSF to have up-to-date information on the authorised sub-funds, the UCIs and SIFs are

requested to complete a form indicating authorised but un-launched sub-funds; as well as sub-funds waiting to be reactivated and sub-fund(s) for which liquidation / closure has been decided or effected but which still appear in the prospectus / issue document.

The UCIs and SIFs that do not have any un-launched sub-funds, sub-funds waiting to be reactivated or sub-funds in the process of being liquidated, are requested to indicate that in the same reporting form.

- 1.5 The reporting form, which is available on the CSSF website, must be sent by 15 October 2012 and reflects the situation at the end of September 2012.

- 1.6 The CSSF Circular can be found at:

[http://www.cssf.lu/fileadmin/files/Lois\\_reglements/Circulars/Hors\\_blanchiment\\_terrorisme/cssf12\\_540eng.pdf](http://www.cssf.lu/fileadmin/files/Lois_reglements/Circulars/Hors_blanchiment_terrorisme/cssf12_540eng.pdf)

### 2 Securitisation – Revised Best Practices

- 2.1 At the end of July 2012, the CSSF published a Q&A document on securitisation, resulting from its experience in terms of regulatory oversight of the Luxembourg securitisation market since the inception of the Law of 22 March 2004 relating to securitisation, as amended.
- 2.2 The Q&A document replaces the detailed positions and explanations set out by the CSSF in its 2007 annual report. It provides nineteen questions and answers addressing the most important aspects of the requirements currently applicable to regulated securitisation vehicles.

- 2.3 The Q&A can be found in French only at:

<http://www.cssf.lu/fileadmin/files/Titrisation/FAQ%20titrisation.pdf>

### 3 Calculation of leverage by UCITS

- 3.1 On 1 August 2012, the CSSF published a press release 12/29 which provides clarifications in respect of the disclosure requirements, in terms of leverage, in the prospectus and the annual report for those UCITS determining the global exposure using a Value-at-Risk ("VaR") approach. These clarifications follow the release by ESMA of its Q&A document relating to the Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS.

- 3.2 ESMA Clarifications – leverage disclosure

The leverage to be included in the prospectus and the annual report for those UCITS determining the global exposure using a VaR approach, is to be calculated on the basis of the sum of the notional of derivative instruments used, while allowing these UCITS to supplement this information using leverage figures

calculated through the commitment approach. Consequently, the sum of the notional approach is now the standard reference.

### 3.3 CSSF requirements

The CSSF requires that, from the moment they are launched, newly created UCITS determine the leverage level based on the sum of the notional approach. Existing UCITS shall determine as quickly as possible, and at the latest from 1 January 2013, the leverage level based on the sum of the notional approach.

As regards the disclosure in the prospectus:

- newly created UCITS must determine their level of leverage on the basis of the notional approach;
- existing UCITS must update their prospectus, at the latest, by 31 December 2012.

As regards the disclosure in the annual report:

- for any financial year ending after 31 December 2012, the leverage information should be disclosed on the basis of the sum of the notional approach for the period after 1 January 2013 (i.e. commitment up to 31 December; sum of notionals from 1 January);
- for the financial year ending on or after 31 December 2013, this information must be based entirely on the sum of the notional approach.

### 3.4 Updating of the regulatory framework

The CSSF will be updating its Circular 11/512 in order to incorporate the clarifications set out in the document ESMA/429 on leverage disclosure in the prospectus and the annual report.

### 3.5 The CSSF press release is available at:

[http://www.cssf.lu/fileadmin/files/Publications/Communiqués/Communiqués\\_2012/PR\\_ESMA\\_FAQ\\_EN\\_3107.pdf](http://www.cssf.lu/fileadmin/files/Publications/Communiqués/Communiqués_2012/PR_ESMA_FAQ_EN_3107.pdf)

## 4 Risk Management and Conflict of Interests for SIFs

### 4.1 On 13 August 2012, the CSSF issued Regulation N° 12-01 on risk management and conflict of interests requirements for Luxembourg SIFs.

