
MARCH 2019

# Asset Management and Investment Funds Group

*Legal and Regulatory Update*

## Preparations for a hard-Brexit Continue Ahead of "Meaningful Vote"

As reported in our February update, a number preparations are underway at EU, UK and Irish level for a potential "no-deal" Brexit. With the crucial "meaningful vote" on the withdrawal agreement between the UK and the EU scheduled for March 12, we consider some recent legal and regulatory developments of relevance in the event that the UK leaves the EU without a deal in place.

### CENTRAL BANK UPDATES

Issue 3 of the Central Bank's Markets Update (published on 7 March) contains a number of Brexit related clarifications. These include a Notice of Intention that, in the event of a no-deal Brexit, the Central Bank will consider whether UK UCITS, which will become UK AIFs at that point, should be included as a category of eligible investment for UCITS and retail AIFs. The Central Bank notes that while this is under consideration that it will not adopt a default position that they are ineligible. However, in the case of UCITS, any investment in UK AIFs must fall within with the aggregate limit of 30% for investments in all AIFs.

MiFID investment firms are eligible OTC derivative counterparties for Irish UCITS and retail AIFs. In the event of hard-Brexit, UK authorised investment firms, as non-EU country non-banking entities would not be eligible OTC counterparties for Irish UCITS and/or retail AIFs. Again, the Central Bank will not immediately determine these entities to be ineligible counterparties while it decides whether to include them as an eligible category of OTC derivative counterparty.

The update also clarifies that the Multilateral Memoranda of Understanding that were agreed between European securities regulators and the FCA on 1 February 2019 facilitate delegation or outsourcing arrangements between Irish UCITS Management Companies/AIFMs/MiFID Firms and UK entities.

Additionally, the AIFMD Q&A has been updated to clarify that QIAIFs with UK AIFMs (which become non-EU AIFMs) are subject to the full AIFMD depositary regime including the AIFMD depositary liability provisions (ID #1129).

### OMNIBUS BREXIT LEGISLATION

On 6 March 2019, the Irish Government's omnibus Bill for a no-deal Brexit - the Miscellaneous Provisions (Withdrawal of the United Kingdom from the European Union on 29 March 2019) Bill (the "**Bill**") - was passed by the Irish parliament (Dáil) and will go through the Irish senate (Seanad) in the week commencing 11 March.

The Bill is intended to be consistent with and complementary to the EU's preparations for the UK's withdrawal from the EU. Part 7 of the Bill, which contains 17 parts in all, introduces legislative amendments to support the implementation of the European Commission's temporary equivalence decision with regard to UK authorised central securities depositories (for more information, please see below) and to extend the protections in the Settlement Finality Directive to Irish participants in relevant non-EU country domiciled settlement systems (for more information please see our recent Derivatives Group briefing here).

### DATA PROTECTION COMMISSION'S GUIDANCE ON DATA TRANSFERS

On 8 February, the Data Protection Commission published guidance on transfers of personal data from Ireland to the UK in the event of a 'No-Deal' Brexit'. The guidance includes information on the extra measures that can be put in place to legally transfer personal data to the UK in the event the UK becomes a non-EU country.

### RECOGNITION OF UK ENTITIES BY ESMA

The European Commission's temporary equivalence decision ("**Decision**") under Article 25 of the Central Securities Depositories Regulation (EU/2014/909) in respect of UK authorised central securities depositories (CSDs) entered into force on 20 December 2018. Without this Decision, in the event of a hard-Brexit there would have been significant disruption to the Irish securities market as most trades in Irish securities are settled in the UK. The adoption of the Decision and the agreement of a Memorandum of Understanding between ESMA and the Bank of England, means that UK CSDs can apply to ESMA for recognition as a third country CSD.

On 1 March, ESMA confirmed that in the event of a "no-deal" Brexit, that *Euroclear UK and Ireland Limited* is recognised to provide its services as a CSD in the EU.

ESMA has also recognised three UK established central clearing counterparties ("CCPs) as third country CCPs under EMIR. In the event of a hard-Brexit *LCH Limited*, *ICE Clear Europe Limited* and *LME Clear Limited* may provide their services in the EU.

In addition, ESMA has also registered *DTCC Data Repository (Ireland) PLC* as a trade repository under EMIR with effect from 1 March 2019.

