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A legal update from Dechert's Financial Services Group

Dechert LLP

Financial Services Europe and International Update

Regulatory Developments

This *DechertOnPoint* summarises regulatory developments in the UK and the European Union in the investment funds and asset management sector during recent weeks.

EU Regulatory Developments

The European Commission's MiFID Review

On 8 December 2010, the European Commission published a public consultation on its review of the Markets in Financial Instruments Directive *(2004/39/EC)* ("MiFID"), the purpose of which is to receive input from market participants, regulators and other stakeholders in order to inform the Commission's legislative proposals to amend MiFID. The principal features of this consultation were considered in a legal update from Dechert's Financial Services Group, "MiFID 2: The European Commission's Consultation on the MiFID Review".

On 15 December 2010, the European Parliament published the provisional text of its resolution on regulation of trading in financial instruments. This is also connected to the European Commission's review of MiFID.

In particular, the Parliament calls for:

- trading venues (including multilateral trading facilities to be supervised in a transparent and equal way;
- enforcement of the provisions of MiFID to ensure that broker crossing networks are correctly regulated;
- ESMA to undertake various studies, including on the systematic internaliser regime, best execution, trade reporting standards, the costs and benefits of algorithmic and high frequency trading on markets, and fee structures;
- a reduction in the proportion of instruments traded over the counter; and
- the Commission and ESMA to consider introducing a transparency requirement for all non equity financial instruments.

(This resolution has now been forwarded by the Parliament to the Council of the EU, the Commission and the European Central Bank.)

It should also be noted that on 21 December 2010, the Committee of European Securities Regulators ("CESR") published two feedback statements relating to the regulation of over-the-counter ("OTC") derivatives, both in the context of the European Commission's MiFID review:

- the extension of transaction reporting obligations in respect of OTC derivatives; and
- standardisation and organised platform trading of OTC derivatives.

European Commission Communication on Strengthening National Financial Services Sanctioning Regimes

Also on 8 December 2010, the European Commission published a provisional version of a Communication adopted on strengthening the sanctions for breach of EU financial services rules. The communication is

addressed to the European Parliament, the Council of the European Union, the European Economic and Social Committee and the Committee of the Regions. In it, the Commission explains that the financial crisis highlighted the fact that EU financial services rules are not always respected and applied as they should be across Member States. It believes that the lack of enforcement of EU rules in one Member State may have significant implications for the stability and functioning of the financial system in another Member State. The Commission is also concerned that differences in this area may distort competition and create the risk of undermining consumer protection, market integrity and confidence in the financial sector.

The Communication sets out possible ways to achieve greater convergence and reinforcement of the national sanctioning regimes in the EU financial services sector and it identifies certain areas for improvement, suggesting possible EU actions to achieve greater convergence and efficiency of these regimes. However the Commission is not considering full harmonisation of national sanctioning regimes, but it is considering whether a minimum common standard should be set at the EU level (by a legislative measure) for certain issues that are key for effective, proportionate and deterrent sanctioning regimes, which it suggests could include:

- the types of administrative, civil and criminal sanctions available;
- the level of these sanctions;
- the availability of sanctions against both financial institutions and individuals responsible for violations;
- the criteria to be taken into account when applying sanctions; and
- the publication of sanctions.

In the Communication, the Commission noted that the action plan agreed by the G20 at its November 2008 summit in Washington included actions aimed at ensuring that appropriate sanctioning regimes are in place and also noted that increasing regulatory enforcement and remedies is one of the objectives of the US financial regulatory reform under the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010.

Comments can be made on the proposed communication until 19 February 2011.

Market Abuse Directive: Legal Uncertainty Arising from the ECJ's *Spector* Judgment

On 7 December 2010, the respected Financial Markets Law Committee ("the FMLC"), sponsored by the Bank of England and chaired by Lord Hoffman, published a paper focusing on the uncertainty surrounding the insider dealing offence in Article 2 of the Market Abuse Directive (*2003/6/EC*) ("MAD") arising from the judgment of the European Court of Justice (the "ECJ") in *Spector Photo Group NV, Chris Van Raemdonck v Commisssie voor het Bank , Financie en Assurantiewezen (Case C 45/08)*.

