Regulatory Evolution: the Helicopter View

Challenges for the Investment Management Industry

January 2015

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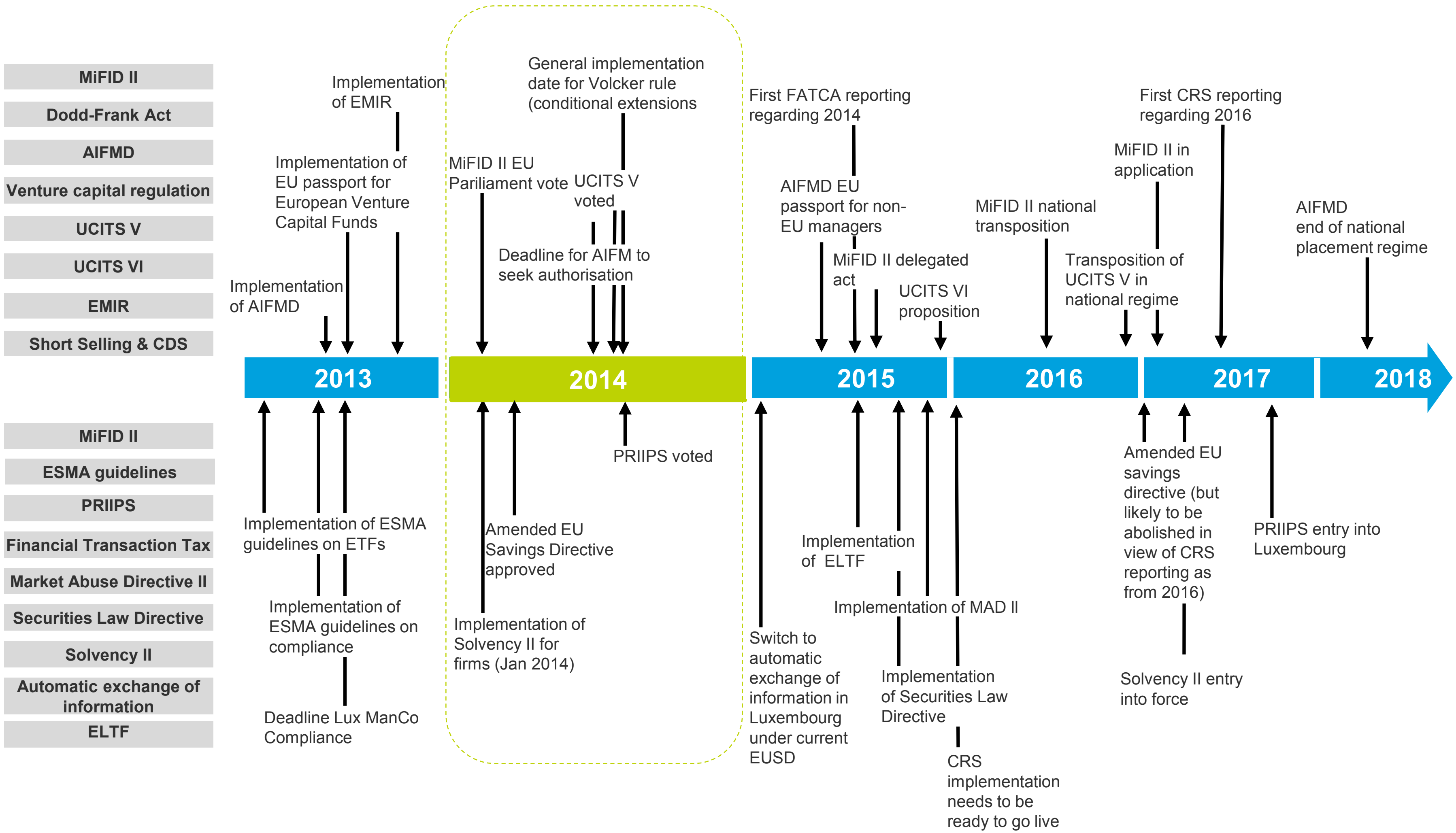
A snapshot of the changes ahead



II. Regulatory developments

1. Alternative Investment Fund Managers Directive (AIFMD)

1. Alternative Investment Fund Managers Directive (AIFMD)

Implementation challenges

Draft paper	Commission proposal	Parliament & Council	EU trilogues	Adopted	Technical measures	**Implemented**

Overview

The Alternative Investment Fund Managers Directive (AIFMD) came into force on the 22 July, 2013 and applies to EU AIFM that manage Alternative Investment Funds (AIF) and to non-EU AIFM that manage and/or market AIF in the EU.

Although it is targeted at fund managers there are significant implications for all parts of the value chain including: administrators, distributors, depositaries, custodians, prime brokers, sub-investment managers and auditors. Crucially AIFM must also be aware of their responsibilities in relation to activities carried out at administrators, transfer agents, distributors and by the AIF itself and plan to implement any additional policies and procedures to ensure compliance.

The Alternative Investment Fund Managers Directive has been transposed into Luxembourg national law on 12 July, 2013.

- 🗐 Passport available as from July 2013
- 🗐 Passport may be available from 2015 for these structures
- ● National private placement may be turned off from 2018
- ● Compliance required for access to EU passport

	EU Manager/ Non-EU Fund	EU Manager/ EU Fund	Non-EU Manager/ Non-EU fund	Non-EU Manager/ EU fund
Marketing Routes into the EU				
EU Passport	🗐	🗐	🗐	🗐
Private placement	●	n/a	●	●
Required Compliance				
Regulatory capital requirements	🗐	🗐	●	●
Depositary	●	🗐	●	🗐
Operational	🗐	🗐	●	●
Transparency / Disclosure	🗐	🗐	🗐	🗐

1. Alternative Investment Fund Managers Directive (AIFMD)
Implementation challenges

Draft paper	Commission proposal	Parliament & Council	EU trilogues	Adopted	Technical measures	Implemented

Key issues

Leverage	• **Fact**: AIFM must set and disclose leverage limits and the level 2 measures* will explain leverage calculations. Regulators can cap leverage under certain scenarios • **Issue**: If the calculation methodology is not inline with internal policies, this may restrict investment strategy
Depositary	• **Fact**: Increased scope of depositary oversight functions, increased liability for depositaries, sub-custody restrictions • **Issue**: Increased bps costs for AIFM, increased challenge from depositaries, strategy (asset custody) limitations
Valuation	• **Fact**: AIFM are fully responsible to the AIF and its investors for the AIF's valuation • **Issue**: More focus will be placed on valuation procedures, increased oversight of fund administrators, increased responsibility
Risk Management	• **Fact**: The AIFM should functionally and hierarchically separate the functions of risk management from the operating units, including portfolio management • **Issue**: Implement systems to identify, measure, manage and monitor appropriately all relevant risks for each AIF
Disclosure	• **Fact**: AIFM required to report quarterly to the regulator, must report maximum fee info to investors and risk / liquidity management info • **Issue**: Increased costs for AIFM, increased scrutiny from regulator, transparency may impact investor decisions
Liquidity	• **Fact**: Implementation and documentation of appropriate liquidity management systems; clearly explain to investors when gates/partial redemption/lockups/temporary borrowing will be initiated; • **Issue**: Depends on current levels of disclosure
Remuneration	• **Fact**: Remuneration framework similar to that for banks, ESMA issued its Guidelines on sound remuneration policies (2013/201) to explain how this should be applied in practice • **Issue**: Employee retention issue if rules do not leave a level playing field.
Delegation	• **Fact**: The AIFM must be able to justify its entire delegation structure with "objective reasons" • **Issue**: what is included in the Investment Management Function delegation have to be clearly defined

* Commission Delegated Regulation EU N°231/2013 of 19 December 2012 on exemptions, general operating conditions, depositaries, leverage, transparency and supervision

A definition of level 2 is provided on page 33.

1. Alternative Investment Fund Managers Directive (AIFMD)

National Private Placement Regimes (NPPR)

Country	AIFMD Implementation	Notification under Article 32 (AIFMD passport permitted *)	Marketing to retail investors permitted under Article 32 **	Article 42 - National Placement Regime "NPR" ***	Marketing to retail investors permitted under Article 42 **/***	AIFMD Article 36 – EU AIFM marketing non-EU AIF **	Marketing to retail investors permitted under Article 36 **/***
Austria	✓	✓	✓	✓	✓	✓	✓
Belgium	✓	✓	✓	✓	✓	✓	✓
Denmark	✓	✓	✓	✓	✓	✓	✓
Finland	✓	✓	✓	✓	✗	✓	✗
France	✓	✓	✗	✓	✗	✓	✗
Germany	✓	✓	✓	✓	✓	✓	✓
Greece	✓	✓	Yes –(partially) min investment of €100,000.-	✗	✗	Only for AIFM domiciled in Greece	Yes –(partially) min investment of €100,000.-
Ireland	✓	✓	✓	✓	Further guidance to be released	✓	Further guidance to be released
Italy	✓	✓	✓	✗	✗	✗	✗

* Although AIFMD may not yet have been transposed, the host state regulator is required to accept notification requests from EU AIFMs wishing to market EU AIFs in accordance with Article 32 passporting requirements providing the EU AIFM has already obtained the AIFM license in its home state.

** These notifications may be subject to compliance with specific (local) conditions, additional (local) requirements and may trigger (local) supplementary reporting.

*** These notifications are permitted only under the following provisos: a) appropriate co-operation arrangements for the purpose of systemic risk oversight are in place between the home state regulator and the supervisory authority of the third country where the non-EU AIF/M is established (MoU) and b) the third country where the non-EU AIFM is established is not listed as a non-cooperative country and territory by FATF.