## EMIR Reporting and Funds: Central Bank Outlines its Expectations for Compliance

The European Market Infrastructure Regulation (EU/648/2012) ("**EMIR**") imposes, amongst other obligations, a reporting requirement on financial and non-financial counterparties, including investment funds (both UCITS and AIFs) that transact derivatives. The reporting obligation means that information on trades must be reported to a trade repository by the end of the working day following the conclusion, modification or termination of the derivative contract. A counterparty may delegate this reporting task to the trade counterparty or a third party, but the responsibility to report cannot be delegated.

In Ireland, the Central Bank is responsible for supervising EMIR compliance and in 2018 it conducted a quality review on reported EMIR data across a cross-section of counterparties. Following this review, the Central Bank has written (20 February) to the boards of counterparties, including investment fund boards, to remind them of their EMIR reporting obligations and to highlight certain deficiencies that were identified during this exercise. Although the Central Bank acknowledges in its letter that the standard of reporting is improving, it notes that significant issues remain and has also set out a number of recommendations for counterparties to address these issues. Further, the Central Bank expects boards to include "EMIR Reporting" as a standing agenda item for all board meetings and is reminding counterparties that failure to comply with the EMIR reporting requirements is a prescribed contravention, which may result in the Central Bank taking supervisory or enforcement action.

The Central Bank's findings highlight issues in relation to delegated reporting, the completeness and accuracy of trade reporting, legal entity identifiers and unique trade identifiers. Some of the key issues and Central Bank recommendations for all counterparties, including investment funds, are set out below:

### DELEGATED REPORTING

#### *Identified Issues*

The Central Bank noted several instances where, having delegated EMIR reporting, counterparties did not take appropriate steps to ensure compliance with the reporting requirements. As noted above, the responsibility for reporting cannot be delegated and so counterparties remain responsible for ensuring that all required information is reported accurately and in a timely manner to the trade repository.

The Central Bank also identified instances where counterparties were not aware of rejection reports or their contents and so were not in a position to ensure that remedial action could be taken to rectify the issues giving rise to rejection. Therefore, they could not verify that their reporting obligation had been met.

#### *Recommendations*

Counterparties should:

» ensure that regular reports are received from the delegate to include details of rejection reports;

» reconcile data reported by the trade repository to the delegate with its own internal systems to ensure that all relevant trading has been reported;

» regularly review rejection reports to ensure all trade submissions are successfully reported to a trade repository, ensure revised correct data submissions are made on a timely basis, and remedial action is taken to eliminate rejected reports in the future; and

» undertake remedial action to address any deficiencies and non-compliance with the EMIR reporting requirements.

If a fund does not delegate reporting to its counterparty, it should still liaise with the counterparty to ensure the consistency of the contents of each report.

### COMPLETENESS AND ACCURACY OF TRADE REPORTING

*Issues Identified*

The Central Bank identified a number of recurring issues in this regard primarily relating to valuations, collateral and outstanding and expired/matured contracts. These issues include the failure to report daily valuation updates; failure to report details of collateral received/posted with respect to trades; and failure to reflect that expired/matured trades are no longer outstanding, resulting in these contracts remaining outstanding indefinitely with the trade repository.

*Recommendations*

Counterparties should:

» regularly review the accuracy and completeness of reports;

» submit daily valuations for all outstanding trades/positions; and

» submit data on collateral held/posted for all outstanding trades/positions.

### LEGAL ENTITY IDENTIFIERS

All trade reports must include a Legal Entity Identifier ("**LEI**") (where the counterparty is a legal entity) and the Central Bank recommends that:

» counterparties share details of their LEI with any entity with which they trades or to which they have delegated reporting;

» all reviews of trade repository data (whether by the counterparty or its delegate) should confirm that the counterparty is correctly identified with its LEI; and

» LEIs should be reviewed annually as lapsed LEIs are invalid for reporting purposes.

### UNIQUE TRADE IDENTIFIERS

Under EMIR a Unique Trade Identifier ("**UTI**") must be generated and agreed between the counterparties. The Central Bank recommends that:

» counterparties should ensure that a UTI is applied to all individual trades and that it is communicated to all relevant parties in advance of the trade being reported to the trade repository; and

» where responsibility for generating the UTI is delegated, the counterparty must ensure that it is advised of the UTI in a timely manner. The counterparty must also be aware of how it can be deemed unique.

