

BRIEFING

Asset Management and Investment Funds Legal and Regulatory Update February 2020

February 2020

Welcome to the latest edition of our Asset Management and Investment Funds Legal and Regulatory Update.



Kevin Murphy
+353 1 920 1177
kevin.murphy@arthurcox.com



Tara O'Reilly
+353 1 920 1787
tara.oreilly@arthurcox.com



Sarah Cunniff
+353 1 920 1171
sarah.cunniff@arthurcox.com



This issue includes updates on the Central Bank's thematic review of liquidity risk management in UCITS, its updated Q&A on investment by UCITS in certain instruments, the extension of the deadline for money market funds quarterly reporting, ESMA's sustainable finance strategy and some open consultations of interest.

If you would like to discuss any of the topics covered, please feel free to contact a member of our team.

UCITS Liquidity Risk Management – Thematic Reviews Underway

Liquidity risk management is a key supervisory priority for both ESMA and the Central Bank this year. On 30 January [ESMA announced](#) that it would be undertaking a common supervisory action, essentially a coordinated themed review, with national regulators throughout 2020 in respect of liquidity risk management in UCITS.

This thematic review is a two-stage process that will be carried out by national regulators so, in Ireland, the Central Bank. In stage one of the review regulators will request quantitative data from a large majority of the UCITS managers (based in their respective Member States) to get an overview of the supervisory risks faced. In the second stage, regulators will focus on a sample of UCITS managers and UCITS to carry out more in-depth supervisory analyses.

On 6 February the Central Bank commenced the first stage of the thematic review by emailing Irish UCITS fund management companies in connection with the completion and submission of a questionnaire to the Central Bank. The questionnaire must be submitted as an online return on the Online Reporting System (“**ONR**”) and the submission of data by any other means will not be accepted by the Central Bank. Information must be provided on all UCITS under management by the fund management company, including non-Irish domiciled UCITS where relevant. Although the questionnaire is not currently available for completion on the ONR system, the Central Bank provided fund management companies with a copy of the questionnaire so that they can begin preparing their responses to ensure a timely submission once the reporting window opens. It is expected that the questionnaire will be available for completion online in March with fund management companies then having about three weeks to complete the return. The Central Bank will contact fund management companies directly when the ONR return is open for submission. The board of directors of each UCITS fund management company is responsible for ensuring that processes are put in place to ensure that the fund management company is in a position to complete and submit the questionnaire on the ONR system in the timeframe provided.

For more information on the steps that funds and fund management companies can take to prepare for a possible thematic review, please see our [previous briefing](#).

Central Bank to Scrutinise Suitability of Certain Investments by UCITS

On 29 January 2020, the Central Bank issued an [updated UCITS Q&A](#) to include a new question and answer (#ID 1094) outlining the Central Bank's approach regarding investment by a UCITS in Contracts for Difference (CFDs), Collateralised Loan Obligations (CLOs), Contingent Convertible Securities (CoCos), and Binary Options. The Central Bank has stated that a UCITS that intends to invest in these types of investments may be subject to enhanced scrutiny at the authorisation phase to ensure that the proposal is appropriate in the context of the overall portfolio of assets.

The Q&A highlights that as a retail product, the UCITS framework has requirements designed to support investor protection, including (amongst others) rules on: eligible assets; diversification; liquidity; and risk management and that a UCITS must ensure that it is in compliance with these requirements. The Q&A states that regard should be had to the requirements set out in Regulation 69 (risk management process) and Schedule 9 of the UCITS Regulations 2011, when formulating the investment objective and strategy of a UCITS.

Management companies are also reminded of their requirements under Schedule 5 of the UCITS Regulations 2011 regarding the analyses they should conduct on the proposed investment's contribution to the portfolio composition, liquidity, and risk and reward profile of

Dara Harrington
+353 1 920 1206
dara.harrington@arthurcox.com



Cormac Commins
+353 1 920 1786
cormac.commins@arthurcox.com



Ian Dillon
+353 1 920 1788
ian.dillon@arthurcox.com



Siobhán McBean
+353 1 920 1052
siobhan.mcbean@arthurcox.com



Audrey Giles
+353 1 920 1895
Audrey.Giles@arthurcox.com

the UCITS before making the investment.

The Central Bank may subject a UCITS to enhanced scrutiny at the authorisation stage to ensure that the proposal to invest in these types of assets is appropriate, taking into account the overall portfolio of assets. Such enhanced scrutiny may include review of:

- model portfolio information;
- the due diligence carried out in respect of the proposed underlying portfolio; and
- evidence to support the view that the proposed investment portfolio is suitable taking into account the above-mentioned requirements.