The FMLC's main area of concern is whether, for a person to commit the offence under Article 2 of the MAD, that person must be dealing in the relevant financial instruments "on the basis" of inside information (which is the position taken in the UK under section 118(2) of the Financial Services and Markets Act 2000 ("FSMA")) or merely "whilst in possession of" inside information. It explains that with the first approach (i.e., dealing on the basis of inside information) a person carries on prohibited insider dealing where his decision to deal is influenced by the inside information he possesses. With the second approach (i.e., dealing in possession of inside information), the FMLC explains that a person is prohibited from dealing in financial instruments where he possesses inside information about these instruments. It is not relevant that he would have dealt in any event and that the inside information had no impact on his decision to deal. The FMLC explains that the ECJ appears to favour the second approach. However, it advises that the ECJ recognises that this interpretation could lead to injustice, and the prohibition of transactions that do not infringe the interests protected by the MAD.

The FMLC considers that the ECJ's approach gives the MAD a far reaching scope envisaged in the second approach, but without any clear set of exemptions or safe harbours of the kind necessary to make that approach just and workable. The FMLC believes that this creates unacceptable legal uncertainty as market participants will need clear guidelines as to what transactions are prohibited. The FMLC therefore believes that the European Commission's current review of the MAD presents it with a good opportunity to address this uncertainty. If the MAD is not amended to resolve the uncertainty, the FMLC considers that the new European Securities and Markets Authority ("ESMA") should adopt technical standards to resolve this issue.

European Commission Consultation on the UCITS Depositary Function and Manager Remuneration

On 14 December 2010, the Commission published a consultation paper on the UCITS depositary function and UCITS manager remuneration.

Following its July 2009 consultation on strengthening the regulation and supervision of UCITS depositaries, the Commission had stated that it would introduce changes to the legislation applicable to the UCITS depositary function in response to the Madoff fraud (which revealed divergent approaches to the depositary function in different member states). The Commission is also aiming to co-ordinate its work on UCITS depositaries with the provisions relating to the depositary function in the Alternative Investment Fund Managers Directive.

The consultation paper covers the following issues relating to UCITS depositaries:

- the duties of the depositary;
- the liability regime;
- eligibility criteria; and
- supervision issues.

In this consultation paper, the Commission also seeks comments on a more controversial proposal of amending the UCITS Directive (2009/65/EC) to include requirements on remuneration principles for UCITS managers.

Comments are invited on the consultation until 31 January 2011.

The Commission then intends to present a legislative proposal in Q1 of 2011 which will update the current framework applicable to UCITS depositaries and introduce new provisions on the remuneration of UCITS managers.

CESR Guidelines on the UCITS IV Key Investor Information Document

On 20 December 2010, CESR published the following level 3 guidance on the key investor information document (the "KII") under the UCITS Directive (*2009/65/EC*) ("UCITS IV"), on which it consulted in July 2010:

- *Selection and presentation of performance scenarios in the Key Investor Information document for structured UCITS:* Article 78 (3) of UCITS IV required structured UCITS (that is, certain types of capital protected and guaranteed UCITS) to use prospective scenarios, rather than the "past performance" section of the KII. CESR has now developed these guidelines with a view to ensuring comparability between structured UCITS and consistency in their choice of prospective scenarios and the format of those scenarios.
- *Transition from the Simplified Prospectus to the Key Investor Information documents:* UCITS IV should be implemented by Member States by 1 July 2011, although Article 118(2) of UCITS IV allows UCITS management companies to defer implementation of the KII until 30 June 2012. These guidelines outline CESR's views on the appropriate approach that management companies should take during the transition period.
- *Guide to clear language and layout for the Key Investor Information document:* in these guidelines, CESR sets out what it considers to be widely accepted good practice to help firms to write and design the KII, with specific guidance for each of the KII's sections.
- *Template for the Key Investor Information document:* CESR's template reflects the KII requirements of Commission Regulation (EU) 583/2010. It shows the type of content and layout that UCITS management companies will be expected to follow for a standard UCITS.

