KIRKLAND & ELLIS

Kirkland Alert

Kirkland's UK financial services regulatory team looks ahead

4 February 2019

Introduction

In 2019, firms involved in financial services will once again be subject to global and local regulatory initiatives and reforms. In this update, Kirkland's UK financial services regulatory team has summarised some of the key developments relevant to our clients doing business in Europe. Brexit will continue to dominate the headlines over the coming months, but financial services regulatory developments are expected in a number of diverse policy areas.

The topics covered in this update are listed below and a glossary is included at the end of the update for easier review.

- Brexit
- AIFMD II
- Proposed New Rules on Capital and Remuneration for EU Investment Firms
- The Securitisation Regulation
- The Credit Servicers Directive
- The Fifth Money Laundering Directive
- The EMIR Refit Regulation
- Proposed Sustainability Measures
- Senior Managers and Certification Regime
- Limited Partnership Reforms

Brexit

The departure of the United Kingdom from the European Union is already having a significant impact on the financial services sector. The precise implications for UK firms and firms providing services into the UK on a passported basis remain uncertain. This is especially the case as it is not yet clear what the terms governing the UK's departure will be and/or whether there will be a transitional period from exit day (29 March 2019) allowing for further negotiation of the terms governing the future relationship between the UK and the EU.

In the UK, the Government is engaged in a process to implement EU laws into domestic legislation so that such laws continue to be effective in broadly the same form after exit day. In addition, the proposed temporary permissions and recognition regimes have been designed by the UK Government and regulators to ensure that EU firms passporting into the UK will be able to continue to provide services in the event that the UK leaves the EU without a deal on exit day. The regimes will allow firms to continue with their business while they apply for permission from the UK regulators.

For firms providing services or marketing from the UK into the EU, no equivalent regime has been proposed by EU regulators. Nevertheless, firms are likely to be able to continue to provide certain investor relations and deal-related services into a number of EU jurisdictions without triggering licensing requirements. The precise scope of what is permissible is fact and jurisdiction specific.

At the time of writing, it is still unclear whether:

- the UK will leave the EU on 29 March 2019 without any withdrawal agreement (i.e. a no-deal Brexit);
- the UK will leave the EU with a withdrawal agreement (and transitional period) in place;
- the exit date will be moved to a later one; or
- there is a possibility the UK will not leave the EU at all.

The uncertainty means that firms need to review their arrangements and plan for these possibilities.

AIFMD II

Who needs to think about AIFMD II?

EU alternative investment fund managers ('AIFMs') and any manager that markets alternative investment funds to EU investors and placement agents.

What is AIFMD II and when is it expected to apply?

In March 2018, the European Commission published legislative proposals collectively known as 'AIFMD II'. At the time of writing, these proposals are entering the final stage of the European legislative procedure and we expect the final text to be published soon. The rules are expected to apply from mid-2021.

What are the proposed key changes?

Pre-marketing

The proposals create a number of concerns for the alternative investment funds industry, particularly around the introduction of a new definition of 'pre-marketing' in the legislative text. Under the original proposals, 'pre-marketing' would only have been possible if a fund vehicle had not been established and, even then, the distribution of private placement memoranda or limited partnership agreements (including in draft form) would have been prohibited. The European Council has rejected this approach in favour of one that is closer to that currently adopted by many Member States.

The Council's proposed approach would allow draft offering documents to be circulated to investors, even after the establishment of the fund vehicle, provided it was clear that these documents were subject to change and did not include 'all relevant information allowing investors to take an investment decision'. There is still some ambiguity as to what this would mean in practice, but it would provide greater flexibility than the original Commission proposals.

There is still some way to go in the legislative process but the latest indications are that the Council's view will prevail. If it does, this is likely to be a welcome change to the proposed measures.

Other proposals to note include:

- **notification in advance of pre-marketing**, requiring managers to notify regulators of their intention to pre-market in a particular jurisdiction. This is an area of potential concern, particularly regarding what a pre-marketing notification might entail. There continues to be engagement from industry on this point;
- **deregistration**, allowing for the discontinuation of marketing and the removal of funds from host state national registers (subject to certain conditions related to

investor participation levels, etc.); and

- **fees and charges**, harmonising the basis on which charges are levied by national regulators and increasing the transparency around such charges.