1. Alternative Investment Fund Managers Directive (AIFMD)

National Private Placement Regimes (NPPR)

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Luxembourg	✓	✓	✓	✓	✓	✓	✓
Malta	✓	✓	Further guidance to be released	✓	Further guidance to be released	✓	Further guidance to be released
Netherlands	✓	✓	✗	✓	✗	✓	✗
Poland	✗	✓	✗	✗	✗	✗	✗
Portugal	✗	✓	✗	✗	✗	✗	✗
Spain	✗	✓	✗	✗	✗	✗	✗
Sweden	✓	✓	✓	✓	✓	✓	✓
Switzerland	✓	✓	?	?	?	?	?
UK	✓	✓	✓	✓	✗	✓	✗

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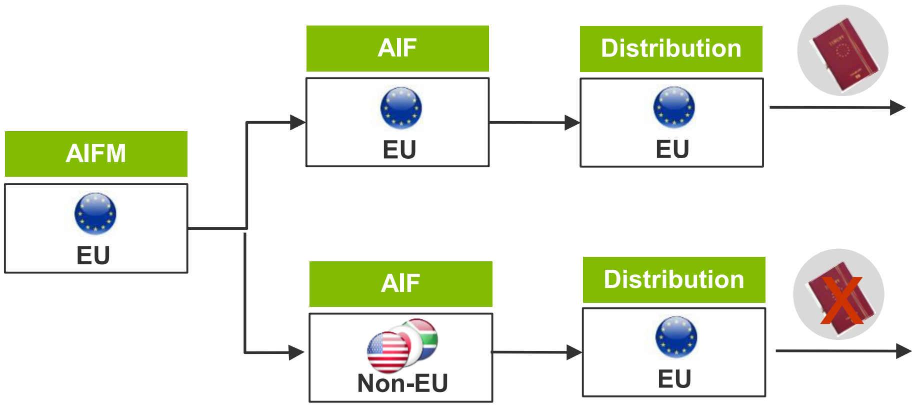
1. Alternative Investment Fund Managers Directive (AIFMD)

Current distribution possibilities

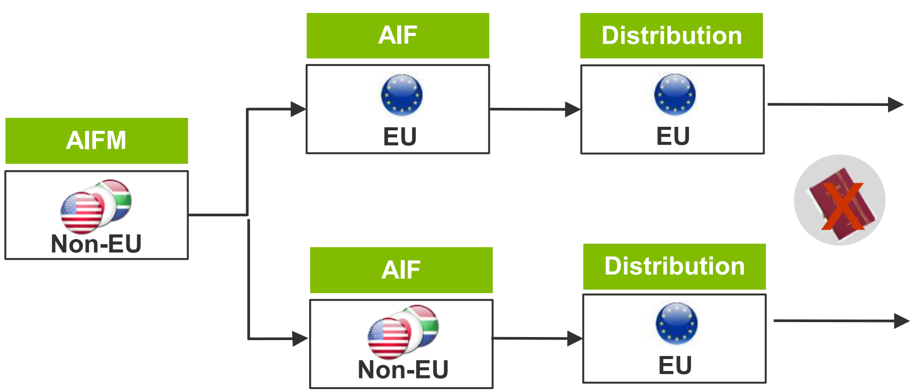


Notification as per AIFMD Articles 31 & 32

- Full Directive applies

Notification as per AIFMD Article 36

- Distribution through National Placement Regime (2013-2018) in addition to full AIFMD compliance except depositary requirements.
- Partial 3rd country requirements* in place



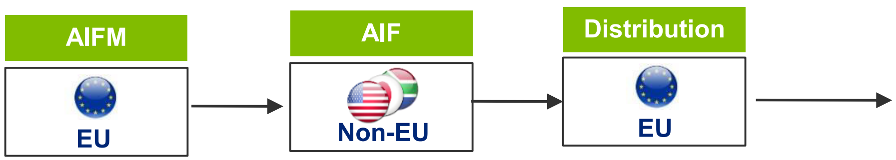
Notification as per AIFMD Article 42

- Distribution through National Placement Regime (2013-2018) in addition to the AIFMD provisions on transparency and controlling interest.
- Partial 3rd country requirements* in place.

* Cooperation agreements between the EU country of distribution and the non-EU country where the AIF is located plus compliance with anti-money laundering and terrorist financing requirements as provided for by AIFMD

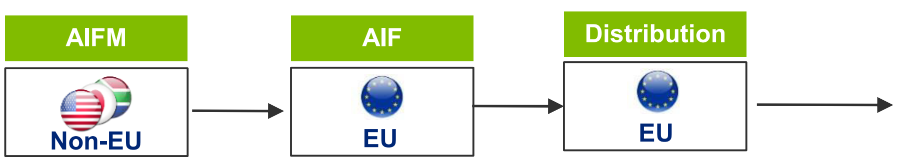
1. Alternative Investment Fund Managers Directive (AIFMD)

Distribution possibilities : post 2015 – Future potential



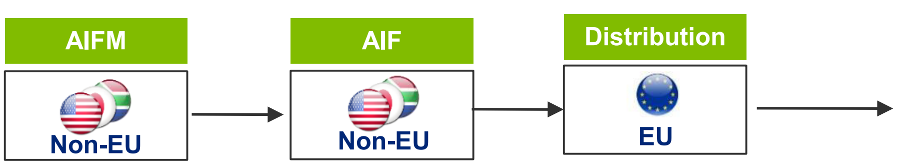
Notification as per AIFMD Article 35 (to replace Article 36)

- EU passport available from late 2015 on, through full AIFMD compliance and full 3rd country requirements **



Notification as per AIFMD Article 39 (to replace Article 42)

- EU passport available from late 2015 through full AIFMD compliance, full 3rd country requirements** and Member State of Reference***



Notification as per AIFMD Article 40 (to replace Article 42)

- EU passport available from late 2015 through full AIFMD compliance, full 3rd country requirements** and Member State of Reference***

** Same as partial requirements with the additional execution of an OECD model tax agreement
*** For each non-EU AIF, an EU Member State of Reference will need to appointed; the financial authority of that Member State will act as the regulator of the non-EU AIFM

2. ESMA's guidelines on ETFs and other UCITS issues

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Transparency and risk mitigation

ESMA consultation	ESMA final report	Official publication	Implementation

Overview

ESMA's 'guidelines on ETFs and other UCITS issues' are a regulatory response to concerns over increasing complexity in UCITS in recent years. With this increase in complexity, regulators became concerned over information deficits, the extent of index tracking errors, securities lending practices and counterparty exposure risks.

The guidelines impact not just UCITS ETFs and index-tracking UCITS. They also affect UCITS investing in financial indices, UCITS using financial derivatives and UCITS using efficient portfolio management (EPM) techniques. The guidelines took effect on 18 February 2013 with 12 month transitional arrangements for certain requirements. ESMA has issued a Q&A document to address various aspects. **Update on collateral limits were published in August 2014**

Financial reporting disclosures

- Disclose tracking errors and additionally in the annual report explain any divergence in comparison with anticipated errors and difference between the performance of the UCITS and the performance of the index tracked
- Disclose information on EPM techniques in the annual report, including revenues arising from EPM techniques together with the direct and indirect operational costs and fees incurred
- Disclose information in the annual report on underlying FDI exposures, the identity of counterparties and the type and amount of collateral received

One year transitional arrangements

- Financial indices rules
- Collateral requirements, except re-investment of cash collateral
- Revenue sharing arrangements
- ETF identifier
- Fund documentation disclosure requirements

Key actions

- Review EPM techniques and arrange for return of EPM profits to the fund
- Review collateral practices, swap arrangements, financial indices investments
- Update policies, procedures and the RMP to meet the new requirements

2. ESMA's guidelines on ETFs and other UCITS issues

Transparency and risk mitigation

ESMA consultation	ESMA final report	Official publication	Implementation

EPM techniques

- Return all net revenue from EPM to the fund
- UCITS should be able to recall securities lent or assets subject to repos at any time

Total Return Swaps

- Underlying exposures to FDIs should be taken into account for issuer concentration rules
- Where the counterparty has discretion over the composition or management of the UCITS' investment portfolio, the agreement between the UCITS and the counterparty is deemed an investment management delegation arrangement.

ETFs / index tracking UCITS

- Disclose replication methodology
- Provide for direct redemption if the stock exchange value of the units or shares of the UCITS ETF significantly varies from its net asset value

Financial indices

- Stricter criteria for investing in financial indices
- New disclosure rules on components and methodologies
- 'Backfilling', i.e. retrospective changes to previously published index values, is not permitted.

Collateral management for OTCs and EPM

- New stricter criteria
- Maximum exposure of 20% of NAV to a single issuer, limit rises 100% for securities issued or guaranteed by a member state **(2014/937 ESMA)**
- UCITS receiving collateral for at least 30% of its assets should have an appropriate stress testing policy in place
- New criteria in relation to cash collateral and the re-investment of cash collateral

3. Automatic exchange of information

3. Automatic exchange of information
FATCA, EU Savings Directive, Common Reporting Standard

Overview

The recent shift towards automatic exchange of information is concretising through various legal instruments:

- Luxembourg concluded an Intergovernmental Agreement with the USA in order to impose FATCA obligations. The first exchange of information under this IGA (which is still to be transposed through a Luxembourg law) will be related to 2014
- Luxembourg decided to unilaterally abandon the savings withholding tax under the current EU Savings Directive as from 1 January 2015, and consequently switch to automatic exchange of information under this Directive as from this date (a draft law relating to this switch should still be voted)
- The amended EU Savings Directive has been approved in 2014 and would significantly extend the scope of the current Directive as from 1 January 2017. However further to the evolution of the Common Reporting Standard, the EU Commission considers to abolish the (amended) EU Savings Directive (which is likely to happen as from 1 January 2016)
- The automatic exchange of information framework under the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters will crystallize under the form of additional legal instruments in the next coming years. The Common Reporting Standard (CRS) developed by the OECD is likely to be broadly used. As far as the EU is concerned, the CRS will be introduced through the amended version of the EU Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation. A political agreement on the draft Directive was reached during the ECOFIN of 14 October 2014. Luxembourg (and all other Member States except currently Austria) will be early adopters of this Directive, with an expected entry into force as from 1 January 2016 (first reporting due in 2017)

Key impacts on investment managers

- Systems and processes updates regarding FATCA should be near completion by now.
- Additional reporting obligations (and thus system changes) should however be anticipated:
  - Funds already in scope of the currently applicable EU Savings Directive will need to ensure the switch to automatic exchange of information is made on 1 January 2015 (which may be discontinued as from 2016, provided the date of entry into force of the CRS and abolishment of the EU Savings Directive is legally confirmed)
  - CRS obligations need to be assessed and are expected to apply, as far as the EU is concerned, as from 1 January 2016 (first reporting in 2017 on calendar year 2016). It will be possible to capitalize on FATCA implementation processes to a certain extent; however certain significant differences exist between FATCA and the CRS

As Luxembourg is an early adopter of the CRS, significant work needs to be undertaken in 2015 to be ready to go live as from 1 January 2016

What do investment managers need to do?

Although it is anticipated that various service providers will provide services to assist funds in their reporting obligations, **the legal responsibility for compliance remains with the fund and/or investment manager**.

As a priority, Investment managers need to familiarise themselves with the requirements of the CRS and understand how it affects their business, e.g.:

- Which entities have / will have reporting obligations under the various legislative frameworks
- What information will need to be reported on investors, and for which countries;
- Investor communications plans need to be in place / worked out;
- Systems and controls (e.g. New client take on, capturing the right information as from the right moment) needed to ensure compliance;
- Agreements with service providers to meet ongoing reporting responsibilities;
- Training and education programme
- GAP analysis between FATCA and CRS implementation in order to exploit synergies and efficiencies where possible.

Investors

4. Dodd-Frank: Form PF and systematic risk reporting

4. Dodd-Frank: Form PF and systemic risk reporting
Understand the requirements now

Overview

In October 2011, the SEC and the CFTC have jointly adopted rules that require SEC-registered private fund advisers to file a new Form PF with the SEC. Form PF will provide confidential information on systemic risk, and may also be used to support enforcement activities.

Scope

The minimum threshold for filing is $150 million in regulatory AUM attributable to private funds.

Advisers that manage over $1.5 billion in hedge fund, $1 billion in liquidity funds and money market funds or $2 billion in private equity funds are termed large private fund advisers ("large advisers") and are required to provide more detailed information than advisers that are under this threshold ("small advisers"). Small advisers will only need to complete section 1 of the PF Form (information on private funds advised, AUM performance and leverage).