At the same time CESR has also published feedback statements which provide details of the changes made to the versions of these documents on which it consulted in July 2010.

Other EU Developments

The following developments are also of interest:

ECOFIN Conclusions

The ECOFIN Council adopted a set of conclusions on crisis prevention, management and resolution, in Brussels on 7 December 2010. The conclusions state that the Council:

- stressed the importance of making progress in respect of the work strands set out in the EU Commission's October 2010 communication on an EU framework for crisis management in the financial sector, and broadly welcomes the approach of the programme presented therein, including the Commission's plans to present legislative proposals in Q1 of 2011;

- concluded that, in developing a crisis management framework, priority should be given to covering as a first step all credit institutions and investment firms with potential systemic ramifications, irrespective of whether they operate cross border or domestically, with a view to covering, as far as necessary, all financial institutions at a later stage;

- agreed with the Commission on the importance of reducing moral hazard by ensuring that shareholders and creditors suffer an appropriate amount of losses in bank resolutions;

- emphasised that the future regulatory framework should ensure that all classes of institutions are resolvable irrespective of their size or interconnectedness;

- noted that supervisory powers of early intervention should be expanded and could also be triggered in cases where a bank or investment firm is likely to fail to meet a requirement of the Capital Requirements Directive;

- stated that, whilst it is not necessary for the framework to impose a single resolution model as regards the use of resolution tools, the Commission should clarify the minimum list of legal resolution powers that should underpin that framework and be available to each authority; and

- noted that an increasing number of Member States have introduced systems of levies and taxes on the financial sector, many of which will come into force on 1 January 2011, and emphasised the importance of ensuring an appropriate coordination in the short term to minimise risks of double charging, and ensuring that such levies or taxes will be part of a credible resolution framework, once established.

CRD 4: Commission Consultation Due in January 2011

The Commission will launch a short consultation on CRD4 in mid January 2011. The consultation will be open for a few weeks only and its aim is to get the proposal into the internal Commission consultation process by the end of March 2011 with a view to getting it adopted before the summer of 2011. (The short consultation period suggests that the Commission is now rushing to finalise CRD4.)

IMD2 Consultation Extended

On 16 December 2010, the European Commission extended its consultation on the review of the Insurance Mediation Directive (2002/92/EC) to 28 February 2011 (originally due to end on 31 January 2011).

Initiatives for 2011 for Financial Services

On 22 December 2010, the Commission published its agenda and timetable for legislative proposals and non-legislative acts during 2011. These include a large number of financial services initiatives:

- the second Omnibus Directive (Omnibus II), expected to be adopted in January 2011;

- legislation on the legal certainty of securities holding and transactions (known as the Securities Law Directive), also expected to be adopted in January 2011;

- a Regulation on responsible mortgage lending and borrowing, with an expected adoption date of 23 February 2011;

- a Regulation on access to a basic payment account, also with an expected adoption date of 23 February 2011;

- a revised Market Abuse Directive (*2003/6/EC*) (MAD) and three related implementing directives, expected to be adopted in Q2 of 2011;

- amendments to the Capital Requirements Directive (*2006/48/EC* and *2006/49/EC*) (the "CRD"), expected to be adopted in Q2 of 2011: these includes two separate initiatives relating to the CRD, both scheduled for adoption in Q2 of 2011—amendments intended to render the regulatory framework even more responsive to market conditions, and—enhancement of the quality of corporate governance mechanisms in credit institutions and investment firms. However, the Commission does not make clear how these initiatives relate to the Commission's proposed directive to amend the CRD in order to implement the Basel III reforms in the EU (i.e., CRD 4);

- the review of the Markets in Financial Instruments Directive (*2004/39/EC*), also expected to be adopted in Q2 of 2011;

- a legislative initiative on a framework for crisis management and resolution in the banking sector also expected to be adopted in Q2 of 2011;