### 4.2 The provisions relating to risk management cover the following areas:

#### *Organisation of the risk management system*

- SIFs shall establish and maintain a risk management function ("the function") which is hierarchically and functionally independent from the operating units. However, the CSSF may

allow a SIF to derogate from that obligation in view of the nature, scale and complexity of the business, as well as the structure of the SIF.

- The function shall have the necessary authority and access to all relevant information necessary for the fulfilment of its missions.
- SIFs may delegate to third parties part or all of the risk management function, provided that the third party has the necessary competence and capacity to perform the activities.
- The directors shall adopt the risk management system of the SIF and submit it to a regular and documented review.
- SIFs shall communicate to the CSSF a description of the risk management system and any subsequent material change.

#### *Risk Management Function*

The risk management function is in charge of:

- implementing and maintaining an adequate and documented risk management policy;
- ensuring compliance with the risk limitation system of the SIF.

### 4.3 As regards conflicts of interests, the regulation provides the criteria for the identification of conflicts of interest.

SIFs shall:

- establish, implement and maintain an effective conflicts of interest policy. This policy shall be set out in writing and shall be appropriate to the size and the organisation of the SIF, as well as the nature, scale and complexity of its business;
- establish, implement and maintain a policy aimed at preventing any relevant person from carrying out personal transactions that may give rise to a conflict of interest;
- develop adequate policies aimed at preventing or managing any conflict of interests resulting from the exercise of voting rights attached to instruments held; and
- confirm in its application file for the CSSF that it will implement the requested conflict of interest policy.

### 4.4 The regulation will come into force on 8 October 2012. Existing SIFs, at the time of the entry into force of the regulation, will have until 31 December 2012 to comply with the new provisions.

### 4.5 The regulation can be found in French only at:

[http://www.cssf.lu/fileadmin/files/Lois\\_reglements/Legislation/Reglements/RCSSF\\_No12-01.pdf](http://www.cssf.lu/fileadmin/files/Lois_reglements/Legislation/Reglements/RCSSF_No12-01.pdf)

## 5 Implementation of the AIFMD

5.1 On 24 August 2012, the Luxembourg Government submitted a bill of law to the Luxembourg Parliament in relation to the transposition of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (the "AIFMD") ("the bill of law").

5.2 The bill of law also introduces amendments to several laws that will be influenced by the implementation of the AIFMD into Luxembourg law, details as follows:

- The laws which apply to regulated investment vehicles, i.e. Undertakings for Collective Investment (Part II of the 17 December 2010 law), Specialised Investment Funds (SIFs law of 13 February 2007) and Risk Capital Investment Companies (SICARs law of 15 June 2004).
- The law of 5 April 1993 on financial sector professionals ("FSP"), introducing a new FSP status of "depository for assets other than financial instruments".
- The law of 10 August 1915 on commercial companies by modernising the existing common limited partnership regime in Luxembourg (*société en commandite simple*) and introducing improvements to the corporate partnership limited by shares (*société en commandite par actions*) and a new special limited partnership regime (*société en commandite spéciale*). The creation of this new vehicle will constitute an attractive alternative to the Anglo-Saxon LPs.

5.3 The bill of law can be found in French only at:

[http://www.chd.lu/wps/PA\\_1\\_084AIVIMRA0614327110000000/FTSByteServingServletImpl/?path=/export/exped/sexpdata/Mag/133/173/113722.pdf](http://www.chd.lu/wps/PA_1_084AIVIMRA0614327110000000/FTSByteServingServletImpl/?path=/export/exped/sexpdata/Mag/133/173/113722.pdf)