4. Dodd-Frank: Form PF and systemic risk reporting
Understand the requirements now

What investment managers need to do).

Understand the requirements
- Make large adviser / qualifying hedge fund determination
- Analyse implications of fund structures, managed accounts and related persons
- Document scope of data requirements

Assess impact
- Gap Form PF requirements against current state data aggregation and reporting capabilities
- Review relevant policies and operational procedures
- Identify gaps in current state processes

Design and develop
- Review internal, vendor and service provider solutions
- Select solutions and develop Form PF solution architecture
- Develop policies and procedures for Form PF
- Design automated processes to meet Form PF filing timeline (15 days from end of fiscal quarter for large liquidity fund advisers, 60 days from end of fiscal quarter for large hedge fund advisers, 120 days from end of fiscal year for large private equity advisers and small advisers)

Implement
- Create Form PF implementation plan
- Test proposed solutions and train resources
- Implement selected solutions and enhanced policies and procedures

Key challenges

- **Form PF specific terms:** Advisers may be required to think about concepts, such as AUM and fund types, in ways that they do not currently.
- **Data clustering:** Advisers may currently have raw data that Form PF requires, but may be unable to aggregate the data per requirements. For example, Form PF contains preset asset class and detailed sub-asset class categories for reporting hedge fund holdings. A mapping exercise or the addition of procedures and tools for a parallel tracking system may be required.
- **Operational & regulatory risk:** Form PF may present a significant data exercise that will likely impact current state operations and technology. The level of data granularity required is a concern (exposure/turnover information on a monthly basis, exposures and liquidity of exposures, leverage, borrowings including uncommitted lines, risk metrics, etc.). An implementation plan informed by a gap analysis and future state solution design may be required. Inconsistency in data between Form PF and other reports (investors' reports, ESMA template for AIFM reporting, etc.).

5. Venture Capital Regulation

5. Venture Capital Regulation

A new passport to promote venture capital in Europe

Overview

It is currently complex and costly for Venture Capital firms (VC firms) to raise funds across borders (e.g. fund structuring, parallel vehicles, authorisation procedures, legal fees to comply with private placement regimes). In the EU, most (~ 95%) VC firms will not directly benefit from the AIFMD passport.

To promote VC in the EU, the European Commission published a proposal for a regulation pin December 2011. At its centre is a **voluntary EU passport** for venture capital firms. EU Regulation 345/2013 of 17 April 2013 was published in the OJ on 25/04/2013 and came **into force on 22 July 2013**.

The Regulation applies to managers of venture capital funds (**VC Managers**) established in the EU and registered with the competent authority of their home Member State pursuant to AIFMD, which manage qualifying venture capital funds, whose assets under management in total do not exceed a threshold of EUR 500 million.

Qualifying venture capital funds that carry the protected designation of **"European Venture Capital Fund" (EVCF")** are those that dedicate at least 70 percent of their aggregate capital contributions and uncalled committed capital to investments in small and medium sizes enterprises, using equity or quasi-equity and do not use leverage.

In March 2014 ESMA published a Q&A on the main topics of EuVECA Regulation that aim to serve a "practical convergence tool". The Q&A will be continually edited and updated in the following years.

Considerations

The EU passport creates opportunities for VC firms below the AIFMD threshold, so smaller funds can improve their access to capital.

Achieving EuVECA designation may become a cross-reference in other pieces of legislation with an impact on venture capital.

However, the benefits of an EU passport may not be realised if there is no harmonisation of the national fiscal regimes.

Also, there may be consistency issues due to the introduction of a third regulatory category besides UCITS and AIF.

Future developments

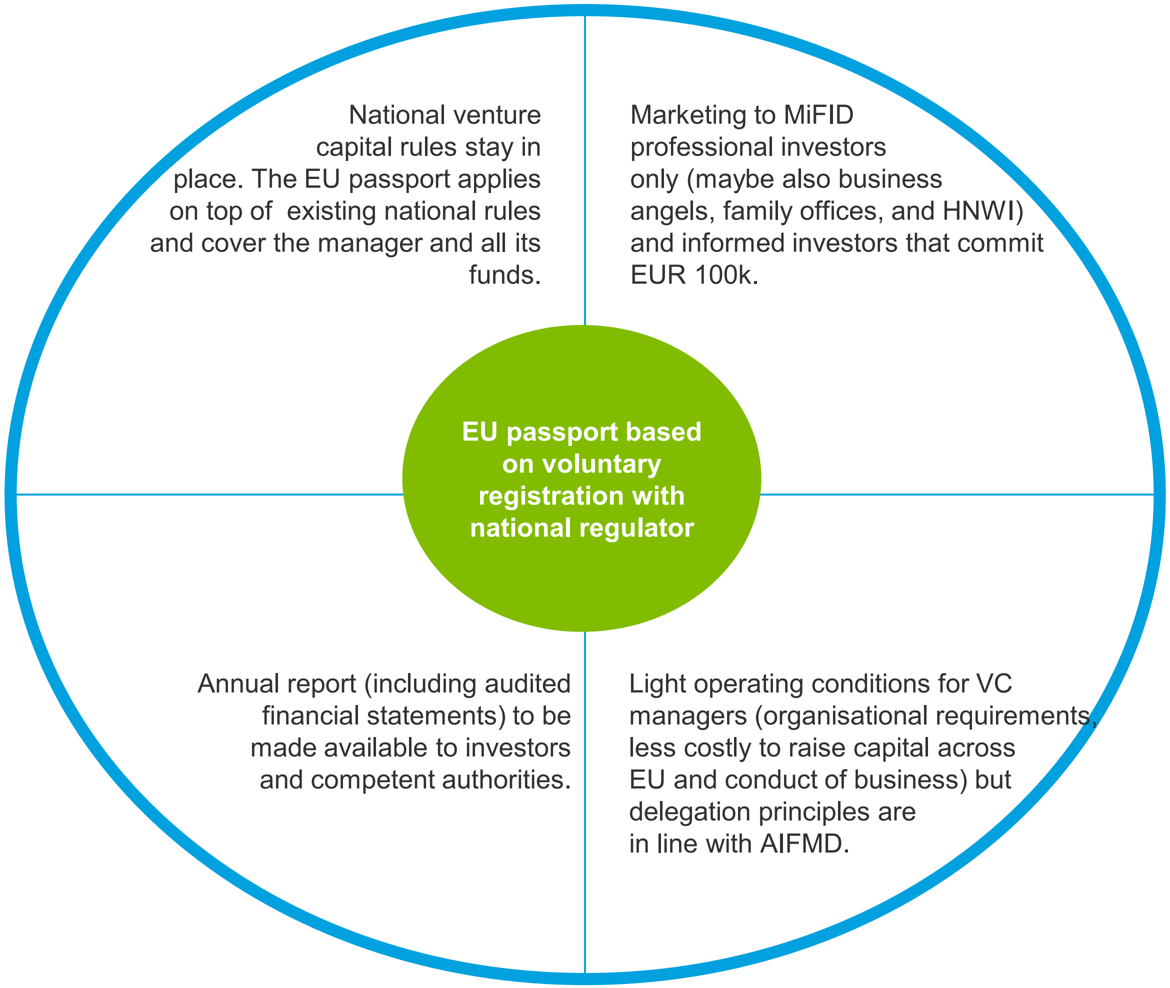
The European Commission (EC) is yet to come up with a limited numbers of Delegated Acts (i.e. conflicts of interest).

At the present EuVECA Regulation is only available to EU vehicles being managed by European managers. In 2015, the EC is expecting to review the Regulation, including the possibility of allowing venture capital funds established in third countries to benefit from the Regulation.

By 22 July 2017, the EC is due to start a review of interaction between this Regulation and other rules on collective investment undertakings and their managers, in particular those laid down in the AIFMD.

5. Venture Capital Regulation
A new passport to promote venture capital in Europe

Key elements of the regime



6. UCITS evolution

6.0. UCITS evolution

From UCITS IV to UCITS V and then on to UCITS VI…

2010
UCITS IV

- Key Investor Information Document
- Management Company Passport
- Cross-border mergers
- Master-feeder structure
- Simplified notification process

2015
UCITS V

- Harmonization of the depositary function ensuring that investors receive the same level of protection of their assets in custody across all EU MS
- Rules on the remuneration of risk takers and senior management
- Minimum harmonisation of the sanctions regime for breach of the main investor protection sanctions in the UCITS Directive

201?
UCITS VI

- Eligible assets and the use of derivatives
- Assessment of the criteria for efficient portfolio management (EPM) techniques need to be modified
- Opportunity for OTC derivative transactions to be dealt with when assessing UCITS limits on counterparty risk
- Extraordinary liquidity management rules and need of a common framework liquidity bottlenecks in exceptional cases
- Discussion about the introduction of a depositary passport and areas which require further harmonization
- Specific regulatory framework for Money Market Funds (MMF) and assessment of whether produce a systemic risk and require EU harmonization
- Long term investments and how these can be available to retail investors

- Alignment of the UCITS regime with the alternatives regime to provide **retail investors** with an **increased level of protection**.
- New custodian rules (for Alternatives and UCITS) are a key step towards harmonization, a number of challenges still need to be addressed.
- Expected benefits are increased investor protection against non-financial risks, clarification of custodian roles and responsibilities, more consistency across alternative and UCITS funds and reduction of regulatory uncertainty across EU member states
- Major challenges will reside in the maintenance of a pragmatic operating model for the investment fund sector, ensuring responsibility of those entities controlling the assets, avoid duplication of tasks in the asset servicing value chain,
- Clarification on specific investment types and ensuring continuous access to various markets

6.1. UCITS V
Not only a new depositary regime

Draft paper	Commission proposal	Parliament & Council	EU trilogues	**Adopted**	Technical measures	Implemented

Overview

The financial crisis highlighted divergent depositary regimes across the EU and focussed regulators on remuneration and behaviour in the financial sector.

UCITS V has three key aims:

1. Harmonise UCITS depositary regime clarifying duties and liability
2. Harmonise remuneration rules with other sectors
3. Harmonise sanctions regime for UCITS breaches

Given that the European Parliament ultimately rejected some of the more controversial elements, agreement between the EU institutions has been a long and cumbersome process with a final adoption by April 2014

Dec 2010	Jul 2012	Apr 2014	Jul 2014	2016
Commission consultation	Commission proposal	Adoption by parliament	Entry into force	Transposition in national regime

6.1. UCITS V
Not only a new depositary regime

1- Depositary regime

- **Eligibility criteria** – credit institution or MiFID authorized investment firm subject to extensive conditions, with a 2 year grandfathering period
- Defines and harmonizes across the EU the notion of “**safekeeping**” distinguishing between custody duties and asset monitoring duties (see AIFMD) and depositary oversight
- **Liability** for UCITS depositaries currently extends to “unjustifiable failure” to perform its duties (left to the Courts to interpret)
- UCITS V imposes a new “**strict liability**” for assets held in custody – in the event of loss anywhere in the sub-custody network these assets must be returned (financial instrument of an identical type or of corresponding amount) by the depositary “without undue delay”
- The depositary can **only discharge its liability** if there is an “external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary”
- In the event of the **insolvency** of the depositary, the assets held on behalf of the UCITS will not form part of the body of assets available to the depositary's creditors.