- a Regulation amending the EU Regulation on credit rating agencies (*1060/2009/EC*), also expected to be adopted in Q2 of 2011;
- a legislative instrument on packaged retail investment products ("PRIPs"), also expected to be adopted in the Q2 of 2011;
- a Regulation on central securities depositories also expected to be adopted in Q2 of 2011;
- amendments to UCITS IV (*2009/65/EC*) relating to the rules on UCITS depositaries and new rules on UCITS remuneration policy, expected to be adopted in Q3 of 2011 (This amending directive is now generally known as "UCITS V".);
- a review of the Transparency Directive (*2004/109/EC*), expected to be adopted in October 2011;
- a directive on insurance guarantee schemes, expected to be adopted in Q4 of 2011;
- a Directive establishing an EU framework for the approximation of sanctioning regimes in the financial sector, also expected to be adopted in Q4 of 2011; and
- revision of the Insurance Mediation Directive (*2002/92/EC*) (IMD) also expected to be adopted in Q4 of 2011.

Non-legislative acts which the Commission intends to adopt during 2011 include:

- a working paper on best practices aimed at avoiding foreclosure procedures for mortgages, expected to be adopted in Q1 of 2011;
- a Level 2 measures for the Solvency II Directive (*2009/138/EC*), expected to be adopted in Q2 of 2011;
- a Communication on improving the functioning and regulation of commodity markets, expected to be adopted in May 2011;
- a Green Paper on a framework initiative on corporate governance, expected to be adopted in Q2 of 2011;
- a Communication on the taxation of the financial sector, expected to be adopted in July 2011;
- a recommendation on the financial dispute resolution network, expected to be adopted in Q3 of 2011; and
- an action plan for improving the access of small and medium-sized enterprises (SMEs) to capital markets, expected to be adopted in Q4 of 2011.

ESMA 2011 Work Programme

On 4 January 2011, the European Securities and Markets Authority ("ESMA") published its work programme for 2011 (together with FAQs on ESMA).

The work programme sets out ESMA's work streams, timeframes, objectives and priorities. Its top priorities include the establishment of ESMA and work relating to the Alternative Investment Fund Managers Directive ("the AIFM Directive") and the proposed European Market Infrastructure Regulation ("EMIR").

CFTC and SEC Proposals for Major Swap Participants and Major Security-Based Swap Participants

In early December 2010, the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission (the "SEC") in the United States proposed further legislational definitional changes the effect of which is expected to be that anyone falling within the revised definitions above will become subject potentially to US regulation. These proposals are analysed in more detail in a *DechertOnPoint* on the proposals issued in December 2010, "CFTC and SEC Propose Definitions for Major Swap Participants and Major Security-Based Swap Participants".

UK Regulatory Developments

Finance Bill 2011: Consultation on Draft Legislation: Financial Services Implications

On 9 December 2010, HM Treasury published a consultation document on the 2011 Finance Bill. This provides a summary of the draft legislation published, with updates on measures that will be included in the Bill where draft legislation has not yet been drafted.

Items of interest include:

- *Modernisation of investment trust companies:* this measure was announced in the June 2010 Budget and was consulted on in July 2010. The Government's response to the consultation has now been published. (For further details, see the legal update from

Dechert's International and Domestic Tax Group, "Investment Trusts – Tax Modernisation Update".

- *Stamp duty reserve tax: interests in collective investment schemes:* further to the announcement in the June 2010 Budget, legislation is being introduced to amend the SDRT rules relating to investment funds in Schedule 19 to the Finance Act 1999 (see further details below).

- *Junior ISA:* The Government announced on 26 October 2010 that it will create new tax-free children's savings accounts. This is likely to be legislated for through a combination of Finance Bill 2011 and detailed secondary legislation. (The Government is now working closely with interested parties on the design of these new accounts and intends to publish draft legislation including the detailed secondary legislation in the spring of 2011).

- *Bank levy:* further amended legislation relating to the bank levy has been published following publication of draft legislation in October 2010.