What should sponsors do now?

Sponsors impacted by these proposals should monitor the progress of the draft legislation.

Proposed new rules on capital and remuneration for EU investment firms

Who needs to think about this?

Any clients with an EU-authorised MiFID investment firm in their group. Many sponsors with a presence in the EU have not established AIFMs authorised under the AIFMD, but have instead chosen to set up adviser/arranger firms authorised under MiFID to assist with EU deal sourcing/arranging and fund marketing. It is these investment firms that will be affected by the EU proposals.

What are the new rules and when are they expected to come into force?

The European Commission published legislative proposals in December 2017 to change the rules for EU investment firms regarding regulatory capital and remuneration. The proposals are still going through the EU legislative process, with a view to coming into force at the end of 2019. The overall aim is to ensure that the prudential regime for EU investment firms is appropriately calibrated to the nature of a firm's activities and the systemic risk these pose.

As regards the new proposals on capital, the metrics chosen to measure systemic risk, as currently proposed, will result in some firms having a substantial increase in their capital requirements. This will be particularly relevant to investment firms providing only investment advice and/or arranging deals, which currently have very light capital requirements.

As regards the new remuneration proposals, these include measures limiting bonuses by reference to fixed pay, concerning the deferral and composition of bonuses and requiring the publication of the aggregate pay of senior individuals.

Further detail is provided below.

New capital requirements

Currently, investment firms that carry out a limited set of advising or deal arranging/sourcing activities are subject to a simple, flat regulatory capital requirement. Under the new proposals:

- the regime will become more complex and will take into account different factors, such as risk to clients. Unfortunately, the methods of assessing these factors are not well formulated and include using metrics such as assets under management/assets under advice;
- investment firms will have to hold capital against the amount of client funds they 'control';
- some firms will likely find their capital requirements increasing significantly; and
- there is some uncertainty as to whether (and if so, how) these capital requirements will apply to firms authorised under AIFMD that also have permission to carry on some MiFID activities (so-called collective portfolio management investment or 'CPMI' firms). It is possible that the new capital requirements will not apply to CPMI firms or that the requirements will only apply in respect of the CPMI firm's MiFID activities and not to the firm's business as a whole.

New remuneration requirements

There is growing consensus to introduce a 'bonus cap' (limiting the ratio of variable to fixed remuneration) into the legislation. This is likely to apply to firms with an off-balance and on-balance sheet total of more than €100 million.

There are proposals requiring investment firms to disclose several elements of their remuneration policy to the public. In addition, firms will be required to disclose the aggregate remuneration for senior management and staff whose activities have a material impact on the risk profile of the firm. For smaller firms that employ few such personnel, it could prove challenging to disclose such information without compromising the confidentiality of the individuals concerned.

What is the timing?

It is likely that the final text will not be agreed upon until sometime in 2019. How Brexit will affect the application of these proposals in the UK is currently unclear and will depend on what happens with the negotiations around the UK's exit from the EU.

The Securitisation Regulation

Who needs to think about the Securitisation Regulation?

The Securitisation Regulation places obligations on a range of entities including AIFMs which manage AIFs in the EU ('EU AIFMs').

The Securitisation Regulation is also expressed as applying to AIFMs which market AIFs into the EU. Uncertainty remains as to whether this was intended to include AIFMs established outside of the EU ('non-EU AIFMs') which have registered for marketing under one or more national private placement regimes ('NPPRs') pursuant to Article 42 of the AIFMD. In particular, there are some indications in the text that suggest it should not be so applied. Moreover, Article 42 of the AIFMD did not require non-EU AIFMs marketing pursuant to an NPPR to comply with the risk retention requirement under the AIFMD regime. Given that risk retention is a key part of the Securitisation Regulation, there is considerable uncertainty as to whether the Securitisation Regulation was intended to roll-out the risk retention requirement to non-EU AIFMs. As a result, there has been some uncertainty for securitisation market participants and it is hoped that further clarity will be obtained.