2- Remuneration provisions

- Remuneration policies should promote sound and effective risk management, discourage risk taking and avoid conflicts of interest
- Applies to staff whose professional activities may have a material impact on the risk profile of the UCITS:
    - senior management,
    - risk takers,
    - individuals performing controlled functions, or
    - any employee receiving total remuneration which takes them in the same remuneration bracket as senior management and risk takers
- Applies only to staff within the UCITS management company, not to delegated portfolio managers
- Rules for guaranteed variable remuneration
- Rules for fixed and variable components of total remuneration
- Rules on pension benefits
- Rules for payments related to termination of employment

3- Sanctions regime

- Minimum catalogue of administrative sanctions, fines and measures
- Minimum list of sanctioning criteria
- Whistle-blowing mechanisms for national regulators and management companies
- National regulators will be required to publish details of sanctionable offences detailing the nature of the breach and the party involved

6.2. UCITS VI

Rolling back complexity?

Overview

Only days after the release of the UCITS V proposal, the European Commission published a consultation document on UCITS on 26 July 2013. This was a very open-ended consultation, inspired largely by the regulatory concerns over the potential risks and impacts of “shadow banking”. Shadow banking refers to non-bank credit activity, which performs important functions the financial system. The consultation paper covered eight wide-ranging areas and sought more information on market practices. This initial consultation paper has been dubbed “UCITS VI” as it is seen as the origin of a further set of amendments to the UCITS Directive.

Since that consultation paper, two areas (money market funds and long-term investments) have been addressed separately outside of the UCITS framework. The delay in adopting UCITS V has undoubtedly impacted further progress on UCITS VI, which has yet to issue as a formal proposal.

Areas covered in the original “UCITS VI” consultation

Eligible assets	EPM techniques	OTC derivatives	Liquidity management
Depositary passport	Money market funds	Long term investments	Addressing UCITS IV
	Money Market Funds Regulation	European Long Term Investment Funds	

Key areas

Eligible assets

- The Commission expresses concern over the appropriateness of sophisticated investment strategies for UCITS and is considering a review of eligible assets.
- A “look though” approach for transferable securities, investments in financial indices or closed-ended funds is proposed.
- Distinguishing or limiting the scope of eligible derivatives based on the payoff is considered. While the term “exotic derivative” is used no definition is provided.
- Moving away from VaR as a method of global exposure and relying solely on the commitment approach is proposed.
- The paper considers permitting in UCITS only derivatives which are traded on multilateral trading platforms and cleared through a Central Clearing Counterparty (CCP)

Key considerations

Rowback of eligible assets

- The UCITS III reforms enabled UCITS to gain exposure to a range of otherwise ineligible assets through the use of derivatives structuring.
- A look though to underlying assets or a limitation on the scope of derivatives that may be used could have a significant impact on the investment profiles of many UCITS.
- Many UCITS employing leverage under the commitment approach would be unable to comply with the 100% global exposure limit of NAV if they used the commitment approach.
- The reforms could lead some providers to exit UCITS in favour of setting up more flexible AIFs.
- It is unclear whether grandfathering would be provided for existing UCITS.

6.2. UCITS VI
Rolling back complexity?

Key areas

Efficient portfolio management	• Efficient portfolio management (EPM) techniques relate to activities such as securities lending and repos and reverse repos. • A UCITS is not permitted to borrow or lend but the Commission is concerned that certain EPM are the equivalent of borrowing or lending. • The Commission is concerned with the transparency, counterparty risk, quality of collateral and re-investment of collateral associated with EPM techniques. • The consultation considers making EPM transactions recallable at any time. • The consultation considers putting a limit on the amount of portfolio assets that may be the object of EPM.
OTC derivatives	• The Commission is concerned about a UCITS exposing its entire portfolio to a single OTC derivative counterparty, which can happen if that counterparty provides collateral for more than 90% of the exposure of the UCITS. • The paper points out that while there is a requirements to calculate global exposure on a daily basis there is no corresponding requirement to calculate OTC counterparty risk and issuer concentration daily.
Liquidity management	• The Commission is concerned about liquidity challenges during the financial crisis, when investors were unable to redeem. • The Commission is considering defining “exceptional cases” when it would be appropriate to place a temporary suspension on redemptions. • The Commission wants to consider the use of “extraordinary liquidity management tools” such as side pockets and is also concerned about ensuring sufficient liquidity in secondary markets for ETF investors.

Key considerations

Efficient portfolio management	• Securities lending can be a very significant source of revenue for many UCITS. This practice may be significantly impacted by the proposed changes. • Limiting a proportion of the portfolio that could be lent or otherwise engaged in EPM would constrain opportunities for revenue generation and could therefore impact competitiveness. • New criteria on the eligibility. liquidity, diversification and re-use of collateral could also have cost impacts. The industry has pointed out that ESMA’s new guidelines in this area should be sufficient. • Mandatory haircuts on collateral received could also reduce UCITS market access.
OTC derivatives	• It is unclear what action the Commission may take in relation to contracting with a single counterparty as it has only solicited views at this stage. Any changes may affect UCITS that engage in a single OTC transaction covering their entire portfolio. • Changes also need to be considered in terms of developments on EMIR, which seeks to mitigate OTC derivative counterparty risk.
Liquidity management	• The Commission is concerned initially with gathering market views and information on market practice. • Industry has pointed out that since UICTS IV, UCITS are subject to a liquidity management framework. • It is also important to recognise the need for different redemption practices (particularly time limits) in respect of different fund types and those with different investment strategies.

6.2. UCITS VI
Rolling back complexity?

Key areas

Depositary passport

- AIFMD and UCITS V will harmonise EU depositary rules and therefore possibly create the basis for an EU depositary passport.
- The Commission is seeking views on the advantages and drawbacks for the creation of EU passport for depositaries.
- The paper enquires as to whether the introduction of a depositary passport would require further harmonisation (e.g. NAV calculation, tasks, permitted activities, capital requirements, supervision, etc.).
- The Commission is seeking information on specific issues, burdens, costs which are associated with the supervision if the UCITS and depositary are not located in the same country.

Addressing UCITS IV

- The Commission is seeking to be empowered under the UCITS Directive to adopt delegated acts with respect to self-managed investment companies with a view to harmonising requirements with those applicable to UCITS management companies.
- Some 'tidy up' measures are also proposed, including application of the same information standards in all master-feeder scenarios, improvement of notification procedure between member states and increasing legal certainty around the 20 working day time limit for notification for cross-border mergers.
- Some of AIFMD's provisions are more detailed: organisational rules, delegation, risk and liquidity management, valuation, reporting or calculation of leverage. The Commission is considering whether further alignment between UCITS and AIFMD is necessary to improve consistency.

Key considerations

Depositary passport

- Industry has given a cautious welcome to the concept of a depositary passport.
- The potential advantages include increased efficiencies and economies of scale, resulting in lower depositary fees. A depositary passport also creates the potential for centres of excellence to emerge that are equipped to serve a global operating model.
- The potential disadvantages include the loss of local expertise and a risk of applying local rules incorrectly or providing less robust oversight, as well as increased concentration in a few market players.
- There may also be local tax residency implications for contractual UCITS if the residence of the trustee were to shift.
- The industry has recommended a step-by-step approach in which ESMA should first ensure that the required level of harmonisation has been reached under UCITS V.

Harmonisation measures

- The application of the full UCITS management company requirements to SMICs was an area of contention during and after the implementation of UCITS IV.
- Eventually it was agreed with the Central Bank that the appointment of a permanent compliance function and permanent internal audit function could be disapplied in the case of SMICs.
- Commission harmonising measures could raise these full management company issues for UCITS SMICs, which have been able to disapply some rules based on their "nature, scale and complexity".
- Harmonisation of UCITS management company delegation and substance requirements in line with the letter box entity rules of AIFMD is also a key industry concern.

7. Regulation on Money Market Funds

7. Regulation on Money Market Funds
"Shadow banking" concerns

Draft paper	**Commission proposal**	Parliament & Council	EU trilogues	Adopted	Technical measures	Implemented

Overview

The European Commission released its draft Regulation on Money Market Funds (MMFs) on 4 September 2013. The proposal seeks to address the risk that investor "runs" could affect market stability and is likely to have significant impacts. The Commission has softened its stance in relation to exposure to securitisation (Asset Backed Commercial Paper) and collateral but maintains several challenging requirements. The Regulation will apply to all types of MMFs under both UCITS and AIFMD. Once adopted, the Regulation will be directly applicable across the EU and MMFs will have only six months to submit a regulatory application demonstrating compliance with the new requirements.

3% Capital buffer	Eligible assets	Diversification & concentration
Credit assessment	Risk management	Valuation
Credit rating agencies	External support	Regulatory reporting

7. Regulation on Money Market Funds
"Shadow banking" concerns

Draft paper	Commission proposal	Parliament & Council	EU trilogues	Adopted	Technical measures	Implemented

Key provisions

CNAV MMFs	• Constant NAV (CNAV) MMFs will be required to establish and maintain a "NAV buffer" of at least 3%. • CNAV MMFs that apply the NAV buffer may continue to use an accounting methodology that permits a constant value, or otherwise they will need to convert to a variable NAV.
Investment policy	• MMFs will only be permitted to invest in money market instruments, deposits with credit institutions, financial derivative instruments and reverse repo agreements that meet certain requirements. • A new 5% single issuer limit is proposed.
Risk management	• New portfolio rules on the weighted average maturity and weighted average life of assets are proposed. • Know Your Customer rules in terms of redemption behaviours and stress testing requirements are also proposed. • An MMF may not "solicit or finance" a credit rating agency to rate the MMF under the proposals.
Transparency	• New labelling requirements are imposed and communications must make clear that investment is not guaranteed. • Regulatory reporting on a quarterly basis will be required.
External support	• External support should only be permitted through the CNAV capital buffer or in exceptional circumstances for other types of MMFs.

Key challenges

Economic viability	• The 3% capital buffer is widely considered to be unsustainable for CNAV funds. The maximum capital buffer that the industry considers tolerable is 50 bps. • Maintaining the capital buffer will drive up costs, which will inevitably be passed on to investors. • MMFs may become less attractive to investors as a result.
Valuations	• Amortised cost account or rounding to the nearest percentage point is used across the industry to provide a stable MMF NAV. • Moving to mark-to-market or mark-to-model may present operational challenges and risk of inaccurate valuations based on a lack of market prices or subjective model inputs.
Internal ratings	• The operation of new internal procedures and systems to rate the credit quality of instruments may not be in line with longstanding market practices. • Internal credit quality assessment procedures must be approved by the governing body.
Collateral	• Restrictions are likely to push up demand for eligible assets at a time when there are already a number of initiatives in train that will affect demand for collateral.