## H NETHERLANDS



### 1 Checklist for Investors in Property Funds

- 1.1 On 12 July 2012, the Autoriteit Financiële Markten ("AFM") issued a checklist for investors to better assess the risks associated with their investments in unlisted property funds ("the checklist"). If investors want to invest in these funds, it is important that they ask themselves several questions in order to avoid unpleasant situations.
- 1.2 The checklist provides no guarantee of a safe investment in unlisted property funds, but does help investors to better understand the risks associated with their investments. The checklist can also be used to evaluate an existing investment or to ask questions to the promoter / distributor.
- 1.3 On the same day, the AFM issued a press release on its findings of deficiencies in the product offering of unlisted property funds to investors. The research evidences (serious) weaknesses in the product offering and the information provided to investors, showing the lack of focus in investor interests.
- 1.4 The AFM calls for possible legislation where the parties offering unlisted property funds would fall under its supervision. Also, the AFM advises investors to be aware of the potential risks in investing in such funds.
- 1.5 The press releases are available in Dutch at:

<http://www.afm.nl/nl/professionals/afm-actueel/nieuws/2012/juli/checklist-beleggen-vastgoed.aspx>

<http://www.afm.nl/professionals/afm-actueel/nieuws/2012/juli/vastgoed.aspx>



## I UK



## 1 CP 12 / 12: Implementing the Short Selling Regulation

- 1.1 This CP implements the EU Short Selling Regulation ("SSR") in the FSA Handbook. The SSR was covered in A.4.14 to A.4.22 of our May 2012 Bulletin and will also be effective from 1 November 2012. As a regulation, it is directly applicable in the UK, but existing conflicting or duplicate rules are to be removed, and in some areas the regulation requires matters to be dealt with through national law.
- 1.2 This proposed FSA Handbook material is based on domestic legislation that the FSA expects the Government will propose to amend the Financial Services and Markets Act ("FSMA"). The key proposals are to:
  - repeal the current UK regime in FINMAR;
  - amend SUP to require firms to allow FSA representatives to visit their premises to meet its SSR obligations;
  - provide an outline framework for the use of temporary suspension powers in the SSR, including when a price fall could be considered disorderly;
  - issue supporting rules on penalties and reviews of FSA decisions, and glossary amendments.
- 1.3 The SSR imposes a two stage reporting regime for net short positions in shares and sovereign debt. Private disclosure to regulators is required at 0.2%, and public disclosure for short positions in shares once 0.5% is reached. The existing UK regime requires public disclosures of net short positions of 0.25% of the issued equity or above, where the issuer is a financial firm or undertaking a rights issue. Disclosures must be made under the old rules where a threshold is reached before 3.30pm on 1 November 2012.

- 1.4 The SSR also provides new rules on uncovered short selling and new restrictions on uncovered sovereign CDS positions, along with various emergency powers.

- 1.5 The consultation closed on 20 September 2012. Further details are available at:

<http://www.fsa.gov.uk/static/pubs/cp/cp12-21.pdf>

## 2 CP 12 / 15: Client Assets Firm Classification and Mandate Rules

- 2.1 In this CP, the FSA proposes changes to the classification system used by firms holding client assets, and new regulatory text to provide clarity on the scope of the mandate rules.
- 2.2 Following PS 10 / 16, firms are required to classify themselves as a CASS small, medium or large firm, each January, based on previous year or projected balances. Large and medium firms are required to allocate to a senior manager or director the function of CF10a CASS Operational Oversight. The CF10a holder is required to complete and submit a monthly client money and assets return ("CMAR").
- 2.3 The FSA previously advised that it would defer the requirement for small firms to provide a CMAR until the operational process used by large and medium firms was fully implemented, and it is not proposing to initiate change at this time.
- 2.4 It is, however, proposing to amend the classification rules to clarify that the regulated activity of arranging safeguarding and administration of assets does not fall within the scope of CASS 1A. It will also clarify that firms CASS status takes effect from 1<sup>st</sup> February following notification. A firm that held no client assets in the previous year or did not expect to in the current year, must notify the FSA one day prior to it holding any client assets, with the CASS firm type classification effective as of the day they first hold client assets. Firms will also be able to opt-up into a higher category of firm at any point during the calendar year, and in such circumstances must submit a CF10a application within 30 days.
- 2.5 Chapter 3 of the CP covers amendments to the CMAR forms and tables to remove the need for some current workarounds. The guidance notes will also be updated on topics such as asset valuation.
- 2.6 The mandate rules require firms carrying on investment business or insurance intermediation to maintain controls where they are able to control clients' assets or liabilities. The FSA has received feedback from audit groups that there is uncertainty on the application of the mandate rules, following the reintroduction of mandates within the scope of client money and asset reporting for certain firms.