What is the Securitisation Regulation?

The Securitisation Regulation consolidates the pre-existing requirements (spread across a number of EU legislative packages) applicable to EU fund managers, credit institutions and insurance undertakings. It is designed to harmonise existing rules requiring those classes of investor to diligence securitisation positions in order to verify that the originator, sponsor or original lender retains a material net economic interest of not less than 5% in the securitisation before assuming an exposure to such a position.

In-scope institutional investors are required to have processes in place to monitor continued compliance with the risk retention requirement, and the performance of securitisation positions and their underlying exposures. These investors must also in certain cases perform stress tests in relation to securitisation positions and ensure that there is internal reporting to management bodies on the material risks arising from such positions.

What is the impact on non-EU AIFMs?

The primary concern is that if the Securitisation Regulation is interpreted by certain EU regulators as applying to non-EU AIFMs, such AIFMs will be effectively prohibited from investing in securitisation positions that do not meet the EU's risk retention criteria. For example, although there is a similar 5% risk retention rule which applies to US securitisations, the methodology for calculating the 5% risk retention requirement differs between the two jurisdictions. As such, non-EU AIFMs will potentially be restricted from allowing their AIFs to invest in certain US securitisations (such restrictions already apply to EU AIFMs). The scope of what constitutes a 'securitisation' for the purposes of the EU rules may also differ from that of the US.

Non-EU AIFMs with strategies that include investments in securitisation positions which may not comply with the risk retention criteria will need to monitor whether any future guidance is issued as to the applicability of the Securitisation Regulation and consider the approach that they propose to adopt.

The Securitisation Regulation will also:

- directly require originators, original lenders and sponsors to comply with the risk retention requirement for the first time;
- subject originators, sponsors and securitisation special purpose entities to certain ongoing transparency obligations; and
- introduce new criteria for the designation of 'simple, transparent and standardised' or 'STS' securitisations.

When did the provisions of the Securitisation Regulation come into effect?

The Securitisation Regulation applies to securitisations the securities of which are issued on or after 1 January 2019. Certain provisions in the Securitisation Regulation will be supplemented by Regulatory Technical Standards (subordinate legislation), not all of which have been finalised. Some of the provisions in the Securitisation Regulation will be subject to transitional provisions pending the finalisation of the Regulatory Technical Standards.

The Credit Servicers Directive

Who needs to think about the Credit Servicers Directive?

Potentially, any asset or fund manager that participates (or manages funds that participate) in the secondary loan market and acquires (or manages funds that acquire) loans issued by EU credit institutions.

What is the Credit Servicers Directive and when is it expected to come into force?

In March 2018, the European Commission put forward proposals to introduce a new directive with the stated aim of preventing the excessive build-up of non-performing loans ('NPLs') on bank balance sheets, as well as increasing the efficiency of debt recovery procedures through a proposed 'accelerated extrajudicial collateral enforcement' or 'AECE' mechanism. The proposals are at a very early stage, and on current proposals, it is envisaged that Member States transpose the provisions into national law by 31 December 2020, with the requirements becoming applicable from January 2021.

What are the key proposed changes?

Under current proposals, the Directive will apply to credit servicers (see below) and purchasers of credit agreements issued by a credit institution established in the EU. Notwithstanding the purpose of preventing the build-up of NPLs on bank balance sheets, the proposals do not differentiate between performing loans and NPLs to avoid the fragmentation of the secondary market for bank loans with different standards applying to performing loans versus NPLs.

Credit institutions authorised under CRD IV are excluded from the scope of the proposal on the basis that their business involves the issue and servicing of loans. The term 'credit servicer' is defined as persons carrying a wide range of activities on behalf of a creditor, including monitoring the performance of a credit agreement, collecting and managing information on the status of the agreement, informing the borrower of changes in certain terms under the agreement, enforcing the creditor's rights under the agreement and renegotiating terms under the agreement with borrowers (where the person is not a 'credit intermediary' for the purposes of the Mortgage Credit Directive and the Consumer Credit Directive). This wide definition of 'credit servicer' will potentially capture fund and asset managers who participate in the secondary market for bank loans. Under the proposals, credit servicers will be subject to an authorisation requirement, following which they will be subject to ongoing supervision by their regulators. Credit purchasers will not need to be authorised, but those purchasers based outside of the EU will need to appoint an EU-based representative before purchasing loans involving EU borrowers. Significant disclosure obligations will be introduced for creditors (including credit purchasers) who wish to transfer or enforce a loan.