8. European Long-term Investment Funds

8. European Long-term Investment Funds
Investing in tomorrow's economy

Draft paper	Commission proposal	Parliament & Council	**EU trilogues**	Adopted	Technical measures	Implemented

Overview

The European Long-term Investment Fund (ELTIF) is a new product aimed at promoting sustainable long-term investment in the European economy (infrastructure, sustainable energy, new technologies). There is currently no readily available cross-border product to channel funds into these types of investments and the Commission sees an opportunity to develop economies of scale and promote investment in the EU's economy.

ELTIFs will fall under AIFMD but will be open to both retail and institutional investors. As such, ELTIFs will be the first pan-European retail product to have a distribution passport under AIFMD. ELTIFs will therefore represent an alternative to UCITS for retail investors seeking to invest in illiquid assets over the longer term.

ELTIFs are being introduced by regulation and therefore will be directly binding in EU member states with no possibility to gold plate.

8. European Long-term Investment Funds
Investing in tomorrow's economy

Draft paper	Commission proposal	Parliament & Council	EU trilogues	Adopted	Technical measures	Implemented

The opportunity

- The European Commission estimates infrastructure transaction volumes at between €100-€150 billion a year.
- An estimated €1,500 to €2,000 billion will be needed to finance infrastructure project needs in Europe up to 2020.
- Pension funds and insurance companies with long-term liabilities are seen as key targets, as well as retail individuals planning for future liabilities who might benefit from regular returns afforded by long-term investments.

Eligible investments

- "Eligible investment assets" include:
  - Companies that are not listed or traded on a regulated market and which are not financial undertakings. Such companies ("qualifying portfolio undertakings") must be established in the EU or in a third country that has a cooperation arrangement
  - Equity or debt instruments issued by such companies
  - Loans granted by the ELTIF to such companies
  - Units/shares of other ELTIFs, EuVECAs, EuSEFs
- UCITS eligible assets constitute the other category of eligible investments

Investment restrictions

- At least 70% of capital must be invested in "eligible investment assets".
- The remaining 30% must be invested in assets which meet the UCITS eligibility criteria.
- Portfolio composition and diversification rules apply. The ELTIF has five years to comply with these.
- Up to 30% of capital may be borrowed to acquire assets.
- Exposure to commodities is not permitted.
- Short selling is not permitted and use of derivatives is only permitted for interest rate/currency hedging.
- Securities lending/borrowing, repos or any other agreement that would encumber assets is not permitted.

Additional requirements

- Must be an EU AIF managed by an EU AIFM and will have an EU passport
- Prior publication of a Key Information Document (KID) and disclosure rules apply
- Permitted to distribute income generated by the assets
- Retail investors have a two week cooling off period
- Must not be structured as a partnership for retail investors

9. Benchmarks and indices

9. Benchmarks and indices

A new EU regime

Draft paper	Commission proposal	Parliament & Council	EU trilogues	Adopted	Technical measures	Implemented

Overview

The regulatory interest in benchmarks prompted by the manipulation of LIBOR has now extended into many other areas of the financial system. What began as a banking issue has evolved into a system-wide concern, with potential regulatory impacts for a wide range of firms.

Under a new proposal for a Regulation published on 23 September 2013 by the European Commission, virtually all published benchmarks and indices used as references for traded instruments, financial contracts, and measuring fund performance are set to be covered by the EU's new regime.

Ensuring benchmarks reliability

- Supervision & regulation are set for benchmark providers as will contributors
- Conflict of interest have to be managed
- The providers and contributors to a benchmark need to ensure appropriate governance and controls are set on the benchmark-setting process
- The overall benchmark setting should be transparent and robust; it should insure the appropriate use of accurate & representative data
- Improved transparency of the benchmark-setting process
- Suitability of assessments of benchmarks for retail contracts

Who is affected?

- Firms need to be aware of the proposals for two main reasons:
  1. They may be performing activities which could be construed as administering a benchmark under the Regulation
  2. They may be submitting information which is used as an input for a benchmark
- There are consequences for firms if they do either of these. Governance and internal controls are in focus, and while the burden will be greater for administrators, particularly as they will have to be explicitly authorised as such, submitters are also subject to various requirements. In particular, the Commission proposes that both parties sign a legally binding 'code of conduct', and has set out detailed and prescriptive requirements for oversight arrangements.

How does this impact you?

- It is unlikely that a fund will be either an "administrator " or a "submitter" to a benchmark, however, the proposals may have an impact on those funds that follow indices, the outcome of which is uncertain. The proposal will be negotiated and amended, and there is sure to be pushback from certain parts of the industry that do not agree with the way benchmark regulation has spread to non-bank parts of the system.

10. Luxembourg partnership regime revamp

10. Luxembourg partnership regime revamp
Structuring opportunities ahead

Overview

The modernization of the Luxembourg partnership regime embedded in the AIFMD implementation law dated July 12, 2013 (“the law”) offers a larger spectrum of structuring opportunities for alternative investment fund vehicles. The legislative changes gave birth to a flexible and efficient limited partnership (LP) vehicle meeting the alternative investment funds industry needs primarily for unregulated funds (with very low time to market) but also for lightly regulated funds in a tax neutral way.

Luxembourg is commonly chosen as investment platform jurisdiction due to its strategic location in Europe, its competitive holding company regime, access to EU Directives and extensive double tax treaty network. Combining this use of Luxembourg as investment platform location with a Luxembourg fund structure can add value in terms of operational model and substance and help reducing costs.

Choose the right vehicle	**SCSp (Special LP)**	**SCS (Common LP)**	**SCA (Partnership limited by shares)**
Legal			
Resembles	English LP	Scottish LP	English LLP
Legal personality (distinct from partners)	No	Yes	Yes
Law changes	**New vehicle**	In-depth overhaul	Enhanced
Regulatory			
Unregulated form available	Yes	Yes	Yes
Lightly regulated form available	Yes (SIF/SICAR)	Yes (SIF/SICAR)	Yes (SIF/SICAR)
Tax			
Luxembourg tax characterization	Transparent	Transparent	Opaque
Foreign tax characterization	Depends (likely transparent)	Depends	Depends (likely opaque)

10. Luxembourg partnership regime revamp

Structuring opportunities ahead

Key features of the revamped limited partnership regime

LEGAL			TAX
The law has modernized the existing common LP regime (*société en commandite simple*, **SCS**) and created a new vehicle: the special LP (*société en commandite spéciale*, **SCSp**). The SCSp regime is generally similar to the SCS regime except for some minor differences due to the fact that the SCSp does not have legal personality. Both regimes embed the broad contractual structuring flexibility inherent in the Anglo-Saxon LP model. Indeed there are only few mandatory rules provided by the draft law, leaving notably the flexibility to: • Have/not have the legal personality (SCS vs. SCSp) • Keep the identity of the limited partners confidential • Have partnership interest represented by securities (now also debt securities) or to have partnership accounts • Delegate management duties to an external manager which is only liable for the execution of its mandate • Allow the limited partners to carry out some internal management functions such as advisory and supervisory functions and the granting of loans or guarantees to the fund or its affiliates • Allow contribution in industry (such as efforts of the management team of the fund) in addition to contributions in cash and in-kind • Derogate from the “one share, one vote” principle • Exclude a partner from sharing in the profits and/or losses • Freely arrange for distributions in the LP agreement and preclude claw back of distributions to partners • Freely determine transfer restriction (or the absence) for partnership interests	Full Luxembourg tax transparency is achieved for SCS and SCSp (including for municipal business tax to the extent the general partner holds less than 5% of partnership interests and the SCS/SCSp does not perform actual commercial activity such as active trading)	**Luxembourg tax characterization**	
	The possibility to set–up a LP with legal personality (SCS) or without it (SCSp) offers more flexibility regarding the tax characterization of the vehicle as either opaque or transparent in the jurisdiction of the investors (impacting the tax treatment in their hands)	**Foreign tax characterization**	
	Management services provided to a SCS or SCSp qualifying as alternative investment fund under the draft law would qualify for VAT exemption	**VAT Exemption**	

11. The new KID on the block

11. The new KID on the block

From the UCITS KIIDs to the PRIIPS KID

Overview

For the sake of the retail investor protection, i.e. to make it easier for retail investors to compare products to each other, insurances and banks will soon be required to use a very similar document to the Key Investor Information Document (KIID) introduced for funds with the UCITS IV Directive. Indeed, all those producing or selling packaged retail investment and insurance-based investment products (PRIIPs) will have to produce KIDs (Key Information Documents).

WHAT IS A PRIIP?

A Packaged Retail and Insurance-based Investment Products aka “PRIIP” is an investment product

- which is providing investment opportunities to retail investors,
- where the amount repayable is subject to fluctuations because of exposure to reference values, or in the performance of one or more assets which are not directly purchased by the investor.

The products include investment funds, life insurance policies with an investment element and structured deposits.

11. The new KID on the block

From the UCITS KIIDs to the PRIIPS KID

What you need to know

What products are in scope?

The following products, in the retail market, will be PRIIPs:

- Investment funds (including, following a five-year transitional period, UCITs as mentioned below);
- Insurance investment products (such as unit-linked or with-profits policies); and
- Banking structured products (deposits and securities).

Products that are not PRIIPs include the following:

- non-life insurance products;
- life insurance contracts where the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or infirmity;
- deposits, other than structured deposits;
- Certain pension products (such as Recognised pension products and officially recognised occupational pension schemes)

KID?

Key features

- Stand-alone document, maximum 3 pages when printed in A4
- Easy to read, accurate and not misleading, consistent with marketing information.
- The KID shall be provided to retail investors by the person advising on or selling a PRIIP in good time before the investor is bound by any contract or any offer related to the PRIIP.
- The PRIIP manufacturer shall publish the KID on its website before the PRIIP is made available to retail investors
- The PRIIP manufacturer and the person selling the PRIIP shall establish appropriate procedures and arrangements which ensure that retail investors have an effective way of submitting a complaint, receive a substantive reply in a timely and proper manner after having made a complaint and have access to effective redress procedures in the event of cross-border disputes.

UCITS KIID vs. new PRIIPS KIID: same, same ?

- New format (e.g. up to 3 pages for PRIIP KID i/o 2 for UCITS KIID)
- Questions style heading ("What is this investment?" rather than "Objectives and Investment policy")
- Updated and new sections ("What happens if the PRIIP manufacturer is unable to pay out?")

Why you should care?

