Asset Management and Investment Funds Legal and Regulatory Update October 2020

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

15/10/2020 Briefing

In this issue we consider the introduction of the new PCF-39 roles aligned to the CP86 managerial functions; the Central Bank's new AIFMD and UCITS Q&A on liquidity stress testing reporting; the ILP (Amendment) Bill 2020, recent Brexit statements and some AML and sustainable finance updates.

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

Central Bank Confirms Creation of Six PCF Roles Aligned to CP86 Managerial Functions

In February 2020, the Central Bank published a notice of intention to remove the existing Designated Person ("**DP**") pre-approval controlled function ("**PCF-39**") and replace it with six new pre-approval controlled functions ("**PCF**"), each aligned to the specific managerial functions set out in the Central Bank's Fund Management Company Guidance (commonly referred to as "**CP86**"). The Central Bank has now published the Central Bank Reform Act 2010 (Sections 20 and 22) (Amendment) Regulations 2020 (the "**Amending Regulations**") designating the new DP roles, which are:

PCF-39A DP with responsibility for Capital and Financial Management.

PCF-39B DP with responsibility for Operational Risk Management.

PCF-39C DP with responsibility for Fund Risk Management.

PCF-39D DP with responsibility for Investment Management.

PCF-39E DP with responsibility for Distribution.

PCF-39F DP with responsibility for Regulatory Compliance.

In the associated FAQs, the Central Bank has clarified that DPs in situ on 5 October 2020 (the effective date of the Amending Regulations) are not required to seek the approval of the Central Bank to continue to perform one of the new PCF roles. Funds/fund management companies will be required to submit a list of the individuals performing each of the newly designated PCF 39 A-F roles via an "In Situ return" to the Central Bank. The Central Bank notes that this process will commence after the Amending Regulations 2020 come into effect and a period of six weeks will be provided to submit the In Situ return. If the individual

preforming the role changes after the new DP roles have been introduced, he/she will be required to seek the Central Bank's prior approval in writing to that appointment by means of a new Individual Questionnaire.

Three new categories of PCF have also been introduced, one of which PCF 49: Chief Information Officer may be relevant to certain fund management companies. The Central Bank expects that the Chief Information Officer role would likely apply where the firm's PRISM impact rating is high or medium high, or if IT is a key enabler or core element of their business model. The FAQs provide additional information on this assessment.

Liquidity Stress Testing – Central Bank Updated AIFMD and UCITS Q&As

As previously reported, in July 2020 the Central Bank published a notice of intention regarding ESMA's Guidelines on liquidity stress testing in UCITS and AIFs (the "**Guidelines**"). The Central Bank intends to consult on the incorporation of a requirement in the Central Bank UCITS Regulations 2019 and the AIF Rulebook that UCITS management companies, AIFMs and depositaries adhere to the Guidelines. However, the Central Bank has stated that in the interim it expects full compliance with the Guidelines from 30 September 2020.

Under the Guidelines, fund management companies must notify their national regulators of material risks and actions taken to address them. On 9 October, the Central Bank updated its AIFMD and UCITS Q&As to set out its expectations regarding these notifications. The Central Bank has clarified that notification of material risks in accordance with the Guidelines is a two-stage process as follows:

Initial notification: the Central Bank requires that it be immediately informed via an ONR IF Regulatory Report if a stress test performed reveals a material risk.

Subsequent notification: in addition to the initial notification, where a stress test reveals a material risk, the manager should draw up an extensive report with the results of the stress testing and a proposed action plan. Where necessary, the fund management company should take action to strengthen the robustness of the AIF/UCITS including actions that reinforce the liquidity or the quality of the assets of the AIF/UCITS. The fund management company must again immediately inform the Central Bank via an ONR IF Regulatory report of the measures taken, to include the extensive report and the action plan.

Investment Limited Partnerships (Amendment) Bill 2020

In June 2019, the then Irish government introduced a bill to amend and update the existing legislation governing investment limited partnerships in Ireland. That bill lapsed on the dissolution of the previous government. On 21 September 2020, the Minister for Finance announced the publication of the Investment Limited Partnerships (Amendment) Bill 2020 (the "**ILP Bill**") which, once enacted, will modernise the Irish investment limited partnership ("**ILP**") structure and bring it in line with comparable partnership vehicles in other leading jurisdictions.

