

WINTER
2007/2008



WILKINS •
KENNEDY

Chartered Accountants
& Business Advisers

FINANCIAL MARKETS NEWS



RECAP OF ICAAP

Investment firms are now in the final stages of adopting the extensive Internal Capital Adequacy Assessment Process (ICAAP), which comes into force on 1 January 2008. The process is presenting a challenge as there is no "one size fits all" calculation that can be applied across the board. FSA has indicated that the intensity of their review will be proportionate to the size and complexity of the organisations in question. Consequently a number of different approaches will be taken, both by the regulator and those regulated.

The ICAAP requires companies to assess the amount of internal capital they consider adequate to cover all of the risks to which they are, or are likely to be, exposed. It should include a detailed analysis of the various risks identified by the firm itself and the capital allocated to mitigate those risks. The firm will need to explain the interaction between the Pillar 1 minimum regulatory capital requirement and the Pillar 2 ICAAP. FSA can then decide the amount of regulatory capital the firm is required to hold. The regulator is particularly concerned about firms' ability to maintain sufficient risk capital in the event of an economic downturn.

The ICAAP is not just a one-off regulatory return but is an opportunity for the organisation to review its entire governance and risk management framework. Throughout the process, FSA will seek to identify any weaknesses. This will include analysis of:

- A firm's exposure to risk – current and future
- The processes used for identifying, measuring and controlling those risks
- Its capital resources
- Ongoing compliance with standards laid down in the CRD

If a company fails to meet the criteria set, it may be required to set aside significant sums of risk capital. This could have a significant impact on its future competitiveness.

Firms may wish to refer to FSA's material, recently published to assist firms with developing their ICAAP. This can be found at:

www.fsa.gov.uk/pages/about/what/international/basel/info/pil2/index.shtml

If you have any concerns about the ICAAP (and many firms do), then please talk to your professional adviser as soon as possible. Wilkins Kennedy are currently helping firms to interpret the new regulations.



UPDATE ON REGULATORY REPORTING

REPORTING START DATES

FSA has deferred the start dates for some of the new reporting requirements for investment firms scheduled to start from 1 January 2008. They will now come into force from 30 June 2008, with the exception of FSA003 (capital adequacy) and FSA004 (credit risk). This means that firms will continue to submit their "old" returns for the first half of 2008 but will no longer need to submit FSA009 (key data) as it is replaced by FSA003.

The regulator has also brought forward the start date for the data items due to start in 1 January 2009. They will now start from 31 August 2008. This will affect:

- Investment firms that are not subject to the CRD or Markets in Financial Instruments Directive (MiFID). Their new reporting will start from 31 August 2008 and they can stop submitting their "old" reporting then.
- Firms referred to as "Exempt CAD Firms" will start their full new reporting from 31 August 2008. This means that they will not be required to submit FSA043 (key data) from January 2008 and will continue to submit their "old" returns until the new reporting starts.

The FSA has listed the changes in reporting start dates on its website: www.fsa.gov.uk/pages/doing/regulated/returns/irr/dates/summary/index.shtml.



EXTERNAL ASSURANCE ON REGULATORY RETURNS

Inconsistencies have arisen in FSA's rules over which firms are required to have their regulatory returns routinely audited. FSA issued a consultation paper CP07/15, which closed for comments on 17 October. Subject to the responses received, FSA proposes to:

- Remove routine audit of regulatory returns for non-BIPRU investment firms.
- Use routine audit of regulatory returns where the risk is greatest and where it is the most suitable supervisory tool. FSA has identified insurers and credit unions as two sectors for which it intends to retain the requirement.
- Make more use of reports by external auditors and firms' own internal audit function to gain assurance on regulatory returns where there is a perceived risk.

FSA does not intend to remove the client assets audit report because for MiFID firms it is a directive requirement.

AUDIT

The Auditing Practices Board has issued a consultation draft of the revised Practice Note 21, "The Audit of Investment Businesses in the United Kingdom." The most significant change is the inclusion of new guidance on reporting on client assets under SUP3.10. Guidance on reporting to FSA under SUP3.9 has not yet been removed from the draft, but will be excluded from the final version if FSA's proposals in CP07/15 are implemented.

For further information on any of these rule changes, both actual and proposed, please talk to your usual WK contact.



INVESTMENT MANAGER EXEMPTION (IME)

The IME enables non-resident funds and individuals to appoint UK based investment managers without the risk of exposing themselves to UK taxation, providing certain conditions are met. This is recognised as one of the key components of the UK's continuing attraction for investment managers.

Following a period of public consultation, in July this year HMRC revised its earlier guidance on the IME in an updated version of Statement of Practice 1/01. There had been considerable concern in the industry when the original draft revised statement was published in October 2006. The main issues of uncertainty were the criteria used to establish the independence of a manager and a fund, and the customary payment rate for managers. The updated version provides clarification on the issues subject to consultation and reflects developments in the industry.

To qualify for exemption, the following conditions must be met:

- The UK investment manager is in the business of providing investment management services
- The transactions are carried out in the ordinary course of that business
- The investment manager acts in relation to the transactions in an independent capacity

- The requirements of the 20% test are met
- The investment manager receives remuneration for provision of the services at not less than the rate that is customary
- The investment manager is not the non-resident's UK representative in relation to any other income or transaction otherwise chargeable to UK tax for the same period

All of the tests must be met and failure to meet any one of them (other than the 20% test) results in removal of the exemption. However, if the 20% test is not met then the exemption from tax is restricted.