Sanction regime

Administrative penalties and other administrative measures :

- Marketing prohibition/suspension
- Public disclosure
- New KID to be published
- Administrative fines of EUR 5 million or up to 3% of the total annual turnover or up to twice the amount of the profits gained or losses avoided because of the breach for a legal person
- Up to EUR 700k or up to twice the amount of the profits gained or losses avoided because of the breach for a natural person

Challenging content – in particular the risk section

- The risk section is more than likely to generate questions and substantial work – it should include: a brief description of the risk-reward profile, containing: a summary risk indicator with supplementary explanations; possible maximum loss of invested capital; performance scenarios; conditions for returns or performance caps; impact of tax legislation

ETA: Regulation is likely to become applicable at the end of 2016 with a grand-fathering period for UCITS up to the end of 2019

12. Not in Bank Depositary

12. Not in Bank Depositary

Broaden the PSF's horizon

Overview

Who can be a Special depositary?	• Regulated investment firm entity which does not necessarily qualify as a bank but which can extend its license to become Special Depositary • Funds could appoint a Special depositary subject to the following: ✓ At least 70% of its assets comprise of non-financial instruments (hence a single Depositary can still both hold financial and non-financial assets subject to this limit) ✓ Umbrella investment scheme can appoint Special depositary when all compartments meet the eligibility conditions individually • Special depositary can either be appointed directly by the AIF, or act as a delegate of the AIF's single Depositary
License requirements	• Production of evidence of capital amounting to not less than EUR 500,000 and must be established in the domicile of the fund • Proof of adequate expertise, operational means and financial strength in line with the scale and complexity of the depositary activities of the PSF • PSF requests CSSF authorization to be a "*professional depositary of assets other than financial instruments*". • The PSF Special depositary authorization is only granted to legal persons
Roles & responsibilities	• Oversight, record keeping and ownership verification activities for non-financial assets and generally assets that cannot be safekept • PSF may delegate the safekeeping of financial instruments that can be held in custody to third parties also authorized to safe-keep any financial instruments • When acting as depositary of a Full Scope AIF, a Special depositary is compelled pursuant to safe keep financial instruments that can be held in custody and belonging to this Full Scope AIF

12. Not in Bank Depositary

Broaden the PSF's horizon

PSF challenges entering the depositary activity					
Understand fund structure and risk assessment	**Supervision of functions related to banking activities**	**Set-up of sound control frameworks**	**Information flows with counterparties**	**Business scalability issue**	**Capital requirements**
• Set-up strategy prior to launch • Onboarding process and controls • Initial and ongoing risk assessment • Demonstrate understanding of the fund structure • Identify fund counterparties	• Processing and controls on transactions involving fund assets • Deal documents review and management • Cash monitoring • Collateral management • Exit transactions e.g. IPO • Leverage reporting	• Asset monitoring – record keeping and ownership verification/look-through • Oversight controls - NAV calculation, income distribution, capital transactions, etc. • Investment compliance monitoring • Escalations	• Information flow arrangements for on-going supervision on other assets e.g. PE/RE • Performing initial and on-going due diligence • Cultural switch from manual ad-hoc to streamlined process	• Case of significant increase of the assets under depositary's responsibility and related operating and controls processes • Certain level of expertise required on complex assets	• License triggered by potential capital requirement comparable to banks

Competitive advantage
Ability to perform monitoring duties on not-in bank assets
Leverage expertise in PE/RE and other asset classes
Ability to serve smaller structures
Existing relationship with a client base having real appetite for dedicated and non-vanilla investment schemes

13. Anti-Money Laundering Development

13. Anti-Money Laundering Development
Hot topics with market/best practices

Regulatory overview

- Latest **update of GAFI recommendations – 15 Feb 2012**
- Unchanged Law of November 12, 2004 as amended by the law of July 17, 2008 and the law of October 27, 2010
- Grand-Ducal Regulation – 1st February 2010
- **CSSF Regulation 12-02**
- CSSF Circular 11/519, 11/529 (**Risk Based Approach**)
- CSSF Circular 11/528 (Suspicious Transactions Reporting)
- CSSF Circular 14/590 (**Higher Risk Countries**)

Key points of discussion

Origin of Funds

- Information needs to be collected for all investors
- Corroboration with documentation to be performed using a Risk based Approach

MLRO at Board level for SICAVs

- Different approaches on the market based on discussion with regulator.
- Latest development appears to be that there should be an MLRO at SICAV Board level (even when a ManCo is involved) but this is to be analyzed on a case by case basis.

Training at Board Level for SICAV

- The Market is asking for a lot of AML trainings for Board members considering they are ultimately responsible for the proper application of AML rules in the Funds.

Tax offences

- May be included in the scope of predicate offences of ML in the 4th AML Directive
- Definition will be given by each member state

AML On-Site Due Diligence

- When delegating AML operational duties, oversight remains with the Board of the Fund, as such specific work needs to be performed to ensure compliance with the delegation contract.
- AML Due Diligence performed on site appears to be the best way to ensure such compliance when dealing with higher risk delegate albeit they are often considered a bit pricey by the Market.

14. European Market Infrastructure Regulation (EMIR)

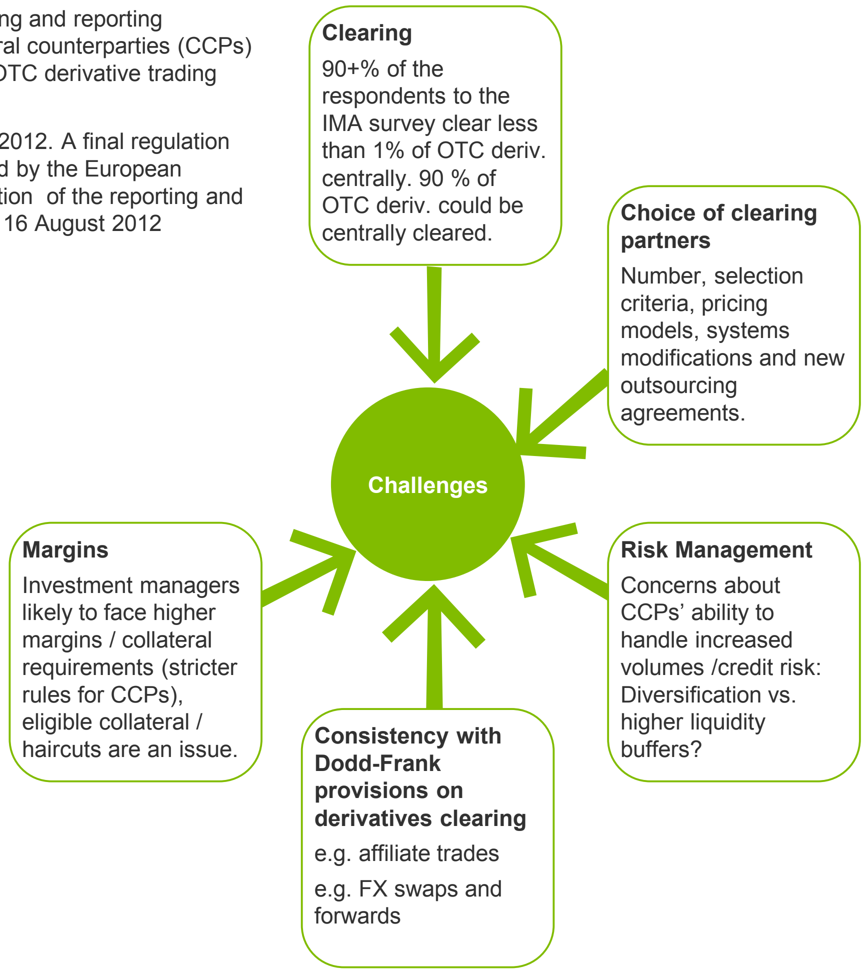
14. European Market Infrastructure Regulation (EMIR)

Time to roll your sleeves up

Overview

The European Market Infrastructure Regulation (EMIR) will introduce mandatory clearing and reporting requirements for OTC derivatives contracts as well as additional requirements for central counterparties (CCPs) and trade repositories. The impact on EU entities is critical because 60% of Europe's OTC derivative trading takes place in London.

EMIR is part of the G20 commitment to clear all standardised OTC derivatives by end-2012. A final regulation (No 648/2012) has been adopted in July 2012. Technical standards have been adopted by the European Commission and entered into force on 15 March 2013 and contain date for the application of the reporting and clearing obligations. The reporting obligations apply to all derivatives entered into from 16 August 2012 onwards.



Key provisions for investment managers

Reporting	All OTC derivatives contracts must be reported to trade repositories within one day of conclusion (includes contracts that are outstanding when EMIR enters into force). Trade repositories need to be authorised by ESMA or established in a third country and EU recognised.
Mandatory clearing	Standardised derivatives contracts (CCPs and ESMA will establish a list) must be cleared by a CCP. Investment managers will need to submit the details of the contract to a chosen clearing member and post additional margins.
Risk mitigation techniques	Bilaterally cleared OTC derivatives (not eligible for clearing) will be subject to formal requirements (in particular: higher capital charges, timely confirmation). Technical standards (e.g. confirmation time, criteria for using marking-to-model) expected.
Scope	The reporting requirement will apply to all counterparties. Mandatory clearing will apply to financial counterparties (MiFID firms, banks, insurances, AIFM, institutions for occupational retirement provision) and non-financial counterparties.

15. OTC Derivatives clearing

15. OTC Derivatives clearing
Comparison of EU and US approaches

In line with the EU's G20 commitments there have been a number of initiatives both by individual jurisdiction and international bodies. At national level, both the US (Dodd-Frank Act) and Japan have passed OTC derivatives legislation. Please find below an overview of differences between the EU and the US regulations:

Issue	EU approach	US approach
General Scope	• OTC derivatives: credit, interest rate, foreign exchange, equity and commodities	• All OTC swaps, forwards and options for credit, interest rate, foreign exchange, equity and commodities. There is a proposed exemption for foreign exchange derivatives and forwards
Product exemptions	• None	• OTC options on equity securities as well as general proposed scope exemption for foreign exchange derivatives and forwards
Participant exemptions	• Non-financial firms whose non-hedging business falls below an ESMA-defined threshold. • Intra-group transactions (conditions apply). • Pension funds carve out for three years.	• Non-financial firms hedging commercial risk.
Segregation: clearing members	• Clearing members must segregate client accounts from house accounts • Clearing members must offer clients the facility for individual segregation accounts but the client is not obliged to take this.	• CFTC: Clearing members must segregate client accounts from house accounts but individual client segregation is not mandatory. • SEC has yet to determine rules in this area.
Historical contracts	• Trades outstanding at the time of a notification to clear (and subsequently subject to a clearing obligation) will have to be cleared.	• Trades executed before the clearing obligation is determined will not have to be cleared. The obligation is prospective only (as long as the trade is reported to a trade repository).
Reporting to trade repository	• Details must be reported no later than the working day after the conclusion, modification or termination of the contract.	• Reporting varies between 15 minutes and 1 day based on various factors including if the trade is electronically executed, regulatory status of counterparties, and if the trade is managed electronically.

16. EU Regulation on Short Selling & CDS

16. EU Regulation on Short Selling & CDS

Tackling the alarm rather than fire?

Overview

Until recently, the EU lacked a common regulatory framework for dealing with short selling, and uncoordinated measures taken by Member States in this area created market uncertainty during the crisis when regulators individually took action.
An EU regulation on certain aspects of short selling and credit default swaps has therefore been adopted on 14 March 2012. On 19 April 2012, ESMA also published a technical advice to the European Commission on the implementation of this Regulation.

Challenges

The CSSF issued Circular 12/548 on 31st October 2012 for immediate application. CSSF also releases its dedicated website for reporting purposes. Different grandfathering rules throughout the EU will need to be taken into account.