- 2.7 The FSA is proposing to clarify the scope of these rules so that there is no risk of consumer detriment and firms are not suffering unnecessary costs. The mandate rules do not apply to a firm in relation to client money held by that firm in accordance with CASS 5 or CASS 7, or client assets held by that firm in accordance with CASS 6, or to an operator of a regulated collective investment scheme, in relation to activities carried on for the purpose, or in connection with, the operation of the scheme.
- 2.8 The definition of mandate will also be clarified to ensure the rules apply to any method through which a firm obtains in written form consent from a client to control his or her assets or liabilities in relation to the provision of instructions regarding:
- that client's money or assets; or
  - where the client incurs a debt or liability to a third party.
- 2.9 The FSA is also taking the opportunity to confirm that the sole requirement of the CASS 8 mandate rules is to ensure that a firm that has mandates must establish and maintain adequate records and internal controls in respect of its use of those mandates.
- 2.10 The consultation closed on 30 September 2012, and a Policy Statement is expected in November, with final rules effective as of 1 January 2013.
- 2.11 Further details are available via:

<http://www.fsa.gov.uk/static/pubs/cp/cp12-15.pdf>

### 3 CP 12 / 16: FSCS Funding Model Review

- 3.1 In this consultation, the FSA proposes amendments to the class structure and cost allocation rules that currently govern the FSCS. The FSCS is funded by levies on the financial services industry, with firms grouped into classes based on industry or target market, and claims met collectively at class level until a threshold is reached, at which point a wider pool of classes are involved.
- 3.2 The five broad classes are deposits, life and pensions, general insurance, investment, and home finance. With the exception of deposits, all classes are split into provision and intermediation sub-classes. The FSCS can currently levy for compensation costs up to the limit of each sub-classes threshold without consultation, but must provide as much notice as possible to the industry when a levy is due.
- 3.3 The CP reflects upon the high number of significant firm failures in recent years, noting that the FSCS had to borrow to meet the costs of bank and building society failures in 2008/9, as these far exceeded the annual levy threshold of the deposit taking firms class. There have also been high claims on the FSCS due to PPI mis-sales and the failure of several significant investment firms.

- 3.4 This has led to calls from industry participants for a review of the current funding model. This CP proposes changes to the cross-subsidy and annual threshold rules.

#### *Class system: no changes proposed*

- 3.5 The current funding model is based on the principle that firms should pay the costs arising from the activities of failed firms that have been grouped together because they share a degree of affinity. However, the FSA is finding that firms are increasingly arguing they feel little affinity to other firms they are grouped with. Firms are allocated to classes based on the regulated activities they undertake. They must report the appropriate levy data for their tariff measure on an annual basis. Many firms will be a member of more than one class and must pay the levy for each class of which they are a member.
- 3.6 If the FSCS is to pay compensation, it allocates costs to the class that corresponds to the regulated activity that gave rise to those costs. This can result in firms being levied for costs for an activity that is not a principal activity within their business model.
- 3.7 The FSCS took the view that the claims against one firm arose as a result of its marketing material, which was issued in connection with its designated investment business, under one of four regulated activities, all of which fell into the investment intermediation sub-class.
- 3.8 The FSA considered a number of potential alternative models, including establishing more broader classes, merging product and intermediation sub-classes, allocating via product or primary business, or by regulatory requirements. However, the FSA's view is that many of these alternatives were unlikely to be any fairer or less contentious than the current system. The FSA believes that using broader classes would not be supported by providers, as this would, in effect, be a one-way subsidy to investment intermediaries based on recent claim trends.
- 3.9 The FSA is also not proposing to reallocate the regulated activities of 'safeguarding and administering investments' and 'arranging safeguarding and administering of assets', currently in the Investment Intermediation class to the Investment Fund Management class. It believes that there is no strong evidence that these activities should be aligned to either of the classes. It could complicate tariff data compilation if firms have to attribute annual eligible income between each category.
- 3.10 Allocating by product or primary business model was also ruled out as the FSA believes that, in the absence of defined categories, this would require firms or the FSA to make subjective judgements, and any class system could result in multiple categories with low numbers of firms and volatile levy calls.
- 3.11 The FSA's conclusion is, therefore, to retain the current approach based on regulated activities as this strikes the most reasonable balance between fairness, affinity and