The ILP Bill will also make technical amendments to the ICAV Act 2015 ("**ICAV Act**") to enhance the efficiency of the ICAV structure and to align the ICAV Act with certain provisions of the Companies Act 2014. In addition, the ILP Bill extends the beneficial ownership requirements applicable to corporate and unit trust fund structures to ILPs and common contractual funds.

The ILP Bill has commenced the legislative process, having been introduced in the Seanad (the upper house of the Irish Parliament) on 23 September 2020. Before entering into law, the ILP Bill will be subject to various stages of review and approval by the Irish parliament, but it is hoped that the legislation will be approved in the coming months.

For more information on some of the key provisions of the Bill, please see our detailed briefing here.

Brexit Statements

TPR Notification Window Re-opens

On 30 September the FCA announced that the notification window under Temporary Permissions Regime ("**TPR**") had re-opened. Accordingly, firms and fund managers that have not yet notified to enter the TPR can do so before the end of the transition period (31 December 2020). These notifications must be made by 30 December 2020.

There will also be an opportunity for fund managers to update their previously submitted notifications, if necessary. Fund managers wishing to do so should email recognisedcis@fca.org.uk by the end of 9 December 2020 confirming that they wish to update a previous notification and including their FCA registration number.

The FCA notes that fund managers should expect to be able to submit their updated notification from 14 December 2020 and that they should only submit their updated notification when they are certain that all the correct funds are included. Updated notifications must be received before the end of 30 December 2020.

The FCA also notes that fund managers should continue to follow current processes via their Home State regulator for marketing new funds in the UK and should allow sufficient time for notifications to be received and processed by the FCA to ensure that any new funds are eligible for the TPR. Fund managers can continue to create new draft notifications on the FCA's Connect system to monitor their fund population. If new funds have been added to a fund manager's population since an earlier notification was submitted, the new funds will not be included in the temporary marketing permission regime unless fund managers request to update their notification and include them in that updated notification.

ESMA Statement on UK-authorised Benchmark Administrators

Following the end of the Brexit transition period on 31 December 2020, previously authorised UK benchmark administrators will become third country administrators and will be removed from the ESMA register of EU administrators. However, given that the Benchmarks Regulation provides for a transition period until 31 December 2021 during which supervised entities (including UCITS, UCITS management companies and AIFMs) can continue to use third country benchmarks, ESMA has clarified that these entities can continue to use

benchmarks provided by a UK administrator even if they are not included in the ESMA register.

Similarly, where third country benchmarks were recognised or endorsed in the UK prior to exit day (and so included on the ESMA register), these benchmarks will also be deleted from the register. However, as the transitional period also applies to these third country benchmarks, supervised entities may continue to use these benchmarks during the transitional period.

In the absence of an equivalence decision by the European Commission, in both the foregoing instances, UK administrators will have until the end of the BMR transitional period of 31 December 2021 to apply for recognition or endorsement in the EU, in order for the benchmarks provided by these UK administrators to be included in the ESMA register again.

AML Update

Central Bank AML Bulletin on Transaction Monitoring

The Central Bank recently published Issue 6 of its Anti-Money Laundering Bulletin ("**AML Bulletin**"), which focuses on transaction monitoring.

Under the Criminal Justice (Money Laundering and Terrorist Financing) Acts 2010-2018, designated persons must monitor transactions in order to identify whether they are suspicious in nature. They must also, in accordance with their policies and procedures, examine the background and purpose of all complex or unusually large transactions and all unusual patterns of transactions, which have no apparent economic or lawful purpose, and should increase the degree and nature of the monitoring to determine whether these transactions appear suspicious.

The AML Bulletin sets out the Central Bank's findings following inspections across a number of credit and financial institutions, and also sets out the Central Bank's expectations regarding the application of transaction monitoring controls.