	Scope	Disclosures	Timing	Short selling restrictions
Equity	• Short sale of shares issued by a company • Includes indirect or synthetic short exposures in the above (options, futures, CFD, spread bets, probably also funds…)	• **Flagging**: all share orders on trading venues* be marked as 'short' if they involve a short sale • **Disclosure to regulator** (identified) of significant net short positions in shares or equivalent (threshold: 0.2% of issued share capital and 0.1% intervals above this) • **Disclosure to market** (anonymous) of significant net short positions in shares or equivalent have to be disclosed to the market (threshold: 0.5% of issued share capital and 0.1% intervals above this)	Calculation should happen at the end of each trading day, T+1 for automated night trades.	**To enter a short sale of a share or sovereign debt, an investor must have:** • Borrowed the instruments concerned, • Entered into an agreement to borrow them, or • An arrangement with a third party where the share has been located and ("or" for sovereign debt) there is reasonable expectation that settlement can be effected. **An investor cannot enter into uncovered CDS in the sovereign debt of an EU Member States:** • Except for hedging a long position in that the sovereign debt or a position that is "correlated" to the value of the sovereign debt • National regulators will be able to suspend the ban in relation to its own sovereign debt (initially for up to 12 months and then for further periods of up to six months at a time) under strict conditions.
Debt	• Short sale of sovereign debt of the EU or of an EU Member State • Includes indirect or synthetic short exposures in the above • Includes "uncovered" position in an EU sovereign CDS	• **Disclosure to regulator** (identified) of significant net short positions in EU sovereign debt (incl. CDS) and of uncovered positions EU sovereign CDS. Notification thresholds to be determined at level 2*. • Can net CDS against a basket if this is appropriate * Regulated market or Multilateral Trading Facility	Calculation should happen at the end of each trading day, T+1 for automated night trades.	

* A definition of level 2 is provided on page 33.

17. MiFIDII

17. MiFID II

What are the main impacts and challenges ?

Investor Protection and Inducement	A series of measures will reinforce investor protection (e.g. 'Independent Advice' definition, Structured UCITS are considered as complex instruments) By limiting the common practice of retrocessions, MiFID II poses challenges on revenue and therefore on organizations strategy and business model
Governance	New requirements for corporate governance Introduction of the new concept of "management body" Strengthened criteria for qualified senior management Stricter control of remuneration of staff advising or selling to clients Strengthened role of the compliance officer
Market Structure	Additional financial instruments in scope (e.g. Structured deposits, PRIIPs, emissions allowances A new execution venue (the OTF) for non-equity instruments (e.g. bonds, derivatives, structured products) Third-country firms have to establish a branch in each EU country (when serving retail clients) or register with ESMA to gain EU passport (when serving ECP or Professional per se)
Reporting	Transparency requirements will be extended to non-equity instruments: from 6'000 equities to 100'000 financials instruments Trade reports will need to be published through Approved Publication Arrangement (APA) firms Transaction reports will need to capture additional information (currently 23 data attributes compare to 93 in the future)
Regulatory Supervision	ESMA and national regulators (i.e. CSSF in Luxembourg) have powers to permanently ban financial products, activities or practices. Dissuasive administrative sanctions, fines and penalties will be made public

Overview

MiFID II seeks to address issues raised by the financial crisis in line with the G20 commitments to improve the transparency and regulation of more opaque markets, such as derivatives.

The full impact of the changes will not be clear until the legislation is passed, by which time some controversial points could be omitted, and there is sight of the Level 2 and Level 3 proposals*.

However, firms should start to assess the potential market and business specific impacts of the proposals, for instance on the electronic trading of derivatives, and use these to inform their business plans.

Similarly, they should look at the linkages between the various regulatory reforms in the EU and elsewhere, such as the Dodd-Frank reforms, to identify potential opportunities and synergies, thereby minimising the cost of implementing the amendments.

Key challenges

- **Business models**: For example, firms that have extensive OTC derivative trading operations will potentially face very significant changes to their business models and should understand and discuss potential issues.
- **Cost of implementation :** Significant IT changes may be required. Also, firms should ensure that they have full sight of linkages between legislation (both pan-European and global) to minimise the cumulative cost of implementation.

18. Financial Transaction Tax

18. Financial Transaction Tax

Will it become, if ever, an EU or a Eurozone tax?

Overview

The EC released a proposal for a Council directive on 28 September 2011 which is supported by Austria, Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain.

The proposal has not be proposed by the Barroso commission but should be put again at the agenda under the Junker era.

Also, France has introduced a tax on financial transactions in August 2012 (2 bp on French large cap share transactions, plus taxes on French high-frequency traders and naked short sovereign CDS).

If passed in current status, a tax of 0.1%, calculated on gross transactions before netting and settlement would be applied on a wide scope of financial transactions (except for transactions in derivatives, taxed at 0.01% of notional amount).

Where 2 EU financial institutions enter a transaction, the FTT is paid by both parties (effectively doubling the rate). The FTT is also paid when an instrument moves within a group.

The tax would be due the moment an electronic transaction is carried out or within 3 working days in all other cases.

Which geographical scope?

- Residence principle: A financial transaction is taxable in the EU if one party is a financial institution and at least one party is located in the EU.

Which financial institutions?

- UCITS, alternative investment funds and their managers
- Investment firms, banks, pension funds, holding companies, etc.
- Whether acting as party to a financial transaction (for own account or for the account of other persons), or acting in the name of a party to the transaction.

Which transactions?

- Purchase and sale
- Securities lending / borrowing and repos
- Conclusion / Modification and trading of contracts
- Transfers of financial instruments between group entities
- Whether concluded on an organised market or OTC.
- Primary market transactions for shares and bonds exempted (subscription and redemption of fund units/shares not exempted)

Which financial instruments?

- All MiFID financial instruments as well as structured products (e.g. transferable securities, money-market instruments, units and shares in UCITS and AIF, forwards, futures, swaps, financial CFD).
- For derivatives: both the conclusion of the agreement and the delivery of financial instruments would be taxable.

19. Market Abuse Directive II

19. Market Abuse Directive II

A wind of change?

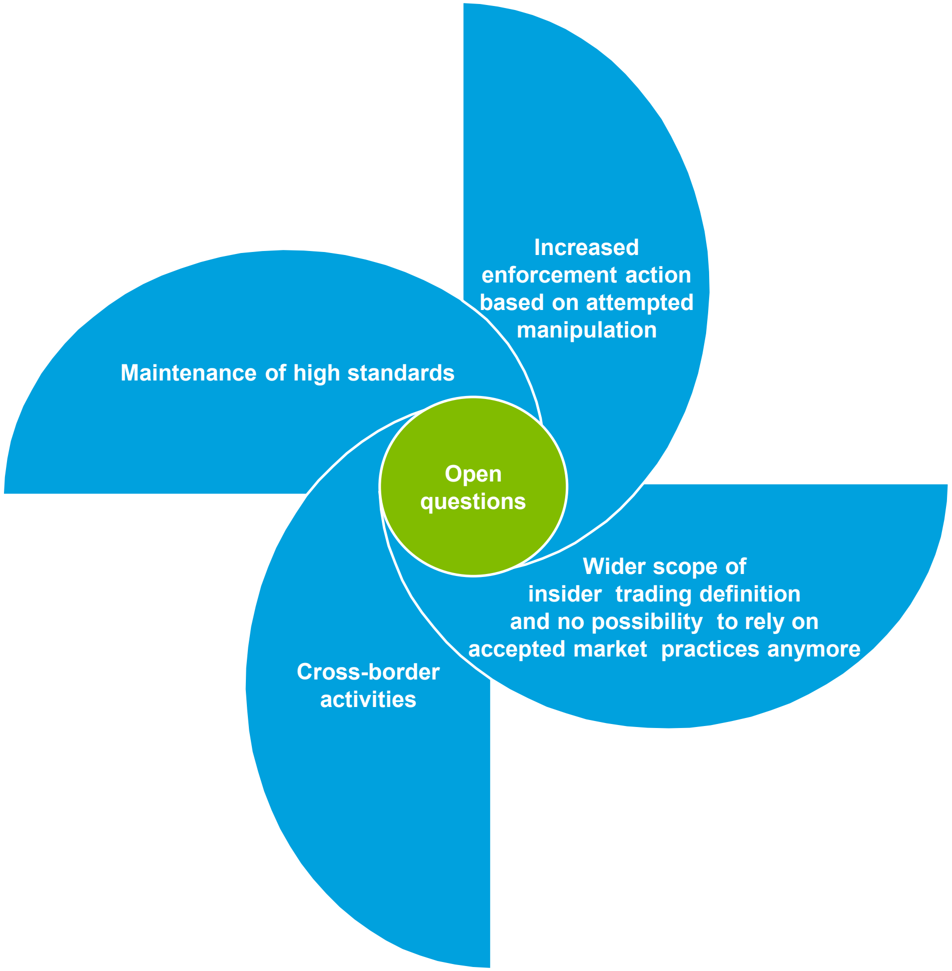
Overview

The Market Abuse Directive (MAD) solidified the framework for tackling market abuse and harmonised the rules on market abuse across the EU.

In October 2011, the EU Commission released a draft for revision of the MAD to address existing shortcomings, including regulatory gaps, such as coverage of products traded on unregulated markets, OTC instruments, commodities and inconsistent sanctions. The new proposals include a Regulation and Directive at level 1. The use of a Regulation represents a major change in the level of direct European regulation for EU firms.

Key provisions for investment managers

- **Scope:** MAD I only applied to financial instruments which are admitted to trading on a regulated market. MAD II will cover instruments traded on MTFs and OTFs, as well as to any related OTC instruments which can have an effect on them (a noteworthy target being CDS). Also, emission allowances will be covered by the rules against insider trading, with specific disclosure requirements and exemption thresholds.
- **Attempted market manipulation:** Sanctions may be imposed even if the perpetrator does not succeed in actually trading. There is no onus on regulators to prove that the market was actually manipulated when investigating such behaviour.
- **Sanctions:** The Regulation introduces minimum rules for administrative measures, sanctions and fines (this does not prevent Member States from fixing higher standards). The proposals also introduce criminal offences of insider dealing and market manipulation.
- **SME exemptions:** The proposals include exemptions for SMEs not to maintain insider lists in certain circumstances. These complement pan-European initiatives to assist SMEs with obtaining financing.



20. Securities Law Directive

20. Securities Law Directive
A complex but important reform

Overview

- The EU Commission is currently preparing a draft Directive on legal certainty of securities holding and transactions (Securities Law Directive – SLD).
- The Directive will seek to regulate the legal framework governing the holding and disposition of securities held through securities accounts and the processing of rights flowing from securities held through securities accounts.

Timeline

- Proposal by the EU Commission in Q3 2012
- Transposition into Member States' law by end 2015
- On 6 April 2013, Luxembourg implemented the law on dematerialized securities, which takes into account existing preliminary work on the draft of the Securities Law Directive.