sustainability, and the FSA has not identified a credible alternative method. It does, though, propose to rename the Investment Fund Management class the 'Investment Provision' class.

*Spreading costs: deposits segregated, and the creation of a future Financial Conduct Authority ("FCA") retail pool*

3.12 This section of the CP reflects that the cross-subsidy rules were introduced in April 2008, and were used for the first time in January 2011, when the Investment Fund Management class was asked to contribute £233m to a compensation bill of £326m, which originated in the Investment Intermediation class. The FSA believes this demonstrated that the cross-subsidy rules worked as an effective contingency arrangement to ensure that the FSCS had the capacity to meet extraordinary compensation costs.

3.13 There are arguments though against cross-subsidy, noting that:

- as the pool widens the degree of affinity between firms reduces;
- subsidy dilutes the impact to a sector with distortive effects such as blurring risks.

3.14 The FSA proposes to revise the rules so that there is no cross-subsidy to or from the Deposits class, and no cross-subsidy between the General Insurance Provision, Life and Pension Provision and Deposits classes. In the case of deposits, it believes that, for financial stability reasons, it could be preferable, as in 2008, to borrow from the national loans fund, and in the case of general insurance, claim levels are unlikely to breach the thresholds in place. For the same reasons the FSA does not believe that there should be a cross-subsidy between the General Insurance Provision and Life and Pension Provision classes and the General Insurance Intermediation and Life and Pension Intermediation classes respectively.

3.15 With respect to the FCA classes, in order to ensure costs are met the FSA proposes that compensation costs in excess of the relevant thresholds should be met from a wider pool of levy payers. Compensation costs will be from an FCA retail pool made up of those classes that potentially give rise to compensation claims: Investment Provision, Investment Intermediation, Life and Pensions Intermediation, General Insurance Intermediation and Home Finance Intermediation. If the FCA retail pool is triggered (as a class threshold has been reached), the other future FCA classes will contribute to a funding requirement in proportion to their thresholds.

3.16 The CP also discusses pre-funding the FCA retail pool, but this remains a decision for government.

*Class thresholds*

3.17 The current FSCS thresholds were set in April 2008

based on the previous FSCS funding review. The thresholds were set based on the estimated financial size of each class. The FSA is proposing a number of changes based on funding needs for each class, and the affordability to firms. Of interest will be:

- Investment Fund Management: previously £270m, new £200m;
- Investment Intermediation: previously £100m, new £150m.

3.18 A consultancy firm was asked to carry out a survey of firms to determine the impact of various thresholds on individual firms. This report is available via the FSA website and the methodology was discussed with trade associations at a high level. The modelling did not reflect the extent to which a firm might be supported by a parent institution.

3.19 The CP includes a table showing the impact of various thresholds on each class. The current threshold for the Investment Fund Management class (£270m) is equal to just over 30% of class profits based on the stylised firm analysis. The percentage impact is comparatively high due to the high proportion of firms that operate in both this and the investment intermediation class. The FSA notes that while there is a risk of large loss in the fund management class, the claims are usually limited in scope, as proper operation of the client assets rules should ensure that firm failure does not give rise to investor losses. Given the low amount of historic payouts, the FSA proposes to reduce the threshold from £270m to £200m a year. This would bring down the percentage of profits of stylised firms from the current 35% to approximately 25%.