All information required to be submitted to the Central Bank should be sufficiently detailed to enable the Central Bank to make an informed judgement regarding the particular application involved.

The Q&A does not prohibit investment by a UCITS in these instruments, but fund management companies (including self-managed UCITS) should ensure that they have conducted appropriate due diligence on the proposed investment and the impact it may have on the fund's overall profile, in advance of seeking approval of a UCITS that intends to invest in them.

Fund management companies should also ensure that sufficient information on the nature of these investments (including details about their liquidity) is included in the investment approach memorandum, which is provided to the board for consideration and approval of the launch of the sub-fund.

Existing UCITS funds should also ensure that any investment in, and the risk associated with these types of instruments has been duly considered in light of this Q&A and that evidence of the suitability of the investment can be provided, if required.

If you would like to discuss the foregoing, or require any assistance in assessing your requirements please feel free to contact a member of our team.

EFAMA Report on Fund Liquidity Risk Management

EFAMA has published a [report on Managing Fund Liquidity Risk](#). It is an update to its previous 2016 report and focuses on EU legislation and fund structures.

The purpose of the report is to outline the practical liquidity risk management processes which fund management companies should put in place when establishing a fund and implement throughout the life of the fund. It also provides an overview of the existing European and international regulatory frameworks in the area of fund liquidity risk management. This regulatory framework has been further enhanced since 2016, particularly following the adoption of new rules and standards such as the [Money Market Funds Regulation](#) (2017), [IOSCO's Recommendations on Liquidity Risk Management for Collective Investment Schemes](#) (2018), and [ESMA's Guidelines on Liquidity Stress Testing in UCITS, AIFs and MMFs](#) (2019).

In its press release, EFAMA stated that the report is an opportunity to highlight that the UCITS regulatory framework clearly states that there should be "no presumption of liquidity for listed securities" and that "it allows national competent authorities to oversee where hitherto unlisted securities held by a UCITS fund may be listed". The report also describes how this new comprehensive framework has been tested under various market conditions and scenarios in a number of recent publications, which show that, overall, most AIFs and UCITS do not have significant liquidity mismatches and that a one-size-fits-all approach must therefore be avoided.

The report also includes four recommendations:

- focus on supervision and enforcement of the current comprehensive EU rules;
- make all IOSCO-suggested liquidity management tools available across the EU;
- improve transparency and managers' knowledge of end-investors, to enhance liquidity

Dublin

+353 1 920 1000
dublin@arthurcox.com

Belfast

+44 28 9023 0007
belfast@arthurcox.com

London

+44 207 832 0200
london@arthurcox.com

New York

+1 212 782 3294
newyork@arthurcox.com

San Francisco

+1 415 829 4247
sanfrancisco@arthurcox.com

arthurcox.com

- stress testing and ease the management of potential redemption shocks; and
- enhance market liquidity for corporate bonds and small and mid-cap stocks.

For more information on ESMA's liquidity stress testing guidelines, please see our [previous briefing](#).

Central Bank Extends Money Market Funds Reporting Deadline

Under the Money Market Funds Regulation, money market fund ("MMF") managers must report certain information to their national regulator on at least on a quarterly basis. The frequency of reporting is annual in the case of a MMF whose total assets under management does not exceed €100 million.

The information to be reported includes:

- general characteristics, identification of the MMF and the MMF manager;
- type of MMF;
- portfolio indicators (NAV, WAL, WAM, liquidity indicators etc.);
- results of stress tests; and
- information on assets/liabilities.

The first quarterly reports were due to be submitted to the Central Bank in April 2020. However, the Central Bank is deferring the deadline for the receipt of quarter one information until July 2020 as more time is needed to prepare the reporting infrastructure. Therefore, in July 2020 both the Q1 and Q2 reports will need to be submitted.

For more information on MMF stress testing and reporting requirements, please see our [previous briefing](#).

Brexit: FCA Statement on Transition Period

On 31 January 2020, the UK left the EU and entered into a transition period, which is due to end on 31 December 2020. The FCA subsequently issued a [statement](#) noting that during this transition period, EU law will continue to apply in the UK and firms and funds will continue to benefit from passporting between the UK and EEA. Consumer rights and protections derived from EU law will also remain in place.

The notification window for the Temporary Permissions Regime closed on 30 January and the FCA requires no further action at this stage from firms and fund managers that have already submitted a notification. The FCA will confirm its plans for reopening the notification window later this year, which would allow additional notifications to be made by firms and fund managers before the end of the transition period.