The UK has recently introduced tax rules to improve the attractiveness of establishing an authorised fund of funds in the UK (the FAIFs initiatives). However, one of the drawbacks with respect to the UK versus a non-UK fund of funds was the potential impact of UK stamp duty reserve tax ("SDRT") on share redemptions (at up to 0.5% of the consideration).

The new SDRT measure proposed in the Finance Bill 2011 and which is mentioned above is designed to reduce the circumstances where SDRT could apply in relation to share redemptions where the fund invests in other underlying funds. Essentially, there will no longer be a charge to SDRT on a share redemption where or to the extent that the underlying funds are invested as to less than 20 per cent by market value in non-stampable assets e.g. debt/non-UK equities. In this way, FAIFs involving such underlying funds will be placed on a level playing field with equivalent non-UK fund of funds.

Comments can be made on all the draft legislation until 9 February 2011. The contents of the Finance Bill 2011 will be confirmed in the 2011 Budget Speech, which will take place on 23 March 2011. The Finance Bill 2011 will then be published on 31 March 2011.

FSA Guidance Consultation on Firms' Compliance with the Liquidity Regime

On 7 December 2010, the FSA published for consultation a draft "*Dear CEO*" letter following its review of how firms are complying with its liquidity regime (GC10/8).

The proposed guidance relates mainly to the FSA's detailed risk-management requirements on liquidity and funding risk, in Chapters 12.3 and 12.4 of the Prudential sourcebook for Banks, Building Societies and Investment Firms ("BIPRU").

In the draft letter, the FSA explains that it wrote to the firms that became subject to its liquidity regime in January 2010, asking for confirmation that the new systems and controls requirements had been successfully embedded. The FSA was disappointed that most firms advised that they were not fully compliant. These non-compliant firms have since received a follow-up letter from the FSA setting out the requirements for compliance and the possible sanctions for non-compliance. The FSA then reviewed compliance in a sample of firms that had advised that they were fully compliant with the liquidity regime. In the draft letter, the FSA explains that most of the firms reviewed were not however able to demonstrate full compliance. Annex A to the draft letter summarises the FSA's conclusions from the review, together with the information it would expect to see from firms to demonstrate compliance with the liquidity regime. Annex B to the draft summarises the FSA's review process.

In the draft letter, the FSA also states that it plans to review firms' individual liquidity assessments ("ILAAs") over the coming months. As a result, it suggests that firms pay attention to the findings of the review when preparing their ILAAs. The FSA also states that a firm's compliance with the systems and controls requirements in BIPRU 12.3 and 12.4 will be a significant factor used by the FSA in determining the resulting individual liquidity guidance ("ILG") it issues to the firm. In addition, the FSA advises that it plans to begin work shortly to address the reliability of the quantitative liquidity information that firms have started to report in their new regulatory liquidity returns.

Private Equity Funds

On 13 December 2010, the Guidelines Monitoring Group ("the GMG") published its third report on disclosure and transparency in private equity. This report summarises the results of a review of conformity with the Guidelines for Disclosure and Transparency in Private Equity ("the Guidelines")

published in November 2007. In addition to enhanced disclosure requirements, private equity firms and portfolio companies that meet the criteria within the Guidelines are subject to requirements as to the provision of data to the BVCA, adoption of certain valuation guidelines, reporting to limited partners and timely and effective communication during periods of significant strategic change.

The GMG also reports that its current activities include: considering adding a requirement for portfolio companies to disclose that they have adopted the Guidelines; consulting with private equity firms as to an amendment to the definition of a private equity firm for the purposes of the Guidelines and continuing to consider further reductions to the enterprise value thresholds.

HM Treasury Consultation on Simple Financial Products

On 14 December 2010 HM Treasury published a consultation on simple financial products ("SFPs").

HM Treasury envisages SFPs as products with standardised features, aimed at "mass market" consumers which would generally be sold on a non-advised basis. SFPs are intended to be a safe choice for consumers and a common benchmark against which other products can be compared.

