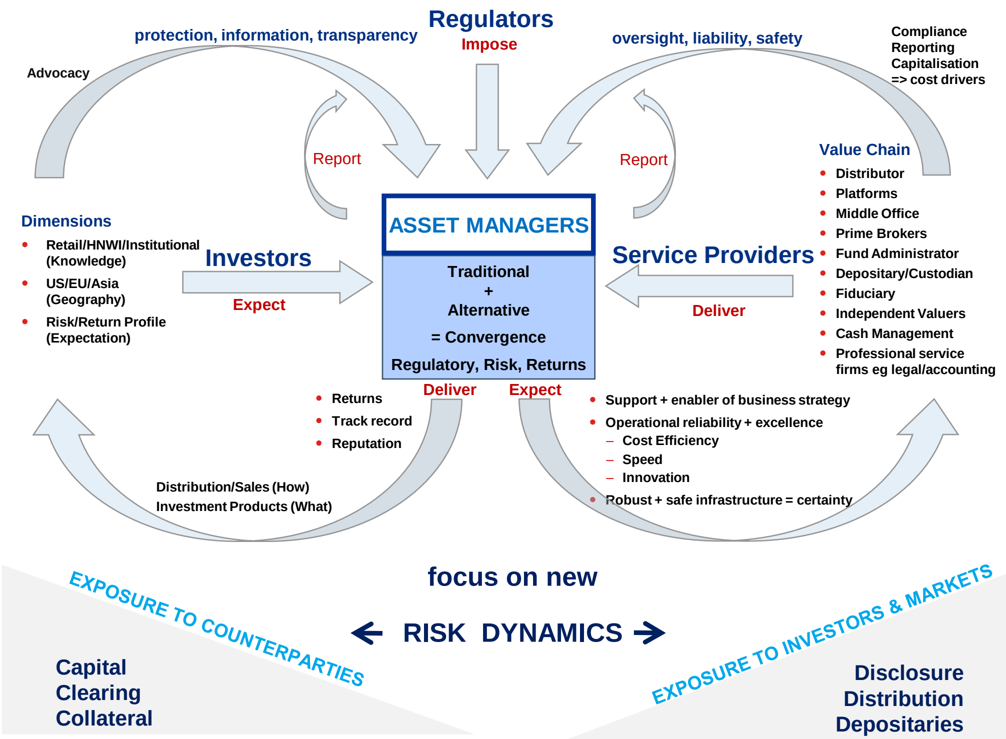
INVESTMENT MANAGEMENT – REGULATORY ECOSYSTEM

~ Mind Map ~

March 2014

Key Regulatory Reforms for Asset Managers

natalie.westerbarkey@citi.com
Director Global Government Affairs



FATCA

US Foreign Account Tax Compliance Act

Timeline

- **Signed into law** in March 2010; from **Aug 2013** IRS online registration available
- **From July 2014** withholding and FATCA compliant procedures must be in place

Key Themes

- **Rationale:** prevent tax evasion by US investors through non-US accounts; **FDIP income** is fixed, determinable, annual or periodical income sourced in US
- **Foreign Financial Institutions FFI** defined as holding financial assets for the accounts of others; can enter into an agreement with US authority IRS to be identified as participating **PFFI**; entails duty to report to US authorities any accounts held by US investors; local reporting possible where countries have signed Intergovernmental Agreement (IGA) with the US IRS
- Non-participating **N-PFFIs** will be subject to **30 % tax withholding** of all US-sourced payments such as dividends/interests paid by US corporates
- **Operational challenges:** to identify end-investor, to verify as US citizen through chain of intermediaries; new documentation and investor disclosure requirement towards US authorities; change of IT systems
- Applies also to **"pass-through payments"** including those "attributable to" withholdable payments/US sourced income resulting in a wide scope

DODD-FRANK-ACT / VOLCKER / CFTC

US comprehensive rules reforming financial services

Timeline

- **Signed into law** in July 2010; phased implementation
- **Dodd-Frank effective from July 2011; Volcker Rule phased from July 2012**

Key Themes

- **US/non-US investment advisors** need to register with the US SEC if AUM greater than USD $100/25 million respectively attributable to US investors
- **Consequence are stricter record keeping, reporting requirements, oversight and inspection** on eg AUM, capital leverage ratios, counter-party credit risk exposure, trading and investment positions, valuation policies, liquidity and short selling provisions, books and records retention: **Form PF for HFs**
- **US CFTC** regulates swaps; has identified 38 areas divided into 8 sections: swap dealers, clearing, trading, data, products, enforcement, position limits, other
- **Volcker Rule** mandates the segregation of banking and proprietary trading and from sponsoring or investing in AI management functions; leading to spin-offs of proprietary trading desks, HF/PE arms by banks (UK equivalent "Vickers report")
- **Central clearing of OTC derivatives** same concept as European EMIR rules agreed by the G20 in 2009

AIFMD

EU Alternative Investment Fund Managers Directive

Timeline

- **Level 1** Directive in force since July 2011; effective for industry from July 2013
- **Level 2** final delegated regulation adopted in Dec 2012, in force from July 2013

Key Themes

- **Applicable:** to **non-UCITS funds**, including hedge funds, private equity
- **EU domicile:** applicable if the alternative fund (AIF) or manager (AIFM) or investor is domiciled in one of the EU 28 member states or 3 EEA countries
- **Passport:** EU managers can apply for a passport from July 2013 (equivalent concept to UCITS); for non-EU managers from 2015, until then private placement
- **Third-country / marketing rules:** non-EU funds eg domiciled in Cayman, Guernsey, Jersey, Switzerland etc will require prior authorisation in EU
- **Reporting obligation:** regarding investment strategies, risk management, governance, remuneration: disclosure required to both, regulators and investors
- **Delegation:** similar to UCITS/MiFID, but aims to prevent any potential approach by service providers of "outsourcing risk or liabilities"
- **Depositary liability rules outlined below:** a single depositary for each AIF needs to be appointed for all non-UCITS funds; impact on fund economics