The Central Bank highlighted a number of common issues that it identified through its supervisory engagements, including failure to use the business and customer risk assessments to develop appropriate transaction monitoring controls; insufficient testing of these controls; a lack of documented procedures for monitoring and investigating suspicious activity; issues related to automated transaction monitoring systems and processes; and a failure to implement a robust AML/CFT control framework for the transaction monitoring process.

The Central Bank's expects:

- transaction monitoring controls to be tailored to the designated person's business risk assessment and the customer risk assessment;
- the business risk assessment to be used to determine the appropriate transaction monitoring solution;
- to see connectivity between a designated person's CDD, transaction monitoring, and suspicious transaction reporting processes;

- controls will be subject to continued and regular review. Where an automated solution is used, the rules, scenarios, and thresholds must be regulatory reviewed to ensure that they continue to detect identified risks and emerging risks
- that there should be a mechanism for making changes to controls to take account of changing risks and new risk indicators;
- that a designated person would not place absolute reliance on an automated transaction monitoring solution and employees should still be aware of the need to manually identify any transactional activity that may be suspicious;
- that where a designated person considers a manual transaction monitoring solution is adequate, that this decision is based on a full assessment of the ability of such manual controls to detect suspicious transactions. The decision must be documented and approved by senior management and the manual controls should be fully documented in the designated person's policies and procedures and included in the risk assessment; and
- that a full assessment to be conducted on any automated solution, (whether proprietary or third-party) regarding its suitability for the risks inherent to the designated person's specific business, including jurisdictional considerations. The designated person must be able to effect changes to the configuration of the transaction monitoring controls as necessary and, as noted above, these controls should reflect the risks identified in the designated person's business and customer risk assessments.

The Central Bank has stated that it will continue to focus on transaction monitoring in its supervisory activities and expects designated persons to demonstrate that the expectations outlined in its AML Bulletin, as well as the guidance set out in the Central Bank's AML Guidelines, are fully considered and implemented where appropriate.

Bill to transpose 5MLD published

The Criminal Justice (Money Laundering and Terrorist Financing) (Amendment) Bill 2020 ("**Bill**") has been published and has commenced the legislative process. Some of the key provisions of relevance for funds in the Bill include those regarding:

Customer Due Diligence

- the Bill amends s.33 of the Criminal Justice (Money Laundering and Terrorist Financing) Acts 2010-2018 ("**CJA**"), which sets out when customer due diligence ("**CDD**") must be carried out, to provide that a designated person must also carry out CDD when they are required to contact the customer under any other legislation, for example tax legislation.
- a new provision has also been inserted to provide that when the identity of a beneficial owner is being identified, if that beneficial owner is a senior managing official, the designated person must take the necessary measures to verify their identity and keep records of the steps taken.
- a new section has been added to s.35 of the CJA to provide that, before the establishment of a business relationship with a customer that is subject to the European Union (Anti-Money Laundering: Beneficial Ownership of Corporate Entities) Regulations 2019 (as modified), a designated person must take steps to obtain relevant information from the appropriate central register of beneficial ownership, i.e., the CRO and Central Bank registers.

PEPs

- the Bill extends the definition of a "politically exposed person" ("**PEP**") to include "any individual performing a prescribed function" and permits a designated person to continue to monitor a former PEP as long as a money laundering risk exists in connection with their previous PEP designation.
- it also provides for the issuance of Ministerial guidelines regarding what constitutes a "prominent public function" for PEP designation purposes.

High-risk Third-countries – Enhanced CDD

- the Bill sets out a detailed list of enhanced CDD measures that a designated person should apply when dealing with a customer residing or established in a high-risk third-country. These require obtaining:
    - additional information on the customer and beneficial owner;
    - additional information on the intended nature of the business relationship;
    - information on the source of funds and source of wealth of the customer and beneficial owner;
    - information on the reasons for the intended or performed transactions;
    - approval of senior management for establishing the business relationship; and
    - conducting enhanced monitoring of the business relationship by increasing the number and timing of controls applied and selecting patterns of transaction that need further examination.

Tipping Off

- a defence to "tipping off" is also provided for where it can be proven that the entity to which the information was disclosed was a specified financial institution that is connected to the designated person, or part of the same group structure.

We are monitoring the Bill's legislative progression and will keep you updated on developments.