The Coalition Government's view is that the development of SFPs should become a wholly voluntary initiative. It believes that, unlike stakeholder products, SFPs should not be subject to mandatory price caps and that, in practice, it may not be possible for products to be completely standardised.

HM Treasury is now seeking views from the financial services industry and consumer groups on how to develop SFPs further. It suggests that the first SFPs to be developed should be deposit savings accounts and protection products (i.e., term life insurance, critical illness and income protection cover).

HM Treasury is also considering the status of previous simple products initiatives, although it believes there is a strong case for retaining stakeholder pensions. It has published an independent report evaluating lessons learned from previous simple product initiatives in retail financial services. This report (by Professor J. F. Devlin of the Nottingham University Business School) suggests that greater effort and imagination are required to attract consumers of simple products, but discusses this only in terms of branding, logos and similar gimmicky.

Comments on this consultation are invited until 25 March 2011.

EU Legislation: UK Implementation and Gold Plating

On 15 December 2010, the UK's Department for Business, Innovation and Skills announced a series of new principles that the Government will use when introducing European measures into UK law. The intention is that the principles will end "gold plating" and introduce a direct "copy out" principle in order that UK businesses are not put at a disadvantage relative to their competitors in other EU jurisdictions.

The key elements of the principles are:

- work on the implementation of a European directive should start immediately after agreement is reached in Brussels. This will give businesses a greater opportunity to influence the approach as well as ensure greater certainty and provide an early warning as to its impact;
- early transposition of EU regulations will be avoided except where there are compelling reasons to do so;
- EU directives will normally be directly copied into UK legislation except where doing so would adversely affect UK interests (such as by putting businesses in the UK at a competitive disadvantage); and
- UK Government Ministers will be under a statutory duty to conduct a review of the domestic legislation that implements a European directive every five years. This will involve consultation with businesses and will allow businesses to influence any necessary improvements based on their own practical experience of applying the rules.

On 23 December 2010, the Government published its Guiding Principles for EU legislation to provide more detail on how the Government will approach EU legislation and implement it into national law.

One of the key principles adopted by the Government when transposing EU law is to ensure that text is copied out directly from the EU directive into UK law unless this would adversely affect UK interests. Where the copy-out procedure is not used, departments will have to explain the reasons for this to a 'Reducing Regulation Committee'. Other general principles include:

- engagement by the Government with the European Commission before it has adopted proposals, in order to increase the UK''s influence on the drafting of legislative proposals;

- ensuring that UK legislation comes into force on the latest date permitted in an EU directive, unless there are compelling reasons to implement the directive early; and

- imposing a statutory duty on ministers to review the UK implementing legislation every five years to give businesses the opportunity to inform the government as to how the legislation is working in practice, and how it might be amended to reduce the impact on business.

The Government has also stated that it will publish new transposition guidance in the spring of 2011.

FSA Policy Statement on Implementing Aspects of CRD 2 and CRD 3

On 17 December 2010, the FSA published a policy statement, *Strengthening Capital Standards: Feedback and Final Rules for CP10/17 (chapters 11-13) and CP10/22 (chapter 3)* (PS10/19).

CRD 2 *(2009/111/EC)* and CRD 3 *(2010/76/EU)* are part of a sequence of EU directives amending the Capital Requirements Directive *(2006/48/EC* and *2006/49/EC)*. In July 2010, the FSA published a consultation paper (CP10/17) on proposals for implementing CRD 2 Related guidelines from CEBS on issues relating to core tier 1 capital, operational risk and large exposures appeared in October 2010, and in CP10/22, the FSA consulted on CRD 3 (which related to changes concerning covered bonds and capital floors which, unlike the rest of the CRD 3 capital measures, required be implemented by 1 January 2010.)

In PS10/19, the FSA now sets out the feedback it has received on its proposals in CP10/17 and CP10/22 and its response to that feedback.