Priorities for industry

The proposal is at an early stage and key aims for the industry include:

- clarifying the types of loans covered so that only NPLs are within scope of the proposals; and
- broadening the exemption for credit institutions so that it covers other types of regulated financial institutions (e.g. alternative investment fund managers, investment firms etc.)

The Fifth Money Laundering Directive

What is MLD5?

The Fifth Money Laundering Directive ('MLD5') amends the Fourth Money Laundering Directive ('MLD4') with the aim of enhancing EU rules on anti-money laundering ('AML') and counter-terrorist financing ('CTF').

When does it come into force?

MLD5 came into force on 9 July 2018 and Member States are required to transpose this directive into national law by 10 January 2020. MLD5 is designed as a minimum harmonising directive, which means that Member States have discretion in some areas to 'gold-plate' the MLD5 provisions and adopt more stringent measures at a national level. For example, to some criticism, the UK Government has opted to 'gold-plate' certain areas in previous MLDs.

Why is it being introduced?

There was a four-year gap between the initial proposal for MLD4 and Member States being required to implement the Directive. During this period, new technologies and products were developed which posed potential risks from an AML and CTF perspective and which were not within the scope of MLD4. Consequently, MLD5 was introduced in response to political pressure to widen the EU's regulatory perimeter for AML and CTF purposes to mitigate the perceived risks of these new technologies and products. More broadly, MLD5 was introduced in response to a political desire to further strengthen AML and CTF laws across the EU in response to recent public interest events such as the revelations in the Panama Papers and terrorist attacks.

What will be the key changes under MLD5?

Some of the key changes under MLD5 are set out below.

- **Due diligence:** imposing stricter due diligence requirements for firms to monitor financial transactions with persons in non-EU countries identified as high risk owing to deficient AML and CTF protections. These countries include: Afghanistan, Bosnia and Herzegovina, Guyana, Iran, Iraq, Syria, Sri Lanka, Trinidad and Tobago, Tunisia, Uganda and Yemen. These requirements include obtaining additional information on customers and beneficial owners, the source of funds and the rationale for a transaction, as well as a requirement to obtain senior management approval to establish or continue certain customer relationships. In reality, firms with more sophisticated due diligence processes may already be applying some or all of these controls, thereby reducing the practical impact of these additional requirements.
- **Beneficial ownership:** expanding the obligation to identify the beneficial owners of corporates and trusts. Importantly, certain corporate ownership information will be made accessible to the general public, whilst trust ownership information will be made accessible to those with a legitimate interest, including the authorities, non-governmental organisations and investigative journalists. These changes are designed to enhance public scrutiny for AML and CTF purposes. The new rules also lower the threshold that indicates beneficial ownership or control regarding certain types of entities that may present a risk of being used for money laundering or tax evasion (known as 'passive non-financial entities').
- **Beneficial ownership registers:** requiring Member States to establish interconnected centralised registers to identify holders and beneficial owners of bank and payment accounts. The aim of this is to facilitate cooperation and information exchange across the EU and assist efficient and effective AML and CTF detection and response. Financial Intelligence Units ('FIUs') and national regulators will be able to access these registers on a 'need-to-know' basis to further promote cooperation and information sharing.
- **FIUs:** expanding FIUs' data access rights in line with Financial Action Task Force ('FATF') standards, so that FIUs can request AML and CTF information from any in-scope firm and directly access information held by those firms even where no suspicious activity report has been made. The aim is that this allows increased proactive intelligence gathering and enforcement by FIUs.
- **Cryptocurrency:** extending the scope of the AML and CTF regime to capture virtual currency exchange platforms and custodial wallet providers, meaning that any such entities will be subject to AML and CTF requirements including requirements to carry out due diligence and report suspicious activity to FIUs.

