

# FCA and Financial Services Newsletter - Summer 2013



<b>Introduction</b>	<b>Events since the start of the recession in 2008 have seen financial services come under increasing scrutiny and calls have been made for the government to improve regulation of the sector.</b>
<b>Basel III &amp; CRD IV</b>	<b>In this update we look at the rules about capping bonuses, and the Alternative Investment Fund Managers Directive now that it is in force. We also examine changes to the handbook and the proposed changes to the client money regime.</b>
<b>AIFMD</b>	
<b>Handbook changes</b>	<b>Basel III and CRD IV</b>
<b>FCA Periodic Fees</b>	On 17 July 2013 Basel III and the Capital Requirement Directive (CRD) IV came into EU Law. The new rules apply from 1 January 2014 and the FCA have released a consultation paper (CP13/6) which proposes how the new rules will be incorporated into the FCA Handbook.
<b>Client money regime</b>	It is proposed that this will be achieved by adopting a sourcebook within the FCA handbook called the Investment Firms Prudential Sourcebook (IFPRU). The FCA are currently proposing to transpose the majority of the GENPRU sourcebook into IFPRU unchanged, thus limiting the effect on firms.
<b>Protected cell regime</b>	CRD IV was designed for banks but will also apply to investment firms which fall under MiFID regulation. The unfortunate effect of this is there will be potentially more regulation placed upon certain investment firms, however the FCA are proposing to use a number of discretions to reduce the impact on non-banking firms.
<b>Other points</b>	The new rules place a cap on bonuses in that the variable component of remuneration (i.e. bonuses) can't be more than 100% of the fixed component without shareholder consent. With consent, the variable component can be increased to a maximum of 200%. This is designed to discourage excessive risk taking.
	The good news is that the current capital requirement calculations aren't changing at the moment and the proposal is that the calculation of the various components of the capital requirement will remain the same.
	To sum up, it is envisaged that the new changes will primarily affect banks, however they will result in changes to the way the FCA handbook looks from January 2014.
	<b>In the news</b>
	The effects of Basel III have been evident in the news recently with the PRA exposing a future capital shortfall in Barclays Plc. Part of the new provisions are that banks are required to have a minimum 3% leverage ratio, which is the percentage of common equity against total risk weighted assets. Barclays currently falls short of this requirement and needs to raise an additional £12.8bn in capital. In response, they are shoring up their capital reserves with a £5.8bn rights issue, and a £2bn issue of convertible bonds.

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Time will tell if other banks also find themselves in this situation and are required to take a pro-active response similar that of Barclays.

### Alternative Investment Fund Managers Directive (AIFMD)

This came into force on 22 July 2013 and aims to create a tighter regulatory framework for Alternative Investment Funds (AIFs). The definition of AIFs is broad, with a few exceptions, and includes hedge funds, investment companies and private equity funds. The management of any 'collective investment undertaking' which is not subject to the UCITS regime is caught by AIFMD.

As well as beefing up regulation, the aim is to allow AIFs to be marketed cross-border, thus creating a more level competitive playing field within the European Economic Area.

An AIF manager can be 'full scope' or subject to a lighter regime if assets under management are below certain thresholds. The main effects of the AIFMD are:

- A number of fund managers in the UK will need to be re-authorised by the FCA under AIFMD.
- Investment companies which do not employ an external manager will need to be authorised or registered with the FCA under AIFMD.

The transitional period began on 22 July 2013 and firms can now apply for AIFMD status. Firms currently managing AIFs have until 22 July 2014 to apply for authorisation to the FCA. The level of total assets under management affects the level of authorisation, with firms managing over €100m of assets in AIFs being subject to 'full-scope UK AIFM' requirements. An application form template can be found on the FCA website.

Managers skirting close to the €100m threshold can opt-in to full-scope authorisation should they wish.

### Handbook changes

#### COBS 4.2

The rules surrounding financial promotions have been clarified to improve disclosure to investors regarding risks in investments. Essentially the firm must ensure that if it uses terms like 'guaranteed' or 'protected' that it is not misleading investors in this regard. The FCA/PRA should also be disclosed as the regulator where applicable.

#### Other changes

There have been a number of other small changes made to the handbook but the content/substance of the rules has not been altered. The changes are most notably around updating wording to include AIFs and the AIFMD.

### FCA Periodic Fees

In April the FCA set out its funding requirements for 2013/14 and stated that its fees needed to increase by 15% to cover system upgrades and to administer the transition to the new 'twin peaks' FCA and PRA model. The FCA have recently sent out their invoices for 2013/14 fees, and changes have been implemented to the way they are calculating periodic fees.

Some firms however have seen their fees increase by significantly more than this as the calculation of periodic fees for advisors, dealers and brokers has moved from being based on headcount, to annual income (turnover). This has caused some upset for small to medium sized firms who are now faced with these large fees, as the FCA and PRA said that the majority of the increase in fees would be borne by the larger financial institutions.

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## Proposed changes to client money regime

Firms holding client money fall under FCA CASS rules and consultation paper CP13/5 proposes some changes to the CASS rules. Investment firms can currently use a "delivery versus payment" exemption from client money rules if a transaction with an investor's money settles within three business days. This is referred to as the "DvP window". The FCA found some firms misapplying the rule and stretching the window. They propose to clarify the rules regarding the DvP window, and potentially close it should firms not use it correctly. In this scenario all investor money would need to go through a client bank account. It is also proposed that the investor consents to the use of the DvP window in their agreement with the firm.

It is also unclear what a firm should currently do with unclaimed client money. If reasonable steps have been taken to return the money to the owner but have been unsuccessful, the proposal is that after six years the money can be distributed to charity.

A final proposal is that firms will have to annually write to owners of client money held on their behalf detailing their safeguards and rules in place.

## Protected cell regime

Investment management firms need to ensure their Open Ended Investment Companies (OEICs) are in compliance with this new legislation by 20 December 2013. For all OEICs under management authorised before 21 December 2011 (funds authorised beyond this point are automatically included), an application should be made to the FCA to include them within the regime. The prospectus and KIID documents should also be updated as required.

## Other points

The FCA proposed that firms would have six months from the point of cutover to the new regulations to update their stationary and website information to reflect the new regulator. This means that by the end of October firms should not be sending anything to customers with references to the old 'FSA'. It is also advisable to make changes to compliance manuals to reflect the new regulator if this hasn't already been done.

**Specific advice should be obtained before taking action, or refraining from taking action, in relation to the above.**

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