

## Chapter 11

# Collective Portfolio Management Firms and Collective Portfolio Management Investment Firms

## 11.1 INTRODUCTION

### Application

11.1.1

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This chapter applies to:

- (1) a collective portfolio management firm; and
- (2) a collective portfolio management investment firm.

11.1.2

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A *collective portfolio management firm* that manages an *AIF* is an *internally managed AIF* or an *external AIFM*. If the *firm* is a *full-scope UK AIFM* this affects the *firm's base capital resources requirement* (see ■ IPRU-INV 11.3.1R). An *internally managed AIF* that is a *full-scope UK AIFM* is not permitted to engage in activities other than the management of that *AIF*, whereas an *external AIFM* that is a *full-scope UK AIFM* may manage *AIFs* and/or *UCITS*, provided it has *permission* to do so. A *full-scope UK AIFM* that is an *external AIFM* and/or a *UCITS management company* may undertake any of the additional investment activities permitted by article 6(4) of *AIFMD* or article 6(3) of the *UCITS Directive* (as applicable), provided it has *permission* to do so, but if so it is classified as a *collective portfolio management investment firm*, as opposed to a *collective portfolio management firm*.

A *collective portfolio management investment firm* is also subject to the requirements of either (i) *GENPRU* and *BIPRU* or (ii) *IFPRU* in addition to the requirements of ■ IPRU-INV 11, as explained in ■ IPRU-INV 11.6.2G.

11.1.2A

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A *small authorised UK AIFM* that is not also a *UCITS management company* is not a *collective portfolio management firm* or a *collective portfolio management investment firm* and is therefore not subject to ■ IPRU-INV 11. This type of *firm* is subject to ■ IPRU-INV 5 if it is an *investment management firm*, *GENPRU* and *BIPRU* if it is a *BIPRU firm* or *IFPRU* if it is an *IFPRU investment firm*.

### Relevant accounting principles

11.1.3

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- (1) Except where a *rule* makes a different provision, terms in this chapter must have the meaning given to them in the *Companies Act 2006* or the *firm's* accounting framework (usually *UK* generally accepted accounting principles or *IFRS*) where defined in that Act or framework.
- (2) Accounting policies must be the same as those adopted in the *firm's annual report and accounts* and must be consistently applied.

Purpose

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- (1) This chapter amplifies *threshold condition 2D* (Appropriate resources) by providing that a *firm* must meet, on a continuing basis, a minimum capital resources requirement. This chapter also amplifies *Principles 3 and 4* which require a *firm* to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems, and to maintain adequate financial resources by setting out a capital resources requirement for a *firm* according to the *regulated activity* or activities it carries on.
- (2) This chapter also implements relevant requirements of *AIFMD* and the *UCITS Directive*, which includes imposing capital and professional indemnity insurance requirements on a *full-scope UK AIFM* and a *UCITS management company*. *AIFMD* and the *UCITS Directive* incorporate references to provisions of the *Banking Consolidation Directive* and the *Capital Adequacy Directive* in relation to initial capital, own funds and fixed overheads. However, in line with article 163 of the *CRD*, the *Banking Consolidation Directive* and the *Capital Adequacy Directive* are repealed from 1 January 2014 and references to these directives are replaced with references to the *CRD* and the *EU CRR* in line with the correlation table set out in Annex II to the *CRD* and in Annex IV to the *EU CRR*.

## 11.2 MAIN REQUIREMENTS

### Collective portfolio management firm

#### 11.2.1

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A firm must:

- (1) when it first becomes a *collective portfolio management firm* or a *collective portfolio management investment firm*, hold *initial capital* of not less than the applicable *base own funds requirement* (in line with ■ IPRU-INV 11.3.1R);
- (2) at all times, maintain *own funds* which equal or exceed:
  - (a) the higher of:
    - (i) the *funds under management requirement* (in line with ■ IPRU-INV 11.3.2R); and
    - (ii) the amount specified in article 97 of the *EU CRR* (Own funds based on fixed overheads) (as replicated in ■ IPRU-INV 11.3.3AEU)); plus
  - (b) whichever is applicable of:
    - (i) the *professional negligence capital requirement* (in line with ■ IPRU-INV 11.3.11G(1)(a)); or
    - (ii) the *PII capital requirement* (in line with ■ IPRU-INV 11.3.11G(1)(b)); and
- (3) at all times, hold liquid assets (in line with ■ IPRU-INV 11.3.17R) which equal or exceed:
  - (a) the higher of:
    - (i) the *funds under management requirement* (in line with ■ IPRU-INV 11.3.2R) less the *base own funds requirement* (in line with ■ IPRU-INV 11.3.1R); and
    - (ii) the amount specified in article 97 of the *EU CRR* (Own funds based on fixed overheads); plus
  - (b) whichever is applicable of:
    - (i) the *professional negligence capital requirement* (in line with ■ IPRU-INV 11.3.11G(1)(a)); or
    - (ii) the *PII capital requirement* (in line with ■ IPRU-INV 11.3.11G(1)(b)).

[Note: article 9(5) and 9(7) of *AIFMD* and article 7(1)(a)(iii) of the *UCITS Directive*]

**Professional negligence**

11.2.2

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- (1) The *professional negligence capital requirement* applies to a *full-scope UK AIFM* which, in line with ■ IPRU-INV 11.3.11G(1)(a), covers professional liability risks by way of *own funds*.
- (2) The *PII capital requirement* applies to a *full-scope UK AIFM* which, in line with ■ IPRU-INV 11.3.11G(1)(b), decides to cover professional liability risks by professional indemnity insurance.

## 11.3 DETAIL OF MAIN REQUIREMENTS

### Base own funds requirement

11.3.1 **R** The *base own funds requirement* is:

- (1) EUR 125,000 for a *firm* that is a *UCITS management company* or a *full-scope UK AIFM* that is an *external AIFM*; and
- (2) EUR 300,000 for a full-scope UK AIFM that is an *internally managed AIF*.

[Note: article 9(1), (2) and (10) of *AIFMD* and article 7(1)(a) of the *UCITS Directive*]

### Funds under management requirement

11.3.2 **R** The *funds under management requirement* is (subject to a maximum of EUR 10,000,000) the sum of:

- (1) the *base own funds requirement*; plus
- (2) 0.02% of the amount by which the *funds under management* exceed EUR 250,000,000,

[Note: article 9(3) of *AIFMD* and article 7(1)(a)(i) of the *UCITS Directive*]

### Fixed overheads requirement

11.3.3 **R** [deleted]

### Own Funds based on Fixed Overheads

- 11.3.3A **EU**
- (1) In accordance with Articles 95 and 96, an investment firm and firms referred to in point (2)(c) of Article 4(1) that provide the investment services and activities listed in points (2) and (4) of Section A of Annex I to Directive 2004/39/EC shall hold eligible capital of at least one quarter of the fixed overheads of the preceding year.
  - (2) Where there is a change in the business of an investment firm since the preceding year that the competent authority considers to be material, the competent authority may adjust the requirement laid down in paragraph 1.
  - (3) Where an investment firm has not completed business for one year, starting from the day it starts up, an investment firm shall hold

eligible capital of at least one quarter of the fixed overheads projected in its business plan, except where the competent authority requires the business plan to be adjusted.

[Note: article 97(1) to (3) of the *EU CRR*]

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**Professional negligence**

11.3.11 **G** A full-scope UK AIFM should:

- (1) cover the professional liability risks set out in article 12 of the *AIFMD level 2 regulation* (professional liability risks) (as replicated in ■ IPRU-INV 11.3.12EU) by either:
  - (a) maintaining an amount of *own funds* in line with article 14 of the *AIFMD level 2 regulation* (additional own funds) (as replicated in ■ IPRU-INV 11.3.14EU) (the *professional negligence capital requirement*); or
  - (b) holding professional indemnity insurance and maintaining an amount of *own funds* to meet the *PII capital requirement* under article 15 of the *AIFMD level 2 regulation* (professional indemnity insurance) (as replicated in ■ IPRU-INV 11.3.15EU) and ■ IPRU-INV 11.3.16R; and
- (2) comply with the qualitative requirements addressing professional liability risks in article 13 of the *AIFMD level 2 regulation* (qualitative requirements addressing professional liability risks) (as replicated in ■ IPRU-INV 11.3.13EU).