Industry Funding Levies 2020

The Central Bank Act (Section 32D) Regulations 2020 (the "**Regulations**") prescribing the 2020 industry funding levies were published in September. Category E in the schedule to the Regulations sets out the fees relating to: Investment Funds, Alternative Investment Fund Managers and other Investment Fund Service Providers. (Category D sets out the fees in respect of investment firms).

The Regulations provide that all funds shall pay a minimum levy of €4,990. Umbrella funds must also pay a contribution per sub-fund of €375 up to ten sub-funds and a further levy of €250 on sub-fund numbers greater than ten, to a maximum of twenty sub-funds, resulting in a maximum contribution for umbrella funds of €11,240.

Sustainable Finance: ESAs' Consultation on Environmental and/or Social Financial Product Templates

On 21 September 2020 the European Supervisory Authorities (EBA, ESMA and EIOPA) (the "**ESAs**") launched a consultation seeking feedback on presentational aspects of product templates, pursuant to Article 8(3), Article 9(5) and Article 11(4) of the Sustainable Finance Disclosures Regulation ("**SFDR**"). The consultation closes on **16 October 2020**.

The ESAs requested feedback on the layout of the templates, which reflects the text of the draft Regulatory Technical Standards ("**RTS**") from the recent public consultation on the SFDR that closed on 1 September 2020.

The consultation package includes:

- three preliminary, illustrative mock-ups of pre-contractual and periodic disclosure templates of products promoting Environmental and/or Social (E/S) characteristics (under Article 8 and Article 11 of the SFDR). ESMA has stated that the templates for the disclosure of products with a sustainable investment objective (Article 9) are very similar to those for the products promoting E/S characteristics and have not been included in the on-line survey. ESMA further notes that the mock-ups are purely illustrative for the purposes of gathering feedback on the presentation of information. The pre-contractual mock-up is presented in two variations: with and without icons, to gather feedback on the use of the icons; and
- an on-line survey.

ESMA notes that the final content of the templates is subject to the outcome of a concurrent consumer testing exercise and the ESAs' final report on the draft RTS under SFDR.

For more information on the EU's sustainable finance initiatives, please see our more detailed briefings in our ESG series for funds and fund managers:

Sustainable Finance –What the ESG legislative measures mean for asset managers

ESG for Fund Managers: The EU Framework Regulation / the Taxonomy Regulation

ESG for Fund Managers: Disclosures Regulation

ESG for Fund Managers: Integrating Sustainability Risks and Factors into the AIFMD and UCITS Frameworks

ESMA Publishes its 2021 Work Programme

ESMA has published its 2021 Work Programme, which sets out its priorities and areas of focus for the next year. ESMA's key areas of focus will include:

- **Supervisory Convergence** – one of ESMA's priorities is to build an EU common risk-based and outcome-focused supervisory culture. Areas of focus will include fund liquidity risk and liquidity management tools, retail investment products costs and performance, quality and usability of data, supervision of ESG reporting and ESG data usage, and the implementation of EMIR.
- **Peer reviews** – ESMA expects to conduct peer reviews on:
    - the supervision of cross-border activities of investment firms;
    - national regulators' handling of relocation to the EU27 in the context of Brexit;

    - national regulators' scrutiny and approval procedures regarding prospectuses under the Prospectus Regulation (which includes prospectuses of closed-ended funds); and
    - supervision of CCPs and CSDs.
- **Risk Assessment** – there will be an emphasis on integrating the new focus on financial innovation and ESG into ESMA's risk analysis, providing data for risk-based supervision and to support policy and convergence work. ESMA will also continue to monitor the impact on markets of the (post) COVID-19 pandemic and Brexit;
- **Single Rulebook** – priority areas will include legislative reviews of MiFID and AIFMD and identifying possible rulebook changes in support of the Capital Markets Union. Additionally, following the EMIR review and the EMIR Refit changes, ESMA will review technical standards where necessary which, depending on market developments, may include the clearing thresholds and obligation; and
- **Direct Supervision** – with a focus on third country central counterparty supervision as critical financial market infrastructures under EMIR 2.2 and preparation for the new supervisory mandates regarding Benchmarks and Data Service Providers.