Changes to the FSA Handbook to implement the new rules are set out in the Capital Requirements Directive (Handbook Amendments No 2) Instrument 2010 (FSA 2010/66) included in an Appendix to PS10/19. This instrument came into force on 31 December 2010, in respect of the CRD 2 amendments relating to core tier 1 capital, operational risk and large exposures, and will come into effect on 1 January 2011, in respect of the CRD 3 amendments relating to covered bonds and capital floors. (Both dates reflect the implementation deadlines set out in CRD 2 and CRD 3.)

The FSA's New Remuneration Code

On 17 December 2010, following the issue of CEBS' Guidelines on remuneration and bonuses eight days earlier, the FSA issued its Policy Statements (PS 10/21 and PS 10/20) on the above subject incorporating the text of its new code in an Appendix to CPS 10/20.

PS10/21 also reports on the feedback the FSA received to its November 2010 consultation on implementing the requirements of the Directive amending the Capital Requirements Directive (*2006/48/EC* and *2006/49/EC*) ("CRD 3").

Whilst the FSA has taken into account the final guidelines on remuneration published by CEBS it is of the view that changes to the CEBS Guidelines are not significant enough to require major changes to its consultation process. This means that:

- the FSA is implementing requirements on disclosure of remuneration which are consistent with CRD 3. Firms will need to disclose details of their remuneration policies on at least an annual basis; and

- the FSA is using a four tier proportionality framework which means that firms in tier 1 will need to make full disclosure, whilst firms in lower tiers will be subject to less onerous requirements. Appendix 2 to PS10/21 contains the FSA's guidance on proportionality.

Changes to the FSA Handbook to implement the new rules are set out in the Prudential Sourcebook for Banks, Building Societies and Investment Firms (Remuneration Disclosures) Instrument 2010, included as Appendix 1 to PS10/21.

The rules came into effect on 1 January 2011. The FSA requires firms to make their first disclosure in relation to 2010 remuneration as soon as practicable, but no later than 31 December 2011.

The FSA will decide on the next steps about consulting on extending disclosure requirements to certain firms by 28 February 2011.

Concurrently, the FSA has published its policy statement on revising the remuneration code as PS10/20.

PS10/20 reported on the feedback the FSA received to its July 2010 consultation on the remuneration

code (CP10/19). (PS10/20 was originally due to be published in November 2010, but was deferred so the FSA could take into account the final guidelines on remuneration published by CEBS in December 2010.)

The main changes to the previous proposals which the FSA consulted on in CP10/19 are:

- for code staff (i.e., staff who have a material impact on a firm's risk profile), the requirement that at least 50% of any variable remuneration should be paid in shares or other specified instruments will now be applied equally to both the deferred and undeferred portions of variable remuneration; and

- the FSA strengthened its guidance on guaranteed bonuses, stating that provisions should be applied on a firm wide basis (and not just to code staff).

When establishing and applying remuneration policies for code staff, a firm can comply in a way and to an extent which is appropriate to its size, internal organisation and the nature, scope and complexity of its activities. In response to suggestions and concerns about proportionality, the FSA devised the four tier proportionality framework. The FSA's expectations for compliance within each tier have been set out in PS10/20 and it has also included guidance on proportionality (as Appendix 2 to PS10/20 as indicated above.)

As mentioned above, the revised remuneration code came into force on 1 January 2011. Firms already within scope of the remuneration code need to comply in full with the revised version from 1 January 2011. However, firms newly within scope should comply as soon as reasonably possible and by 1 July 2011 at the latest.

Settlement Finality and Financial Collateral Arrangements: Revised UK Legislation

On 16 December 2010, HM Treasury published a revised draft of the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010 (*SI 2010/2993*) (the "Amending Regulations").

The Amending Regulations implement Directive 2009/44/EC (the "Amending Directive") amending the Settlement Finality Directive (*98/26/EC*) (the "SFD") and the Financial Collateral Arrangements Directive (*2002/47/EC*) (the "FCD") as regards linked systems and credit claims. (HM Treasury published a draft of the Amending Regulations for consultation in August 2010, and the revised draft reflects responses to that consultation.)