The Government has now announced that legislation will be introduced, with effect from the date that the Finance Bill 2008 receives Royal Assent, to make particular changes that could not be introduced through guidance.

The Pre Budget Report of October this year proposes legislation that will amend the IME legislation to:

- Clarify and simplify the scope of transactions to which the IME applies by aligning more closely to activities regulated by FSA, with certain exclusions
- Provide a more proportionate tax effect for arrangements or transactions where one of the IME conditions is not met, by removing the rule that causes the whole of a non-resident's UK profits to be brought into UK tax if the investment manager carries out any transactions in the capacity of a permanent establishment.

The overall effect of the revised statement of guidance, coupled with the proposed legislation, is to create greater certainty around the planning of funds. There may however be some instances of doubt over whether a fund is trading or not, and professional advice will be required.



VAT UPDATE

HMRC has recently issued a Revenue & Customs Brief (58/07) in response to the ECJ (European Court of Justice) judgment in *JP Morgan Fleming Claverhouse*. This judgment provided that fund management services provided to investment trusts qualify for VAT exemption. The Brief indicated that claims for the refund of VAT on the management of funds other than investment trusts and not specifically exempted under UK law will be refused. It has been argued by some commentators that the ECJ judgment could extend exemption to fund management services supplied to other types of fund, and there is likely to be further litigation in this area.

The European Commission has published proposals for updating the VAT treatment of financial and insurance services. The proposal includes detailed definitions of services - including intermediary services, previously the subject of much litigation - qualifying for VAT exemption, and measures designed to reduce the level of irrecoverable VAT arising on cross-border charges. The principal changes, if approved by Member States, are expected to be implemented in 2009. The proposal also includes plans to allow service providers to opt to tax certain financial transactions in order to improve their VAT recoverability, but these changes are unlikely to be implemented before 2012.

Wilkins Kennedy are ranked within the Top 30 UK accounting firms. Our Financial Markets Group is a multidisciplinary team of industry experts.

Services include:

- Audit and assurance
- FSA capital adequacy and financial reporting
- Management information systems and reporting
- Corporate finance, including mergers and acquisitions
- Financial due diligence
- Forensic accounting and litigation support
- Corporate insolvency and asset recovery
- Compliance and planning: indirect and direct tax services

In the first instance, please speak to Robin Haslam in London (robin.haslam@wilkinskennedy.com) or talk to your usual contact partner.



Chartered Accountants
& Business Advisers

www.wilkinskennedy.com

LONDON

Bridge House, London Bridge, London SE1 9QR
Tel: 020 7403 1877 Fax: 020 7403 1605
E-mail: london@wilkinskennedy.com

AMERSHAM

Risborough House, 38-40 Sycamore Road, Amersham, Bucks HP6 5DZ
Tel: 01494 725544 Fax: 01494 431571
E-mail: amersham@wilkinskennedy.com

CAMBRIDGE

8 Dukes Court, 54-62 Newmarket Road, Cambridge CB5 8DZ
Tel: 01223 301166 Fax: 01223 462054
E-mail: cambridge@wilkinskennedy.com

EGHAM (HEATHROW)

Gladstone House, 77-79 High Street, Egham, Surrey TW20 9HY
Tel: 01784 435561 Fax: 01784 430584
E-mail: egham@wilkinskennedy.com

GUILDFORD

Mount Manor House, 16 The Mount, Guildford, Surrey GU2 4HS
Tel: 01483 306318 Fax: 01483 565384
E-mail: guildford@wilkinskennedy.com

HERTFORD

Cecil House, 52 St Andrew Street, Hertford, Hertfordshire SG14 1JA
Tel: 01992 550847 Fax: 01992 554515
Email: hertford@wilkinskennedy.com

HORSHAM (CORPORATE FINANCE)

6 Kings Court, Harwood Road, Horsham, West Sussex RH13 5UR
Tel: 01403 216690 Fax: 01403 253672
Email: info@wkcorporatefinance.com

ORPINGTON

Greytown House, 221-227 High Street, Orpington, Kent BR6 0NZ
Tel: 01689 827505 Fax: 01689 831478
E-mail: orpington@wilkinskennedy.com

READING

6c Church Street, Reading, Berkshire RG1 2SB
Tel: 0118 9512131 Fax: 0118 9512161
E-mail: reading@wilkinskennedy.com

ROMSEY

3-4 Eastwood Court, Broadwater Road, Romsey SO51 8JJ
Tel: 01794 515441 Fax: 01794 830705
E-mail: romsey@wilkinskennedy.com

SOUTHEND-ON-SEA

1 Nelson Street, Southend-on-Sea, Essex SS1 1EG
Tel: 01702 348646 Fax: 01702 330148
E-mail: southend@wilkinskennedy.com

WINCHESTER

Parmenter House, 57 Tower Street, Winchester SO23 8TD
Tel: 01962 852263 Fax: 01962 841197
E-mail: winchester@wilkinskennedy.com

FALKLAND ISLANDS

Globe Offices, Philomel Street, Stanley, Falkland Islands
Tel: 00500 22918 Fax: 00500 22918
E-mail: falklands@wilkinskennedy.com



A Member of IAPA (International Association of Practising Accountants)



A Member of the European Network

ASSOCIATE OFFICES WORLDWIDE

Registered to carry on audit work and regulated for a range of investment business activities by the Institute of Chartered Accountants in England and Wales.

This newsletter is designed for the information of readers. Whilst every effort has been made to ensure accuracy, information contained in this newsletter may not be comprehensive and recipients should not act upon it without seeking professional advice.