3.20 The FSA also proposes to increase the investment intermediation class threshold from £100m to £150m, which would represent approximately 25% of stylised firms' profits. The CP states that the FSA would have proposed a higher threshold if it was not constrained by affordability concerns.

*Levy calculation:*

3.21 In chapter 7 of the CP, the FSA proposes to amend its rules so that the FSCS can look to include a share of the compensation costs that it reasonably anticipates will arise over the next three years when setting its compensation costs levy for the separate funding classes each year. This proposal will apply to all classes, except for the Deposits class.

3.22 If actual compensation costs in the year following the date of the levy turn out to be lower than collected, the FSCS would continue to have the discretion to refund any surplus or retain it to offset the expenses 'expected to be incurred' over the next three years. The FSA believes that by taking a longer view of anticipated compensation costs, the year-to-year 'cliff edges' in levy burden may be smoothed making levies easier for firms to absorb into their business models.

### *Tariff Calculation*

- 3.23 This chapter reflects that the FSA has made changes to tariff bases at the request of firms where this improves the fairness of the allocation process. The Investment Fund Management class levy is given as an example, it having changed from a 'funds under management' basis to 'gross income' and then more recently to 'annual eligible income'.
- 3.24 However, after the FSCS raised its interim levy in January 2011, it became apparent that not all firms were adopting the same approach in relation to reporting income from collective investment schemes ("CIS"). The FSCS issued a statement in June 2012 on how this should be reported. In the CP, the FSA states it is aware of reports that firms can gain an advantage through refining their tariff submission. The FSA asks if firms share its view that annual eligible income is preferable to gross income for intermediation classes. The FSA is also unconvinced by calls to introduce a transaction / product sale based tariff. It has also not established a reliable correlation between levels of complaints and FSCS payouts.
- 3.25 The CP acknowledges that the current Financial Services Bill will split responsibility for writing rules governing the FSCS between the Prudential Regulatory Authority ("PRA") (for deposit and insurance firms) and Financial Conduct Authority ("FCA") (for other activities). The FSA believes its current proposals are consistent with this. Future management expenses limits will be approved by the FCA and PRA in two parts, but via a co-ordinated process. Base costs would be split 50/50 between the pools regulated by each body.
- 3.26 The FSA has also noted current European developments, including a recast of the Deposit Guarantee Schemes Directive ("DGSD") and revisions to the Investor Compensation Schemes Directive ("ICSD"), but at the time of issue of this CP, negotiations on these had stalled.
- 3.27 Responses to the FSA are requested by 25 October 2012. Further details are available at:

<http://www.fsa.gov.uk/library/policy/cp/2012/12-16.shtml>

## **4 CP 12 / 19: Retail Distribution of Unregulated Schemes**

- 4.1 In this consultation, the FSA is proposing to ban the promotion of unregulated CIS ("UCIS") and similar substitute products, which it collectively describes as 'non-mainstream pooled investments' ("NMPI"), to retail investors.
- 4.2 The justification is FSA's view that the majority of promotions and sales are unsuitable, leaving ordinary investors exposed to risk of detriment. It carried out a

survey which found only one in every four sales was suitable.

- 4.3 The paper is taking on the proposals it outlined in a DP on product intervention last year, and its recent guidance stating Traded Life Policy Investments ("TLPIs") were not a suitable investment for retail investors. The rules do not capture indirect investment through products such as unit linked insurance bonds (and, for example, Non-UCITS Retail Schemes ("NURS")) that can invest in such assets as part of a mix of underlying assets. The FSA believes that existing controls on these products mitigate these risks.
- 4.4 The proposals should be viewed as part of the FCA style intervention approach.