UCITS IV / V

EU Mutual Funds

Timeline

- **UCITS IV** in force and mostly implemented by EU 28 member states
- **UCITS V** proposal published in July 2012; target industry effective date end 2014

Key Themes

- **Passport:** in force for management companies
- **Marketing rules / KIID:** Key Investor Information Document will be further standardised + have more information on risk, calculation methodology, charges
- **Master-feeder structures:** a more harmonised approach across Europe may stimulate growth in cross-border pooling and mergers, but tax issues remain
- **"NEWCITS":** HF managers offering more UCITS products since the possible inclusion of **derivatives** tapping into new investor segments + target markets
- **Depositary: new liability rules as in AIFMD** expected spill over into UCITS V whereby depositaries are
  - liable for the loss of financial instruments held in custody
  - have the obligation to return corresponding amount without undue delay
  - only following the return may prove – cumulatively – that the loss is a result of 1) an external event, 2) beyond its reasonable control, 3) the consequence was unavoidable, 4) despite efforts to the contrary

BASEL III

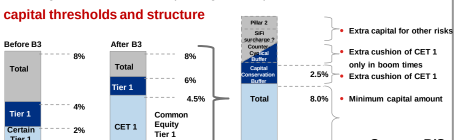
Global Capital Rules for Banks & Insurance

Timeline

- **Banking: G20 -> by end 2012; EU CRD IV**; US Dodd Frank Act provisions
- **Insurance: EU Solvency II by 2015** – similar aim as B3 for insurance sector

Key Themes

- **De-risking/-leveraging:** new global standards designed to strengthen capital and liquidity; stress testing; creating a more robust and resilient banking sector
- **Systemically important financial institutions** (**SIFIs**) to have loss absorbing capacity beyond existing standards; "living-wills" recovery & resolution plan **RRP**
- Higher risk weightings on **derivatives**: 2% against initial margin posted to the **CCP**; clearing members to hold capital against exposure to clients
- **New capital thresholds and structure**



Source: BIS

EMIR

European Market Infrastructure Regulation

Timeline

- **EMIR** entered into force Aug 2012; technical standards in force from March 2013
- **Industry implementation phased from Jan 2013 onwards** (G20 commitment)

Key Themes

- **Central clearing of OTC/ETD derivatives through a CCP** similar to US Dodd-Frank; otherwise capital charges apply; need to **review risk management**
- **Common governance standards for CCPs** and pan-EU requirements for CCP interoperability regarding equities; third country CCPs need to meet new EU standards if used by EU counterparties
- **Increased margin and collateral requirements:** portability and eligibility of collateral not yet finalised, eg required is "highly liquid collateral"
- **Operationally** need to review number and type of collateral relationships with clearing brokers factoring in all risk management aspects & optimization
- **Mandatory daily independent valuation and collateralisation** of those trades that are not cleared through a CCP centrally
- **Trade repositories:** mandatory reporting of all derivative contracts

MiFID/R II

EU Markets in Financial Instruments Directive

Timeline

- **MiFID II** Regulation & Directive proposal published in Oct 2011
- **Industry implementation targeted from 2015 or after**

Key Themes

- **Wider scope in 3 aspects: 1)** new instruments, **2)** venues, **3)** activities; captured will be eg: almost any type of derivatives; organised trading facilities (OTFs), "dark pools"; high frequency / algo / auto trading activities
- **Derivatives on-exchange trading (ETD):** if sufficiently liquid (standardized) derivatives shall be traded on-exchange; then cleared centrally (EMIR)
- **Commodity derivatives** under review re efficient functioning of its hedging and price discovery purpose; potential position limits designed to support liquidity, greater investor transparency through aggregated weekly market breakdown
- **Structured UCITS classified as complex products – marketing impact:** MiFID sales and transparency rules will apply; increased operational complexity
- **Depositary:** now classified as "investment advice" instead of just "ancillary service" under the EU Securities Law Legislation and consequently under MiFID increasing compliance requirements and costs

SHORT SELLING (SSR)

Short Selling Regulation and Credit Default Swaps

Timeline

- Adopted in Sep 2011; effective for industry from **Nov 2012**

Key Themes

- EU regs **ban uncovered sovereign CDS** but member states can suspend rules
- **Covered** short sales require share to be "located" & settlement can be effected
- Ongoing duty to **report net short positions** to regulators (>0.2%) and publicly to market (>0.5%) on named basis plus for each 0.1% increase above the threshold

MAD/R II

EU Market Abuse Directive / Regulation

Timeline

- Proposal published in Oct 2011; possibly effective for industry from **Jan 2015**

Key Themes

- Wider scope: **1)** new instruments, eg OTC & commodity derivatives; **2)** markets, eg MTFs & other venues; **3)** behaviours, eg **attempts** to manipulate the market including manipulation of any benchmark or index eg LIBOR rate-fixing

FTT

Financial Transaction Tax

Timeline

- **France:** effective for industry from **Aug 2012**; other EU countries may follow
- **EU:** issued proposal in Sep 2011 for **Dec 2014**, pan-EU enhanced cooperation

Key Themes

- **0.1%** for transactions in equities (& bonds; **0.01%** of notional derivatives value)
- EU: potential very wide scope: all markets, all instruments, all actors in 'FTT land'