- **Prepaid cards:** restricting the use of anonymous prepaid cards by introducing spending limits online and in stores, requiring providers to identify the customer in the case of remote payment transactions above a certain limit, and restricting the use of prepaid cards from countries outside of the EU unless the cards meet certain requirements. These changes are designed to prevent the use of prepaid cards in terrorist financing and are likely to have AML and CTF resource implications for firms operating in the prepaid cards industry or those accepting prepaid cards as a payment method.

What's next?

The legal and regulatory landscape in the UK after Brexit remains uncertain, including whether the UK will choose to implement MLD5. However, there are good reasons why the UK may retain a similar, if not identical, AML and CTF regime to that of the EU after Brexit. What is less clear is how information sharing, such as the interconnection of the UK's beneficial ownership register, will be affected by Brexit. Moreover, those firms operating in the EU after Brexit will have to fully comply with MLD5 irrespective of the UK's decision on whether or not to implement MLD5.

Firms do not need to take any immediate action and should already be compliant with MLD4, which was transposed into UK law by the Money Laundering Regulations 2017. Firms are advised to keep track of developments on MLD5 ahead of preparations for the new regime commencing in January 2020.

The EMIR Refit Regulation

Who needs to think about the EMIR Refit Regulation?

All sponsors who participate in the derivative markets.

Where are we now?

As a reminder, the Regulation on OTC derivative transactions, central counterparties and trade repositories (Regulation 648/2012) (known as 'EMIR') imposes a number of requirements on counterparties to derivative contracts (including OTC contracts typically used for hedging purposes such as FX forwards), central counterparties and trade repositories.

EMIR came into force on 16 August 2012, but key requirements have been applied on a rolling basis with some requirements yet to come into effect.

What is the EMIR Refit Regulation?

In 2015, the European Commission carried out an assessment of EMIR. The Commission concluded that there was no need for a fundamental change to the nature of EMIR's core requirements, but it highlighted issues with disproportionate and overly complex requirements for non-financial counterparties ('NFCs'), small financial counterparties ('SFCs') and pension funds. The EMIR Refit Regulation is intended to address these issues. Highlights of the proposals include:

- **SFCs:** a new concept, SFCs, will be exempted from the clearing obligation but will remain subject to the risk mitigation obligations, including the margin requirements. It is proposed that the determination of whether an entity is an FC or an SFC will be made using the same clearing thresholds that apply for NFCs;
- **NFC clearing thresholds:** the current 30-day rolling average determination of positions of an NFC against the clearing thresholds is to be replaced with an annual determination, and an NFC that exceeds the clearing threshold for one asset class will now only be subject to the clearing obligation in respect of that asset class (rather than for all asset classes);
- **reporting obligations**: there are several minor changes still under consideration in respect of the reporting obligation, in particular around which parties will be responsible for the reporting;
- **front loading obligation:** it is expected that the clearing requirement for OTC derivatives contracts entered into (or novated) before the clearing obligation takes effect (where the contracts were entered into after a specified date and have a remaining maturity which is higher than a minimum specified by the European Commission when introducing the clearing obligation) will be removed;
- **risk management and exchange of collateral:** it is proposed that more granular rules around risk management be put in place for those counterparties who are required to exchange collateral, including prior approval of such risk management procedures by European regulators.

What are the recent developments?

There were concerns about the scope of the new measures, in particular the proposal to classify securitised special purpose entities ('SSPEs') as financial counterparties and the proposed text extending the new requirements to a wider group of alternative investment funds ('AIFs'). The latest Council draft removes SSPEs from the definition

of financial counterparty, and in relation to AIFs the extraterritorial drafting has been removed. The latest proposed new definition of financial counterparty would capture EU AIFs (irrespective of the location of the AIFM) and AIFs (irrespective of location) with an EU AIFM, but would not capture a non-EU AIFM of a non-EU AIF that has merely been registered for marketing in the EU.

What's next?

The trialogue process between the European Parliament, the Council of the EU and the European Commission began in the summer of 2018 and the final agreement had been expected during the fourth quarter 2018. However, at the time of writing, the finalised version of the proposed regulations has not yet been published.