### *Substitute products and exclusions:*

- 4.5 The proposals do capture pooled investments or 'funds' that have adopted legal structures such that rules on regulated CIS do not apply to them, and securities issued by special purpose vehicles ("SPVs") such as those used to allow retail investment in TLPIs. The draft rules only exclude from scope SPV-issued securities, whether or not they are structured products, where the returns are determined by reference to listed stocks (including baskets of stocks) or one or more stock market indices.
- 4.6 Structured deposits are not intended to be caught by the FSA's proposed rules. The FSA does indicate that it will also consider waiver requests under the normal process, on a case-by-case basis.

### *Promotion Rules*

- 4.7 At present, no restrictions apply to NMPI, other than UCISs which are restricted through primary and secondary legislation together with FSA rules. UCIS cannot be promoted to the general public and marketing is only allowed where an exemption is available. The FSA believes that these restrictions are widely ignored or misinterpreted. In particular, it believes that many distributor firms do not understand that providing financial advice generally includes making a financial promotion.
- 4.8 The FSA notes that there is a significant probability of arbitrage where different legal structures that provide similar investment opportunities face different rules. Execution-only sales are not captured by new rules provided there has been no financial promotion of the NMPI. Wrapped products (e.g. ISAs, SIPPs, etc.) must be 'looked through' and count as direct investment.

### *Proposed ban*

- 4.9 The FSA proposes to change the financial promotion rules to limit the type of customer to whom firms may promote NMPI. The exceptions will be customers:
- certified as sophisticated investors;
  - self-certified as sophisticated investors;

- who meet the criteria to be regarded as high net worth individuals.

#### 4.10 Some current exemptions will be removed:

- Category 1 in COBS 4.12.1R(4) allows firms to promote UCIS to people who are already participants in a UCIS or who have been in the last 30 months. This will be removed given FSA is aware previous advice has been poor;
- Category 2 covers where the firm has made reasonable steps to ensure an investment is suitable. This will also be removed as the FSA believes it is the most abused category, with many firms assuming that the provision of advice satisfies the requirement.

4.11 Existing Handbook guidance on the effect of the financial promotion rules on advised sales will be revised to clarify that personal recommendations generally amount to a financial promotion and, as a result of the marketing restrictions, advice on a non-mainstream pooled investment may result in an unlawful promotion if no valid exemption is available.

4.12 Firms will be required to record the basis on which promotions have been made, and distribution firms will be required to ensure their compliance oversight function (CF10) confirms the compliance of each financial promotion.

4.13 The definition of retail investment product will be revised to clarify the position on advice on UCIS and substitutable products in relation to Retail Distribution Review independence requirements. If a firm holding itself out as offering independent advice does not deal with the types of retail clients who may receive promotions for non-mainstream pooled investments, then it will not need to consider them in its review of product types when giving advice to its retail clients.

4.14 The FSA is proposing to prevent marketing of TLPIs to retail customers, no matter what legal form they take.

#### *Qualified investor schemes ("QISs")*

4.15 The FSA view is that QIS can currently expose investors to risks not dissimilar to those found in UCIS. Currently, QIS fund managers must act as gatekeepers to ensure that only 'qualified investors' are able to buy units in the fund. The criteria is generally the same categories as for UCIS. The FSA proposes that QIS should be subject to similar marketing restrictions as UCIS to equalise the rules.

4.16 QIS managers will still be expected to take care to ensure that units are not registered to retail investors who are not sophisticated. If they rely on information from, for example, distributor firms, fund managers must act in the best interests of the customer and be able to show that such reliance is reasonable.

4.17 The consultation closes on 14 November 2012. A Policy Statement is expected 1Q 2013 including final rules.

Further details are available via:

<http://www.fsa.gov.uk/static/pubs/cp/cp12-19.pdf>

## 5 Handbook Notice 122

5.1 July's Handbook Notice 122 included one item of direct relevance to this publication. In Chapter 8 of CP 12 / 11, the FSA proposed to delay the effective date of the rules and guidance requiring platform service providers and other nominee companies to provide fund information, and information about voting rights to the beneficial owners of units in authorised funds. These rules were to be contained in COBS 14.4.