The Amending Regulations introduce the option not to exclude credit claims from the insolvency protections where the debtor is a small business. The Amending Regulations also provide that an English court cannot enforce orders made in foreign insolvency proceedings if those orders are contrary to the Financial Collateral Arrangements (No 2) Regulations 2003 (*SI 2003/3226*) ("the FC Regulations"). The Amending Regulations do not legislate to extend the protection afforded by the SFD to UK participants in systems outside the EEA.

However, the Amending Regulations do not resolve the issue of whether to bring certain categories of floating charges given in the context of securities clearing and settlement systems expressly within the scope of the FC Regulations. HM Treasury recognises there are aspects of the implementation of the settlement finality and financial collateral arrangements that require further consideration, but notes that these cannot be resolved within the tight timetable for implementing the Amending Directive.

FSA MiFID Article 4 Notification on Client Assets Requirements

On 21 December 2010, the FSA published its notification to the European Commission relating to its client assets requirements applicable to UK investment firms. It has made this notification under Article 4 of Directive 2006/73/EC which implements the Markets in Financial Instruments Directive (*2004/39/EC*) (the "MiFID Implementing Directive").

The FSA had committed to publishing the Article 4 notification in its policy statement PS10/6 in which it provided feedback and its policy response to an earlier consultation on proposals to enhance client asset protection. The Article 4 notification is required because the FSA intends to impose requirements that are additional to the requirements of the MiFID Implementing Directive. These requirements, which are intended to improve the protection of client assets and client money, relate to:

- disclosure of information relating to the re-hypothecation of client assets by prime brokerage firms;

- reporting by prime brokerage firms to clients on the status of their client assets and client money on a daily basis;

- restricting placement of a percentage of client money with group entities; and
- allocating overall responsibility for compliance with the FSA's client assets and client money rules to one position within a firm.

The notification explains how the above requirements are additional to the MiFID Implementing Directive, describes the specific risks they seek to address in the UK, explains why they are proportionate and explains why they do not restrict or otherwise affect the rights of investment firms under Articles 31 and 32 of the Directive 2004/39/EC.

HM Treasury and FSA Consultation on the UK Implementation of UCITS IV

On 22 December 2010, HM Treasury and the FSA published a joint consultation on the implementation of the UCITS Directive (*2009/65/EC*) ("UCITS IV") into UK legislation and regulation.

The consultation sets out details of how HM Treasury and the FSA will implement the requirements of UCITS IV in the following areas:

- the simplified notification procedure;
- the management company passport;
- investor disclosure;
- master-feeder structures;
- fund mergers; and
- improved supervisory co-operation.

The consultation also includes details of consequential amendments to the Financial Services and Markets Act 2000 ("FSMA") and a possible extension of the FSA's disciplinary powers relating to contraventions of the UCITS IV requirements.

With the consultation, the FSA also published drafts of the following:

- *The Undertakings for Collective Investment in Transferable Securities Regulations 2011*. These draft regulations include material (in Part 4) on implementing UCITS IV's requirements on mergers and amendments to relevant primary legislation, in particular FSMA and the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).
- *UCITS Directive Instrument 2011*. This draft instrument sets out amendments to the FSA Handbook, in particular the Collective Investment Schemes sourcebook (COLL), the Conduct of Business sourcebook (COBS) and the Supervision manual (SUP).
- The consultation explains how HM Treasury and the FSA intend to implement UCITS IV's requirements, largely through the above Regulations and Instrument, but does not include any proposals to modify the regulatory regime under the FSA rules for other categories of UK authorised investment funds. The FSA is considering what changes might be appropriate to make to the regime for non-UCITS retail schemes ("NURS") reflecting the UCITS requirements. It aims to consult on any changes relating to NURSs during the first half of 2011, although it does not expect new rules to be in place before July 2011.

This consultation also confirms the announcement made in November 2010 that the government is to launch a new tax transparent vehicle, suitable for UCITS IV master funds. The government also proposes to consult with industry to ensure there are no adverse UK tax consequences for a foreign UCITS fund as a result of having a UK management company.

Comments are invited on this consultation until 21 March 2011. (UCITS IV must be transposed into UK law by 1 July 2011.)

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