**Professional liability risks**

11.3.12 **EU** (1) The professional liability risks to be covered pursuant to Article 9(7) of Directive 2011/61/EU shall be risks of loss or damage caused by a relevant person through the negligent performance of activities for which the AIFM has legal responsibility.

- (2) Professional liability risks as defined in paragraph 1 shall include, without being limited to, risks of:
  - (a) loss of documents evidencing title of assets of the AIF;
  - (b) misrepresentations or misleading statements made to the AIF or its investors;
  - (c) acts, errors or omissions resulting in a breach of:
    - (i) legal and regulatory obligations;
    - (ii) duty of skill and care towards the AIF and its investors;
    - (iii) fiduciary duties;
    - (iv) obligations of confidentiality;
    - (v) AIF rules or instruments of incorporation;
    - (vi) terms of appointment of the AIFM by the AIF;
  - (d) failure to establish, implement and maintain appropriate procedures to prevent dishonest, fraudulent or malicious acts;
  - (e) improperly carried out valuation of assets or calculation of unit/ share prices;
  - (f) losses arising from business disruption, system failures, failure of transaction processing or process management.
- (3) Professional liability risks shall be covered at all times either through appropriate additional own funds determined in accordance with Article 14 or through appropriate coverage of professional indemnity insurance determined in accordance with Article 15.

[Note: article 12 of the *AIFMD level 2 regulation*]

### Qualitative requirements addressing professional liability risks

11.3.13 EU

- (1) An AIFM shall implement effective internal operational risk management policies and procedures in order to identify, measure, manage and monitor appropriately operational risks including professional liability risks to which the AIFM is or could be reasonably exposed. The operational risk management activities shall be performed independently as part of the risk management policy.
- (2) An AIFM shall set up a historical loss database, in which any operational failures, loss and damage experience shall be recorded. This database shall record, without being limited to, any professional liability risks as referred to in Article 12(2) that have materialised.
- (3) Within the risk management framework the AIFM shall make use of its internal historical loss data and where appropriate of external data, scenario analysis and factors reflecting the business environment and internal control systems.
- (4) Operational risk exposures and loss experience shall be monitored on an ongoing basis and shall be subject to regular internal reporting.
- (5) An AIFM's operational risk management policies and procedures shall be well documented. An AIFM shall have arrangements in place for ensuring compliance with its operational risk management policies



and effective measures for the treatment of non-compliance with these policies. An AIFM shall have procedures in place for taking appropriate corrective action.

- (6) The operational risk management policies and procedures and measurement systems shall be subject to regular review, at least on an annual basis.
- (7) An AIFM shall maintain financial resources adequate to its assessed risk profile.

[Note: article 13 of the *AIFMD level 2 regulation*]

**Additional own funds**

11.3.14 EU

- (1) This Article shall apply to AIFMs that choose to cover professional liability risks through additional own funds.
- (2) The AIFM shall provide additional own funds for covering liability risks arising from professional negligence at least equal to 0,01 % of the value of the portfolios of AIFs managed.

The value of the portfolios of AIFs managed shall be the sum of the absolute value of all assets of all AIFs managed by the AIFM, including assets acquired through use of leverage, whereby derivative instruments shall be valued at their market value.

- (3) The additional own funds requirement referred to in paragraph 2 shall be recalculated at the end of each financial year and the amount of additional own funds shall be adjusted accordingly.

The AIFM shall establish, implement and apply procedures to monitor on an ongoing basis the value of the portfolios of AIFs managed, calculated in accordance with the second subparagraph of paragraph 2. Where, before the annual recalculation referred to in the first subparagraph, the value of the portfolios of AIFs managed increases significantly, the AIFM shall without undue delay recalculate the additional own funds requirement and shall adjust the additional own funds accordingly.

