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A legal update from Dechert's Financial Services Group

In this issue

Dechert LLP

Financial Services UK and International Update

IFSB adopts standards on Islamic Collective Investment Schemes and Sukuk Securitisation

The Islamic Financial Services Board (ISFB) has adopted two new standards. These are:

- Guiding Principles on Governance for Islamic Collective Investment Schemes (IFSB 6); and
- Capital Adequacy Requirements for Sukuk Securitisations and Real Estate Investment (IFSB 7).

These new standards complement existing ISFB standards and other internationally recognized standards of governance.

AIMA announces new policy platform, including a major new transparency initiative

The Alternative Investment Management Association (AIMA) has published a press release announcing a series of policy positions. These are:

- regular reporting and increased transparency of systemically significant positions and risk exposures by managers of large hedge funds to their national regulators;
- an aggregated short position disclosure regime;
- support for new policies to reduce settlement failure;
- support for a global manager-authorisation and supervision template based on the UK's FSA model; and
- a call for unified global standards for the industry.

Andrew Baker of AIMA stated that AIMA wished "to dispel once and for all this misconception that the hedge fund industry is opaque and uncooperative".

President of the ECB makes keynote address on future of European financial regulation and supervision

The President of the European Central Bank (ECB) Jean-Claude Trichet has addressed the Committee of European Securities Regulators (CESR) in relation to the future of European financial regulation and supervision.

Mr. Trichet made some general comments about the current financial climate and the responses to it by central banks, governments and other authorities. He discussed ways of strengthening the financial system, including having a financial system that is sustainable and resilient to shocks. Notably, he expressed the view that the current crisis is "a loud and clear call to extend regulation and oversight to all systemically important institutions—notably hedge funds and credit rating agencies—as well as all systemically important markets—in particular the OTC derivatives markets".

FSA publishes Code of Practice on remuneration policies

The Financial Services Authority (FSA) has published a draft code of practice in relation to remuneration policies that will be applicable to all FSA regulated firms. The FSA believes that the code of practice will lead firms to have remuneration policies that do not expose them to excessive risk and will embed the principles of sound risk management. The FSA points out that the code is not concerned with levels of remuneration, which it states are a matter for firms' boards.

The code contains one general principle and ten specific principles split into the categories of governance, measure of performance for the calculation of bonuses, measurement of performance for long-term incentive plans and composition of remuneration.

The FSA states that it may ask the committee with overall responsibility for a firm's remuneration to demonstrate how well its policies compare against these principles and show plans for improvement where required.

The FSA will consult on the code and further proposals for remuneration policy in March.

De Larosiere group publishes report on the future of European financial supervision and regulation

The De Larosiere group, chaired by Jacques de Larosiere (which was established by Jose Barroso, the President of the European Commission in October 2008) has published its report on the future of European financial supervision and regulation. The report states that its aim is to lay out a framework to take the European Union forward towards a new regulatory agenda, stronger coordinated supervision and effective crisis management procedures. The European Commission will publish an initial assessment and preliminary response on 4 March 2009 to the main proposals outlined in the report.

The report recommends that a European System of Financial Supervisors should be created. National regulators would continue to carry out day-to-day supervision, but three new European authorities would be created covering securities, banking and insurance. In addition, there should be a new body called the European Systemic Risk Council to gather information on all macroprudential risks in the European Union.

The report also discusses the regulation of the investment funds industry and focuses on money market funds issues and depositary issues. As a result, the report proposes to "further develop common rules for investment funds in the EU, notably concerning definitions, codification of assets and rules for delegation. This should be accompanied by a tighter supervisory control over the independent role of depositaries and custodians".

EVCA publishes industry response on potential regulation of European private equity and venture capital industry

The European Private Equity and Venture Capital Association has published a response document, "Private Equity and Venture Capital in the European Economy: An Industry Response to the European Parliament and the European Commission".

The document sets out EVCA's thoughts on what it believes is an appropriate and proportionate regulatory framework. The EVCA states that it believes that "this framework should consist of enhanced unified professional standards and an effective enforcement regime with oversight thereof by the appropriate national or European bodies".

CESR publishes risk management principles for UCITS

CESR has published a number of risk management principles for UCITS which should apply both to designated asset management companies and investment companies that have not designated a management company (self-managed UCITS). CESR points out that the principles ensure that investors are adequately protected whilst "the risk management process is appropriate and proportionate in the view of the nature, scale and complexity of the asset management company's activities and of the UCITS it manages".

The risk management principles cover the following headings:

- supervision;
- governance and organization of the risk management process;
- identification and measurement of risks relevant to the UCITS;
- management of risks relevant to the UCITS; and
- monitoring.

McCreevy speech to EC Conference on Private Equity and Hedge Funds

Charlie McCreevy, European Commissioner for Internal Market and Services, made the opening speech to the EC Conference on Private Equity and Hedge Funds. He considered the role of both hedge funds and private equity in the current economic crisis, saying, "we should not forget that hedge funds and private equity have not been central to the crisis". However, he went on to comment that "hedge funds don't need to bring down a large bank before they become a source of systemic risk . . . hedge funds have found themselves between a rock and a hard place—investor redemptions and tighter leverage have led to forced selling of assets, fuelling price declines. This is forcing us to think about the "systemic-ness" not of individual hedge funds, but of hedge funds in the aggregate".

Mr. McCreevy then went on to propose six lessons that should be borne in mind when considering any regulatory or legislative initiatives in respect of hedge funds and private equity. These included the fact that action should be build on the already extensive experience with regulation of alternative investment managers and industry in Europe, and that any action should recognize that many of the criticisms leveled at hedge funds are not unique to them. He commented that "any policy responses that seek to tackle wider problems by targeting hedge funds and private equity will fail".

ISDA publishes Close-Out Amount Protocol

The International Swaps and Derivatives Association has launched its 2009 Close-Out Protocol. This protocol will enable parties to agree upfront that, in the event of a counterparty default, they will use Close-Out Amount valuation methodology to value trades. Close-Out Amount valuation enables participants more flexibility in valuation where market quotations may be difficult to obtain.

AIMA response to HMT consultation "Offshore funds: further steps"

The Alternative Investment Management Association (AIMA) has published its response to the HM Treasury paper "Offshore funds: further steps". AIMA's response recognizes the aim of removing obstructions from the UK tax regime for multi-tiered fund structures, simplifying the offshore tax regime and generally providing more certainty to UK investors and funds. Amongst other issues, AIMA points out that investor capital will be deterred if hedge funds cannot take advantage of the offshore funds regime, and indicates that the requirements for funds operating under the reporting fund regime are likely to be as onerous as the existing distributor status regime, and therefore do not make for the stated aim of simplification.

FSA announces new Contracts for Differences disclosure regime

The FSA has announced a new disclosure regime for Contracts for Differences (CFDs) to take effect from 1 June 2009. These new rules cover financial instruments in the same company, which give a legal right to acquire shares or have a similar economic effect to shares. These financial instruments must be aggregated and disclosed once over the 3% threshold. There is an exemption for CFD writers acting as intermediaries to avoid disclosures which would have no value to the market.

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