Proposed Sustainability Measures

As part of its action plan on sustainable finance, the EU has outlined several legislative proposals with the aim of encouraging capital flows toward the same. The EU defines 'sustainable finance' as finance which includes a strong environmental component that aims to support economic growth whilst reducing pressures on the environment, tackling pollution, minimising waste and improving efficiency in the use of natural resources.

We have highlighted two key proposed initiatives below: the sustainability disclosure; and the introduction of a duty on firms to consider clients' environmental, social and governance ('ESG') preferences.

Who needs to think about sustainability disclosure requirements?

As currently drafted, the draft proposals apply to (amongst others) asset managers and firms which provide portfolio management and investment advisory services.

It is possible that non-EU firms, for example, non-EU AIFMs which market EU/non-EU AIFs to EU investors, may be required to comply with at least some of the proposed rules, particularly where supplemental information relating to sustainability must be added to pre-contractual disclosures made to investors under Article 23 of AIFMD. The extent of the application of the proposed rules is subject to further clarification from the EU.

What are the sustainability disclosure rules at a high level?

The Commission has published draft rules that would require firms to integrate sustainability risks into their investment decision-making, and to disclose certain information relating to sustainability to end-investors. The stated idea is that this will allow end-investors to make what may be perceived to be more informed investment choices.

What are the key requirements with which firms must comply under the sustainability disclosure rules?

Under the proposals, in-scope firms would be required to:

- **publish** on their website written policies on the integration of sustainability risks in their investment decision-making process, and ensure that these are kept up to date; any amendments should be accompanied by a clear explanation of the change on the website; and
- **disclose** in pre-contractual documents descriptions of the following:
  - procedures and conditions applied for integrating sustainability risks in investment decisions;
  - the extent to which sustainability risks are expected to have a material impact on the returns of the financial products made available; and
  - how the remuneration policies of the firm are consistent with the integration of sustainability risks and are in line, where relevant, with the sustainable investment target of the financial product in question.

The method of disclosure will vary depending on how the firm is regulated. The rules state that current regulations applicable to in-scope firms which require pre-investor disclosure should be used and supplemented with the requisite sustainability information.

When will the sustainability disclosure rules apply?

The rules are not yet effective and will undergo review and potential amendment by other EU institutions before they are finalised. Although the EU has not yet confirmed an exact date for their application, it is possible that the final rules could apply from the first quarter of 2020.

In what other ways can the EU's focus on sustainability affect firms' investment activities with their clients?

As part of the EU's aim to further embed sustainability considerations into firms' interactions with their clients, the EU published draft rules in January 2019, applying to (amongst others) firms providing portfolio management and investment advisory services. The draft rules will require in-scope firms to integrate clients' ESG preferences into their overall assessment of clients' investment needs and objectives, such that these ESG preferences guide firms' decisions (as one of a number of factors) as to how they manage and advise on clients' portfolios. Firms will need to consider who they identify as their client for these purposes and the manner in which any new requirements will be addressed. The EU is currently awaiting technical guidance from EU regulatory bodies on the draft rules before these move further through the EU legislative process.

Will there be wider regulatory priority regarding 'green' financial services?

The FCA and PRA have identified the potentially significant impact of climate change and transition to a low-carbon economy on financial markets and products that serve those markets. Both UK regulators have entered into consultation/discussion processes (including, in the FCA's case, publishing a Discussion Paper in October 2018) in this area.

Senior Managers and Certification Regime

Who needs to think about the SMCR extension?

Nearly all FCA-regulated firms. From the end of 2019, the UK Financial Conduct Authority ('FCA') will extend its Senior Managers and Certification Regime ('SMCR') to apply to nearly all firms regulated by the FCA, replacing the existing Approved Persons Regime ('APR').

Why is it being introduced?

Following the financial crisis, the Parliamentary Commission on Banking Standards recommended that a new accountability system that was more focused on senior managers and individual accountability be developed. From those recommendations, the UK regulators established the SMCR to replace the existing APR. The SMCR was first introduced in March 2016 when it applied only to banking firms, and it is now being extended to all authorised firms in the UK.