- (4) The competent authority of the home Member State of the AIFM may authorise the AIFM to provide additional own funds lower than the amount referred to in paragraph 2 only if it is satisfied - on the basis of the historical loss data of the AIFM as recorded over an observation period of at least three years prior to the assessment - that the AIFM provides sufficient additional own funds to appropriately cover professional liability risks. The authorised lower amount of additional own funds shall be not less than 0,008 % of the value of the portfolios of AIFs managed by the AIFM.
- (5) The competent authority of the home Member State of the AIFM may request the AIFM to provide additional own funds higher than the amount referred to in paragraph 2 if it is not satisfied that the AIFM has sufficient additional own funds to appropriately cover professional liability risks. The competent authority shall give reasons why it considers that the AIFM's additional own funds are insufficient.

[Note: article 14 of the *AIFMD level 2 regulation*]

**Professional indemnity insurance**

11.3.15 **EU**

- (1) This Article shall apply to AIFMs that choose to cover professional liability risks through professional indemnity insurance.
- (2) The *AIFM* shall take out and maintain at all times professional indemnity insurance that:
  - (a) shall have an initial term of no less than one year;
  - (b) shall have a notice period for cancellation of at least 90 days;
  - (c) shall cover professional liability risks as defined in Article 12(1) and (2);
  - (d) is taken out from an EU or non-EU undertaking authorised to provide professional indemnity insurance, in accordance with Union law or national law;
  - (e) is provided by a third party entity

Any agreed defined excess shall be fully covered by own funds which are in addition to the own funds to be provided in accordance with Article 9(1) and (3) of Directive 2011/61/EU.
- (3) The coverage of the insurance for an individual claim shall be equal to at least 0,7 % of the value of the portfolios of AIFs managed by the AIFM calculated as set out in the second subparagraph of Article 14(2).
- (4) The coverage of the insurance for claims in aggregate per year shall be equal to at least 0,9 % of the value of the portfolios of AIFs managed by the AIFM calculated as set out in the second subparagraph of Article 14(2).
- (5) The AIFM shall review the professional indemnity insurance policy and its compliance with the requirements laid down in this Article at least once a year and in the event of any change which affects the policy's compliance with the requirements in this Article

[Note: article 15 of the *AIFMD level 2 regulation*]

11.3.16 **R**

If a *firm* satisfies the requirement referred to in ■ IPRU-INV 11.3.11G with professional indemnity insurance it must, in addition to maintaining an amount of *own funds* to cover any defined excess, hold adequate *own funds* to cover any exclusions in the insurance policy that would otherwise result in the *firm* having insufficient resources to cover liabilities arising. A *firm* may satisfy its requirements for professional indemnity insurance with a policy that also provides cover to one or more entities other than the *firm*, provided that the policy satisfies the conditions of the *AIFMD level 2 regulation*, exclusive of the cover provided to other entities.

**Liquid assets**

11.3.17 **R**

- For the purposes of this chapter, liquid assets are assets which:
- (1) are readily convertible to cash within one month; and
  - (2) have not been invested in speculative positions.

**11.3.18** **G** Examples of liquid assets that are acceptable under **■ IPRU-INV 11.3.17R** include cash, *readily realisable investments* that are not held for short-term resale, and debtors.