The problem

- Securities law often still assumes that securities are pieces of paper deposited in vaults, while in reality they are mostly (85-100%) dematerialised.
- In national jurisdictions, book-entry legislation works well. However, when securities are held cross-border, national laws are often incompatible.
- For example, different countries may identify different 'owners' of the same security. This creates legal uncertainty (e.g. will the investor get its securities back in case of insolvency of one of the intermediaries) and complicates the exercise of investors' rights (account provider seen as shareholder in certain jurisdictions, not ultimate investor).

Expected contents

List of account-provider's functions, obligations and liabilities

Account providers are mainly custodians, escrow agents, nominees, UCITS/AIF depositaries, and potentially company registrars.

Pricing

Account providers will need to price cross-border services identically to domestic services.

Account crediting

Account providers will be able to credit an account only where the account provider actually holds the securities himself e.g. securities transferred to a third party under a repo or stock loan no longer recordable in securities account.

Strict approach to account providers liability

E.g. in case of discrepancies between credit entries made by an account provider and securities actually held (i.e. immediately make up any shortfalls).

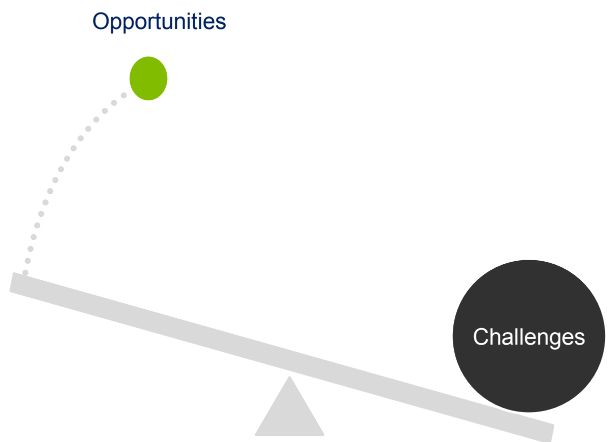
21. Solvency II

21. Solvency II
Opportunity for some, challenge for others

Overview

Solvency II is a new solvency regime for all EU insurers to be implemented by 1 January 2017. Similar to Basel II for banks, it sets the capital requirements for insurers on a risk basis, and has a three-pillar structure covering quantitative requirements, qualitative requirements (including internal risk governance & supervisory review), and market disclosure.

Certain managers see this as an opportunity to provide their clients with bespoke Solvency II solutions whereas others have determined that the costs of compliance mean they exit the insurance market.



Information granularity and timing

Investment Managers that manage assets for insurers will have to provide information on those assets with far greater granularity and in a shorter timeframe.

Capital charges

Hedge funds are classified as the most risky asset class and as such have the highest capital charge for insurers who invest into hedge funds.

Key elements for investment managers

Pillar 1
Quantitative Requirements

- Different capital charges (% of Market value) will be applied to different asset classes
- Insurance companies will be more focussed on asset underlying risk (trade off between risk & return)
- Collective investment schemes and funds will present additional challenges (look trough approach)

Pillar 2
Supervisor Review

- The insurer is responsible for monitoring operational risk related to the investment manager on an ongoing basis
- Increased level of interaction between Insurer and Investment Manager (outsourcing policy).
- Specifically investment managers will need to demonstrate that they have robust controls surrounding the production of the information disclosed, in addition to appropriate governance.

Pillar 3
Market Discipline

- Investment managers will need to obtain data from custodians and administrators
- Does the Investment Manager have capacity to provide the increased volume of data in shorter time frames, and with the requested level of granularity?
- Information required on a by security basis and for debt credit ratings required
- Who is going to aggregate data?
- Additional controls and checks required to ensure quality of data

22. Capital Requirements Directive (CRD) IV

22. Capital Requirements Directive (CRD) IV

Enlightened risk management

Consultation	Commission proposal	Parliament & Council	EU trilogues	Adopted	Technical measures	Implemented

Overview

The Capital Requirements Directive (CRD) implemented the Basel II rules in the EU. The Basel rules aim to ensure the financial soundness of credit institutions and certain investment firms. The CRD came into force on 1 January 2007.

The financial crisis prompted an EU and international effort to develop effective policies to tackle the underlying problems. Therefore, from 2010 onwards, a series of amendments to the CRD were made, with CRD II changes implemented on 31 December 2010 and CRD III coming into effect on 31 December 2011.

The more profound changes and key new requirements (such as new regulatory liquidity ratios) are included in CRD IV (transposing Basel III) that has a more long-term view and is applicable since 1 January 2014, with a transition period for some provisions running until 2020.

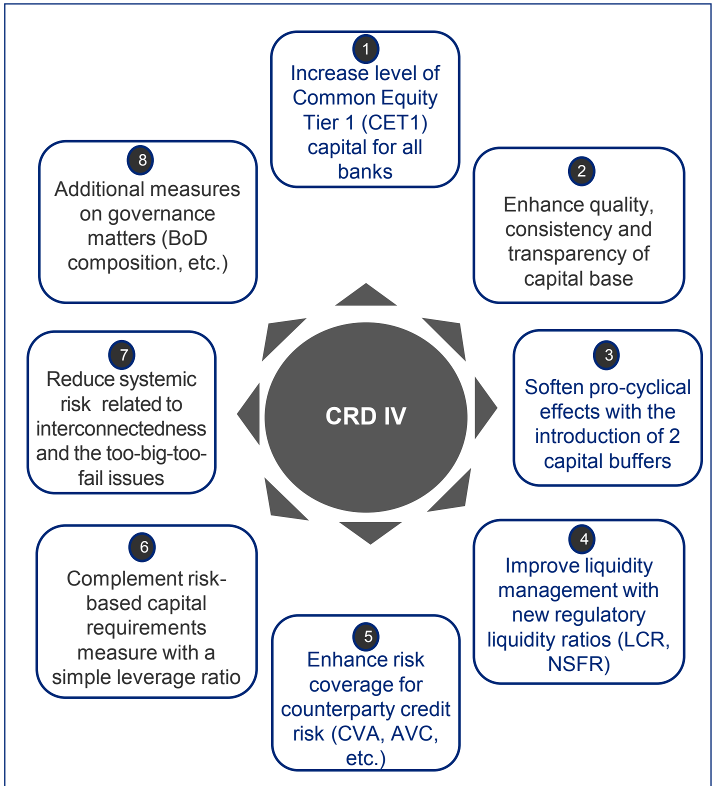
Besides a Directive, the CRD IV package comprises a Capital Requirements Regulation, in order to force maximum harmonisation throughout the EU Member States (cf. concept of “single rule book”).

For those investment managers that are MiFID firms (so called “investment firms”), the applicable ongoing capital and liquidity requirements are those contained in CRD. Therefore, changes to the CRD are likely to impact them.

22. Capital Requirements Directive (CRD) IV

Enlightened risk management

Consultation	Commission proposal	Parliament & Council	EU trilogues	Adopted	Technical measures	Implemented



CRD IV complements the existing framework with new requirements

Impact on investment managers

Additional capital requirements for exposure to counterparty risk when trading OTC derivatives or move to central clearing

Most investment managers will not have a material liquidity coverage ratio (because liabilities from a firm's own operating expenses would receive a 0% requirement)

Effect on leverage still unclear

Attractiveness of investment funds for banks as investors will depend on their eligibility as High Quality Liquid Assets

23. ESMA Guidelines on the Compliance Function

23. ESMA Guidelines on the Compliance Function

The relevant provisions in MiFID II are (Art.162(2))**:**

"An investment firm shall establish adequate policies and procedures sufficient to ensure compliance of the firm including its managers, employees and tied agents with its obligations under this Directive as well as appropriate rules governing personal transactions by such persons".

In September 2012, ESMA published "Guidelines on certain aspects of the MiFID compliance function requirements" (compliance guidelines). These guidelines focus on the responsibilities of the compliance function and increasing the effectiveness, and importance, of the compliance function. They specifically focus on:

1. the responsibilities of the compliance function for monitoring, reporting and advising;
2. the organisational requirements of the compliance function for the standards of effectiveness, permanence and independence;
3. the extent of interaction of the compliance function with other functions;
4. outsourcing of the tasks of the compliance function; and
5. approaches for national competent authority (NCA) review of compliance function requirements

1. Compliance risk assessment and risk-based approach

- General guideline 1 of the compliance guidelines requires that "investment firms should ensure that the compliance function takes a **risk based approach** […]". General guideline 1 also provides that "a **compliance risk assessment** should be used to determine the focus of the monitoring and advisory activities of the compliance function"

2. Monitoring programme

- General guideline 2 of the compliance guidelines requires that "investment firms should ensure that the compliance function establishes a **monitoring programme** that takes into consideration all areas of the investment firm's investment services, activities and any relevant ancillary services". General guideline 2 also provides that "the monitoring programme should establish priorities determined by the compliance risk assessment ensuring that compliance risk is comprehensively monitored"

3. Compliance function and management body

- General guideline 3 of the compliance guidelines provides that "Investment firms should ensure that the **regular written compliance reports** are sent to senior management. The reports should contain a description of the implementation and effectiveness of the overall control environment for investment services and activities and a summary of the risks that have been identified as well as remedies undertaken or to be undertaken. Reports must be prepared at appropriate intervals and at least annually […]"
- General guideline 7 of the compliance guidelines provides that "[…] the **compliance officer should be appointed and replaced by senior management** or by the supervisory function"

4. Permanence of the operation of the compliance function's tasks

- General guideline 6 of the compliance guidelines provides that investment firms shall ensure that the **compliance function** "performs its tasks and responsibilities **on a permanent basis**"

5. Overseeing by the compliance function of the complaints process

- The compliance guidelines 13 require that "the **compliance function should have a role in overseeing the operation of the complaints process** and it should consider complaints as a source of relevant information in the context of its general monitoring responsibilities"

III. Our regulatory services and Contact

Regulatory services to investment managers

New regulations

- Gap analysis
- Implementation projects
- Development of procedures and definition/implementation of the necessary and appropriate controls
- Post-implementation reviews
- Executive updates
- Regulatory training

New activities / business expansion

- Assistance with regulatory applications
- Advisory on compliance with regulatory reporting obligations
- Registration of funds in EU and offshore jurisdictions
- Assistance in finding / appointing local representatives
- Regulatory Due Diligence

Compliance Officer services

- Compliance co- or outsourcing
- Pan-European updates / advice
- Compliance updates
- Central point of contact and liaison with local regulatory authorities in target markets / third party service providers
- Compliance Hot Line

Ongoing regulatory support

- Ad-hoc regulatory queries
- Regulatory opinions
- Review of the adequacy of procedures and organisation
- Investment compliance, review of system parameterisation, processes, and practices
- Internal audit

Marketing

- Review of marketing documentation / KIID
- Definition and review of cross-border distribution compliance
- GIPS verification

Testing and investigations

- Mock regulatory inspections and cold testing (e.g. of investment restrictions)
- Section 166 reports and readiness reviews
- Forensic projects (e.g. Fraud investigation) and expert support in legal cases
- Assistance with NAV calculation errors and investment breaches

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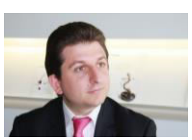

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