5.2 The FSA proposed to defer the effective date from 31 December 2012 to 31 December 2013, with a view to a further consultation later in 2012 to make a number of amendments to COBS 14.4. All respondents to the CP agreed with this proposal and the FSA will proceed as planned. A further consultation on the rules is expected later this year.

5.3 For reference, the other matters raised in the Notice included:

- New regulatory requirements applicable to firms carrying on the new activity of 'bidding in emissions auctions';
- A change to the mortality basis that firms must use for future annuity projections in personal pensions illustrations;
- New eligibility and suitability rules for firms arranging insurance contracts as part of a packaged bank account;
- Guidance to brokers on when they can provide information to buyers, regarding the sale of stock by persons discharging managerial responsibilities;
- Rules to achieve consistency in the regulatory regimes applying to credit unions in Great Britain and Northern Ireland;
- Guidance on arrangements that Recognised Investment Exchanges ("RIEs") and Recognised Clearing Houses ("RCHs") should make to meet their financial resources requirements;
- A re-definition of the term 'substantial shareholder' which describes the conditions in which voting rights being held by a person in specific circumstances will be disregarded for the purposes of calculating voting rights;
- Revisions to how the UK Listing Authority helpdesk provides market participants with individual guidance, including limits on the ability of sponsors to request no names guidance.

5.4 The Notice is available at:

<http://www.fsa.gov.uk/static/pubs/handbook/hb-notice122.pdf>

## 6 HM Treasury and HMRC issue revised Contractual Scheme Regulations

6.1 HM Treasury has released a revised set of draft regulations following feedback from advisory bodies, the FSA and respondents to the consultation, including IMA and DATA. Key changes in the revised proposals included:

- Limited liability for general partners;
- Grandfathering for existing depositaries acting for existing authorised schemes;
- The depositary will not be a limited partner in the partnership scheme.

6.2 HMRC also issued draft tax regulations that included revised rules on mergers and reconstructions applicable to all collective investment schemes. These include clauses on conversions of units which would treat such an event as a re-organisation of share capital, ensuring that there is no chargeable gain event. There was also confirmation that authorised contractual schemes would be treated as special investment funds for VAT purposes and so management charges would be VAT exempt.

6.3 An open session was held at the Treasury on 29th August. We understand that a number of further proposals were made at that meeting, including providing better protection to retail investors should the limited liability of investors not be recognised in a foreign jurisdiction. HM Treasury also confirmed that it would write to foreign jurisdictions to explain the new schemes to assist with recognition as transparent entities.

6.4 Comments on the revised regulations were requested prior to 3 September. Further details are available via:

[http://www.hm-treasury.gov.uk/consult\\_contractual\\_schemes\\_collective\\_investment.htm](http://www.hm-treasury.gov.uk/consult_contractual_schemes_collective_investment.htm)

## 7 FSA highlights work of European Commission towards improving Investor Protection

7.1 The FSA issued a statement on its website in July focusing on three retail orientated proposals from the EC:

- The Commission is to develop a regulation requiring firms selling packaged retail investment products ("PRIIPs") to issue a key information document. It notes that the investment market is largely dominated by these products, which can include complex structures or be difficult to compare.

Further details are provided in A.4.1 to 4.2 of this Bulletin;

- The Insurance Mediation Directive is to be revised to provide common standards for insurance sales, including direct sales conducted by insurers;
- The EC proposes to amend the UCITS Directive to provide a better definition of the tasks and liabilities of UCITS Depositaries, clear rules on manager remuneration, and a common approach to breach resolution. Further details can be found in A.4.4 of this Bulletin.

7.2 The FSA summary can be found at:

[http://www.fsa.gov.uk/library/other\\_publications/miscellaneous/2012/eu-consumer-protection.shtml](http://www.fsa.gov.uk/library/other_publications/miscellaneous/2012/eu-consumer-protection.shtml)

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