What are the key changes?

The key changes and new rules introduced by SMCR for firms authorised and regulated by the FCA include:

- **Senior Managers Regime:** persons carrying out certain senior management functions ('SMFs') will require prior approval from the FCA. Each SMF must have an associated 'statement of responsibilities', which sets out the scope of its responsibilities and certain 'prescribed responsibilities' must be allocated to senior managers;
- **Certification Regime:** persons who carry out functions which involve a risk of significant harm to the firm or any of its customers ('Certification Functions') must be certified by authorised firms annually; and
- **Conduct Rules:** this is a general set of rules that will apply to most employees of an authorised firm, including those who are not carrying out SMFs or Certification Functions. The rules will replace the current FCA Statements of Principle and Code of Practice under the APR.

Precisely how SMCR will apply to a firm will depend on whether the firm is classified as a 'Limited Scope', 'Core' or 'Enhanced' firm. 'Core' firms are subject to the baseline SMCR requirements outlined above. 'Limited Scope' firms are firms which hold certain limited FCA permissions (e.g., to perform certain limited defined consumer credit activities); these firms will be subject to a fewer set of requirements than core firms. 'Enhanced' firms are certain large and complex firms that cross certain pre-defined thresholds outlined by the FCA, and which will be subject to certain additional requirements under the SMCR. The FCA expects that only a small percentage of firms will be categorised as enhanced firms.

When does it come into force?

The extension of the SMCR is expected to apply from 9 December 2019. Firms must identify individual staff performing Certification Functions at day one but there is a 12-month implementation period to allow firms to complete their fitness and propriety assessments and to get the certification paperwork in place by 9 December 2020.

What's next?

It would be prudent for firms to start considering how the extension of the SMCR might impact them. In particular, firms may wish to start taking preparatory steps to assist with the implementation of the regime (e.g., identifying personnel falling within scope

with particular attention required for firms structured as limited liability partnerships; considering current job descriptions, allocations of responsibilities and reporting lines; considering existing escalation and review frameworks, etc.).

Limited partnership reforms

Who needs to think about the proposed limited partnership reforms?

Groups with UK limited partnerships ('UKLPs') in their structure.

What are the proposed reforms?

In a consultation in July 2018, the UK Department for Business, Energy & Industrial Strategy ('BEIS') has proposed the following reforms:

- presenters of applications to register a UKLP must demonstrate that they are registered with an AML supervisory body — there will be a list of overseas jurisdictions with 'equivalent standards', as for other similar legislation;
- at the point of registration, and on an ongoing basis, information will be required to ensure that UKLPs keep a sufficient nexus to the UK. A UKLP must: retain the UK principal place of business in its original registration application; demonstrate legitimate business activity at an address in the UK; or (essentially) retain a service process agent that meets the UK AML supervisory body requirement;
- all UKLPs going forwards (not just Scottish LPs) will be required to file annual confirmation statements. Information provided at registration (and then in such annual confirmation statements) will also be expanded to cover a number of new line items. There will be a transition period for all existing UKLPs to provide such additional information. It is also possible (although this is not currently formally proposed) that corporate partners in UKLPs will be required to provide beneficial ownership information (if they do not themselves have a PSC Register);
- the Registrar will have the power to strike off UKLPs which have been dissolved or which the Registrar concludes are not carrying on business or in operation. There will be a robust notification procedure and further consideration will be given to building in a reinstatement process.

At what stage is the consultation?

On 10 December 2018, BEIS published its final response (the 'Final Response') to the July 2018 consultation.

What are the next steps and what can fund sponsors do in the meantime?

In the Final Response, BEIS confirmed that the Government will now develop legislation to give effect to the proposals and mentioned that the Government intended to legislate 'when parliamentary time allows'. There is, therefore, no timetable currently in place for this next step and with the current constraints on parliamentary time, the first draft of the legislation may not be available for some time. In the meantime, Sponsors can take comfort from the fact that the latest proposals appear far less likely to affect migration arrangements and will not require the level of accounting and reporting required of private companies.