Sustainable Finance: ESMA Launches its Strategy

On 6 February, ESMA published its [strategy](#) on Sustainable Finance. The key priorities for ESMA include transparency obligations, risk analysis on green bonds, ESG investing, convergence of national supervisory practices on ESG factors, taxonomy, and supervision. As part of its strategy ESMA will prioritise:

- completing the regulatory framework on transparency obligations via the Disclosures Regulation;
- pursuing convergence of national supervisory practices on ESG factors with a focus on mitigating the risk of greenwashing, preventing mis-selling practices, and fostering transparency and reliability in the reporting of non-financial information;
- reporting on trends, risks and vulnerabilities (TRV) of sustainable finance by including a dedicated chapter in its TRV Report, including indicators related to green bonds, ESG investing, and emission allowance trading;
- using the data at its disposal to analyse financial risks from climate change, including potentially climate-related stress testing in different market segments;

Dublin

+353 1 920 1000
dublin@arthurcox.com

Belfast

+44 28 9023 0007
belfast@arthurcox.com

London

+44 207 832 0200
london@arthurcox.com

New York

+1 212 782 3294
newyork@arthurcox.com

San Francisco

+1 415 829 4247
sanfrancisco@arthurcox.com

- participating in the EU Platform on Sustainable Finance that will develop and maintain the EU taxonomy and monitor capital flows to sustainable finance; and
- ensuring ESG guidelines are adhered to in the entities that ESMA supervises directly, while being ready to accept any new supervisory mandates related to sustainable finance.

Settlement: Migration of Participating Securities Act 2019

Brexit means that, following the end of a transitional period, Irish securities market participants will no longer be able to access CREST. Euroclear Belgium has been chosen as the replacement settlement system and the migration of securities from CREST to the new system must be completed and be fully operational by March 2021. The legislation to facilitate this transition from CREST, the [Migration of Participating Securities Act 2019](#), was signed into law on 26 December 2019 and commenced on 29 January 2020.

The legislation provides an alternative mechanism for issuers to migrate securities to Euroclear Belgium rather than by way of a scheme of arrangement under the Companies Act 2014. The legislation is of particular relevance for Irish ETFs, however many of these funds may have already taken action to convert to an international central securities depository (ICSD) settlement model in advance of the legislation being enacted.

Central Bank Issues “Dear CEO” Letter re Securities Market Conduct Risk

The Central Bank has issued a “[Dear CEO](#)” letter to investment firms arising from its supervisory work in 2019 with regard to wholesale market conduct risk. This included a thematic review of regulated entities’ effectiveness in identifying and assessing such risk. As part of this exercise, the Central Bank engaged directly with 24 regulated entities, conducted on-site inspections of 10 regulated entities and visited branches of Irish entities in other jurisdictions. Central Bank supervisors conducted over 150 interviews of directors and CEOs, risk and compliance officers and frontline staff and the Central Bank continues to engage with relevant entities in relation to identified deficiencies. The key findings from the review and the Central Bank’s expectations in this respect are set out in the appendix to the letter. The key findings include: inadequate market conduct risk frameworks; inadequate governance of market conduct risk, including poor governance in the context of the Fitness and Probity regime; and a failure to identify the risk of market abuse. The communication should be brought to the attention of the board at its next meeting and issuers to whom the letter is addressed should focus on the relevant concerns expressed regarding the failure to identify market abuse risk.

For more information, please see our [Financial Regulation team’s article](#).

Consultations

Open consultations of interest include:

AML: The European Banking Authority (“**EBA**”) is consulting on revisions to the AML/CFT Risk Factor Guidelines (“**Guidelines**”). The Guidelines apply to financial institutions, including investment funds, and set out the factors that these firms should consider when assessing the money laundering (“**ML**”) and terrorist financing (“**TF**”) risk. The proposed revisions provide more details on terrorist financing risk factors and customer due diligence measures, and also set clear regulatory expectations for firms’ business-wide and individual ML/TF assessments. The consultation will close on **5 May 2020**.

MiFID II/MiFIR: ESMA is consulting on draft technical standards on the provision of investment services and activities in the EU by third-country firms under MiFID II and MiFIR. The consultation will be of most interest to third-country firms providing investment services and activities in the EU either on a cross-border basis, or through a branch in accordance with MiFID II. The consultation is requesting input on proposed additional reporting requirements, format details and draft technical standards and will close on **31 March 2020**.