Fund boards should now review their EMIR reporting arrangements to ensure compliance with the requirements and add EMIR reporting as a standing agenda item to be discussed at all board meetings. Funds and their managers should also be aware of the changes that the EMIR REFIT Regulation will introduce with regard to the reporting obligation. This regulation will amend EMIR to provide that where an OTC derivative transaction is entered into by a UCITS, its management company is responsible for meeting the reporting obligation and ensuring the accuracy of the reports. An AIFM will be similarly responsible where the OTC derivative contract is entered into by an AIF.

## Regulatory Statements on EMIR Clearing Obligation of Small Financial Counterparties

On 21 June 2019 the EMIR clearing obligation for category 3 financial counterparties is due to take effect. Category 3 financial counterparties are those financial counterparties whose aggregate month-end average of outstanding gross notional amount of non-centrally cleared derivatives is equal to or below the clearing threshold of €8 billion. Therefore, although they may have a limited clearing volume, UCITS and AIFs in this category would be required to start CCP clearing some of their OTC derivative contracts.

However, proposed amendments to EMIR, (known as EMIR REFIT), will create a category of financial counterparties whose derivative positions are below the clearing thresholds1 and exempt these small financial counterparties from the clearing obligation. The clearing threshold for this exemption is €1 billion in gross notional value for credit and equity derivatives contracts, and €3 billion for interest rate, foreign exchange, commodity and other OTC derivative contracts. Should EMIR REFIT not come into force before 21 June 2019, certain small financial counterparties whose derivative positions are below the EMIR REFIT clearing thresholds would still have to comply with the EMIR clearing (and MiFIR trading) obligations (for further information on these requirements and on EMIR REFIT, please see our Derivatives Group briefing here).

On 31 January 2019, ESMA issued a public statement noting the challenges that certain small financial counterparties would face to prepare for the 21 June 2019 deadline and stated that although neither ESMA nor national competent authorities ("**NCAs**"), such as the Central Bank, have power to dis-apply legislation such as EMIR or delay the onset of its obligations, ESMA expects NCAs not to prioritise their supervisory actions towards the clearing obligation to be imposed on affected small financial counterparties who will subsequently be outside the scope of the clearing obligation once EMIR REFIT comes into force, and to generally apply

their risk-based supervisory powers in their day-to-day enforcement of this framework in a proportionate manner. On 4 February the Central Bank confirmed that it would apply its risk-based supervisory powers in the manner suggested in ESMA's statement.

## ESMA's 2019 Supervisory Convergence Work Programme

On 6 February 2019, ESMA published its supervisory convergence work programme for the coming year. Unsurprisingly, supervisory convergence measures in the context of Brexit remain at the forefront of ESMA's priorities. From an investment management perspective, ESMA's key supervisory convergence objectives and outputs for 2019 will focus on:

- performance fees;
- closet indexing;
- liquidity stress testing and leverage;
- money market funds; and
- developing and reviewing ESMA's AIFMD and UCITS Q&As.

ESMA's over-arching identified priorities are:

- safeguarding the free movement of services in the EU through adequate investor protection in the context of cross-border provision of services;
- fostering supervisory convergence in the field of financial innovation;
- making data and its use more robust and consistent by developing and further clarifying reporting methodologies and providing guidance to ensure complete and high-quality data; and
- driving forward consistency in the application of the Markets in Financial Instruments Directive and Regulation (MiFID II/MiFIR) and reaching a common understanding on related supervisory challenges.

## Anti-Money Laundering Update

The Department of Justice and Equality has published the General Scheme of the Criminal Justice (Money Laundering and Terrorist Financing) (Amendment) Bill 2019. This bill will transpose the requirements of the 5th EU Money Laundering Directive ("**5MLD**") into Irish Law. 5MLD extends the deadlines for the establishment by Member States of central registers of beneficial ownership to 10 January 2020 for corporates and 10 March 2020 for trusts. It also provides for public access to the central corporate register; while access to the central trust register will be limited to those persons that can demonstrate a legitimate interest.