[Note: article 9(8) of *AIFMD*]




**11.4 [DELETED]**

**11.4.1**

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## 11.6 ADDITIONAL REQUIREMENTS FOR COLLECTIVE PORTFOLIO MANAGEMENT INVESTMENT FIRMS

- 11.6.1** **G** A *collective portfolio management investment firm* is required to comply with the applicable requirements of either of the following sourcebooks in addition to complying with ■ IPRU-INV 11:
- (1) *GENPRU* and *BIPRU* if it is a *BIPRU firm*; or
  - (2) *IFPRU* if it is *IFPRU investment firm*.
- 11.6.2** **G**
- (1) A *collective portfolio management investment firm* may undertake the following *MiFID business*: *portfolio management*; investment advice; safekeeping and administration in relation to *shares* or *units* of collective investment undertakings; and (if it is an *AIFM investment firm*) reception and transmission of orders in relation to *financial instruments*.
  - (2) Subject to the conditions that the *firm* is not authorised to provide safekeeping and administration in relation to *shares* or *units* of collective investment undertakings and is not permitted to hold client money or client assets in relation to its *MiFID business* (and for that reason may not place itself in debt with those clients) competent authorities may allow the *firm* to stay on the capital requirements that would be binding on that *firm* as at 31 December 2013 under the *Banking Consolidation Directive* and the *Capital Adequacy Directive* (in line with article 95(2) of the *EU CRR*). The *FCA* has exercised this derogation and, as such, a *firm* meeting those conditions is a *BIPRU firm*. If the above conditions are not met, a *collective portfolio management investment firm* is an *IFPRU investment firm*.
- 11.6.3** **G** A *collective portfolio management investment firm* is required to comply with the applicable requirements of the sourcebooks set out in ■ IPRU-INV 11.6.1G, in parallel with its requirements under ■ IPRU-INV 11. This means that a capital instrument may be used to meet either or both sets of requirements provided it meets the conditions set out in the relevant sourcebook.
- 11.6.4** **G**
- (1) When a *collective portfolio management investment firm* that is a *BIPRU firm* calculates the *credit risk capital requirement* and the

*market risk capital requirement* for the purpose of calculating the variable capital requirement under ■ GENPRU 2.1.40R it must do so only in respect of *designated investment business*. For this purpose, *managing an AIF* or *managing a UCITS* is excluded from *designated investment business*.

- (2) Generally, *BIPRU* only applies to a *collective portfolio management investment firm* that is a *BIPRU firm* in respect of its *designated investment business* (excluding *managing an AIF* and *managing a UCITS*). However, ■ BIPRU 2.2 (Internal capital adequacy standards), ■ BIPRU 2.3 (Interest rate risk in the non-trading book), ■ BIPRU 8 (Group risk - consolidation) and ■ BIPRU 11 (Disclosure) apply to the whole of its business.

**11.6.5**

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- (1) When a *collective portfolio management investment firm* that is an *IFPRU investment firm* calculates the total risk exposure amount in article 92(3) of the *EU CRR*, the *own funds requirements* referred to in article 92(3)(a) (Risk weighted exposure amount for credit risk and dilution risk) and article 92(3)(b) (Risk weighted exposure amount for position risk) should include only those arising from its *designated investment business*. For this purpose, *managing an AIF* or *managing a UCITS* is excluded from *designated investment business*.
- (2) Generally, *IFPRU* only applies to the *designated investment business* (excluding *managing an AIF* and *managing a UCITS*) of a *collective portfolio management investment firm* that is an *IFPRU investment firm*. However, ■ IFPRU 2.2 (Internal capital adequacy standards) and ■ IFPRU 2.3 (Supervisory review and evaluation process: Internal capital adequacy standards) apply to the whole of its business.

## 11.7 CAPITAL REPORTING

### 11.7.1

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The reporting requirements of capital adequacy for a *collective portfolio management firm* and a *collective portfolio management investment firm* are set out in ■ SUP 16.12 (Integrated regulatory reporting). In summary, the relevant capital adequacy forms for its business of *managing an AIF* or *managing a UCITS* are as follows:

- (1) a *collective portfolio management firm* is required to submit FIN066 (and FSA042 if it is a *UCITS firm*);
- (2) a *collective portfolio management investment firm* that is an *IFPRU investment firm* is required to submit FIN067 (and FSA042 if it is a *UCITS investment firm*) and report using COREP; and
- (3) a *collective portfolio management investment firm* that is a *BIPRU firm* is required to submit FIN068 (and FSA042 if it is a *UCITS investment firm*) and FSA003.