AIFM	An alternative investment fund manager
AIFMD	Alternative Investment Funds Managers Directive (2011/61/EU)
AIFMD II	European Commission's proposals to amend the AIFMD
AML	Anti-money laundering
APR	FCA's Approved Persons Regime
BEIS	UK Government's Department for Business, Energy & Industrial Strategy
Brexit	UK's withdrawal from the EU
Certification Functions	functions which involve a risk of significant harm to the firm or any of its customers that must be certified by authorised firms annually
Council or Council of the European Union	one of two chambers of the EU's legislative branch, representing the executive governments of the EU's Member States
CRD IV	Capital Requirements Directive IV, comprising Capital Requirements Directive (2013/36/EU) and Capital Requirements Regulation

	(575/2013)
Credit Servicers Directive	European Commission's proposals to introduce a new Directive to prevent excessive build-up of non-performing loans
CTF	Counter-terrorist financing
Directive	a legal act of the European Union which requires implementation by the Member States
EEA	European Economic Area comprising 31 member states, including the 28 Member States of the EU
EIOPA	European Insurance and Occupational Pensions Authority, an EU financial regulatory institution
EMIR	Regulation on OTC derivative transactions, central counterparties and trade repositories (Regulation 648/2012)
ESMA	European Securities and Markets Authority, a European Union financial regulatory institution
EU	European Union, a political and economic union of 28 member states that are located primarily in Europe
EUWA	European Union (Withdrawal) Act 2018, an act of the Parliament of the United Kingdom that provides for repealing the European Communities Act 1972 and for Parliamentary approval of the withdrawal agreement negotiated between the Government of the United Kingdom and the European Union
European Commission or Commission	Executive body of the European Union, with responsibility for proposing legislation, implementing decisions and upholding treaties
European Parliament	Directly elected parliamentary institution of the European Union, exercising the legislative function of the European Union together with the Council

FATF	Financial Action Task Force, an intergovernmental organisation charged with developing policies to combat money laundering and terrorist financing
FCA	Financial Conduct Authority, a financial regulatory body in the UK with a focus on the regulation of conduct by both retail and wholesale financial services firms
FIU	A financial intelligence unit, a national centre for the receipt and analysis of suspicious transaction reports and other information relevant to money laundering and terrorism financing
Member State	A party to the founding treaties of the European Union
MiFID	Markets in Financial Instruments Directive (2004/39/EC), as subsequently amended by Directive 2008/10/EC
MiFID II	Markets in Financial Instruments Directive (2014/65/EU) accompanied by Markets in Financial Instruments Regulation (600/2014) amending MiFID
MLD4	Fourth Money Laundering Directive ((EU) 2015/849)
MLD5	Fifth Money Laundering Directive ((EU) 2018/843), amending MLD4
NFC	Non-financial counterparty under EMIR
NPPR	National private placement regimes pursuant to Article 42 of the AIFMD
NPL	A non-performing loan
OTC	Over-the-counter or off-exchange traded
PRA	Prudential Regulation Authority, a financial services regulatory body in the UK with a focus on prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms

Regulation	Legal act of the EU that is directly enforceable as law in Member States
Regulatory Technical Standards	so-called level 2 measures adopted by the Commission pursuant to empowerments in Regulations and Directives
Securitisation Regulation	Regulation laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation ((EU) 2017/2402)
SFC	Small financial counterparty under the EMIR Refit Regulation
SMCR	FCA's Senior Managers and Certification Regime
SMFs	Senior management functions for the purposes of the SMCR
SSPEs	Securitised special purpose entities
UK	The United Kingdom
UKLP	UK limited partnership

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Related Services

Practices

- Investment Funds
- Government, Regulatory & Internal Investigations
- International Risk & Investigations

Suggested Reading

- 12 February 2019 Kirkland Seminar Brave Girls, Not Perfect Book Launch — Women in PE Event
- 29 January 2019 Press Release Kirkland Represents Thoma Bravo in Close of Flagship Fund XIII
- 22 January 2019 Award The Legal 500 Asia Pacific 2019

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