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# Investment Fund Directors

**Webinar Series:**

## Taxation & Regulation update

*Your Partner For What's Next*

# Speakers

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# Investment Fund Directors

**Webinar Series:**

**Wednesday 11 November, 2pm**
Taxation & Regulation

**Wednesday 18 November, 2 pm**
ESG & Valuation

**Tuesday 24 November, 2pm**
Accounting & Auditing

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ATAD Anti-Hybrid Rules

# Tax Hot Topics

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# Reg Hot Topics

# AIFMD Reform & the CP86 Thematic Inspection

01 Delegation & substance – EU developments

02 Future of equivalence and third-country provisions

03 Supervisory approach: the latest from the CBI (CP86 findings)

# Delegation and substance

**A longstanding debate that originally focused on "letter box entities", but Brexit has caused the debate to expand and be more vociferous.**

**ESMA's relocation principles, July 2017:**

:

4. Special attention should be granted to avoid letter-box entities in the EU27.
5. Outsourcing and delegation to third countries is only possible under strict conditions.
6. NCAs should ensure that substance requirements are met.

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At the time, KPMG said, "*it seems inevitable that AIFMD detailed rules on delegation will be extended to UCITS*"

The European Commission's short AIFMD report of June 2020:

- In line with KPMG's findings, did not propose a full re-opening of AIFM
- **No** mention of delegation

**But then…..**

# ESMA's report on the AIFMD review

- AIFMD delegation rules at both Level 1 and Level 2; UCITS only high-level rules at Level 2.
- Some NCAs believe that delegated **portfolio management** services for collective investment funds come under a MiFID licence; others think it should require a fund management licence.
- **Extensive use of delegation** (including to 3rd-country firms and especially of portfolio management):
  - Operational and governance risks
  - Much of the management fee being paid over to other entities
  - Risk of "regulatory arbitrage"
  - Concerns about the use of seconded staff, who may not be working in the company's jurisdiction
- Need for greater legal clarity between **core and supporting tasks** of a management company, and whether supporting tasks (e.g. legal and compliance, investment research, quantitative analysis etc) are subject to the delegation rules.
- **White-label service providers** ("hosting ManCos") are permitted in some member states and not in others. Conflict of interest between the management company provider being responsible for investors' interests but not wishing to lose business from its client, the portfolio manager/initiator.

# ..... and the Commission's AIFMD consultation

**Q 50** Are the delegation rules sufficiently clear to prevent creation of letter-box entities in the EU?

**Q 51** Are the delegation rules under the AIFMD/AIFMR appropriate to ensure effective risk management?

**Q 52** Should the AIFMD/AIFMR delegation rules, and in particular Article 82 of the Commission Delegated Regulation (EU) No 231/2013, be complemented? If yes by:

- quantitative criteria?
- a list of core or critical functions that would be always performed internally and may not be delegated to third parties?
- other requirements?

**Q 53** Should the AIFMD standards apply regardless of the location of a third party, to which AIFM has delegated the collective portfolio management functions, in order to ensure investor protection and to prevent regulatory arbitrage?

**Q 54** Do you consider that a consistent enforcement of the delegation rules throughout the EU should be improved?

**Q 55** Which elements of the AIFMR delegation rules could be applied to UCITS ?

# Equivalence & third countries

## European Commission's approach to equivalence

Decisions need to be risk-sensitive, reflect closely the third country's regulatory and supervisory framework, and take into consideration **the impact of third-country activities in the EU**.

Ongoing compliance with any criteria and conditions must be ensured: **ongoing monitoring** of a third-country's framework, and EC can **suspend or withdraw an equivalence decision at any time**.

**For third countries whose firms are likely to make intensive use of an equivalence decision, a more significant set of risks to the EU will be assessed.**

Both outcomes-based and "a rigorous case-by-case assessment of third-country rules", and **consideration of other factors**, e.g. tax transparency and anti-money laundering rules.

**Future approach to third-country provisions?**
Equivalence versus requirement to register in the EU

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# CP86 Dear CEO Letter Findings

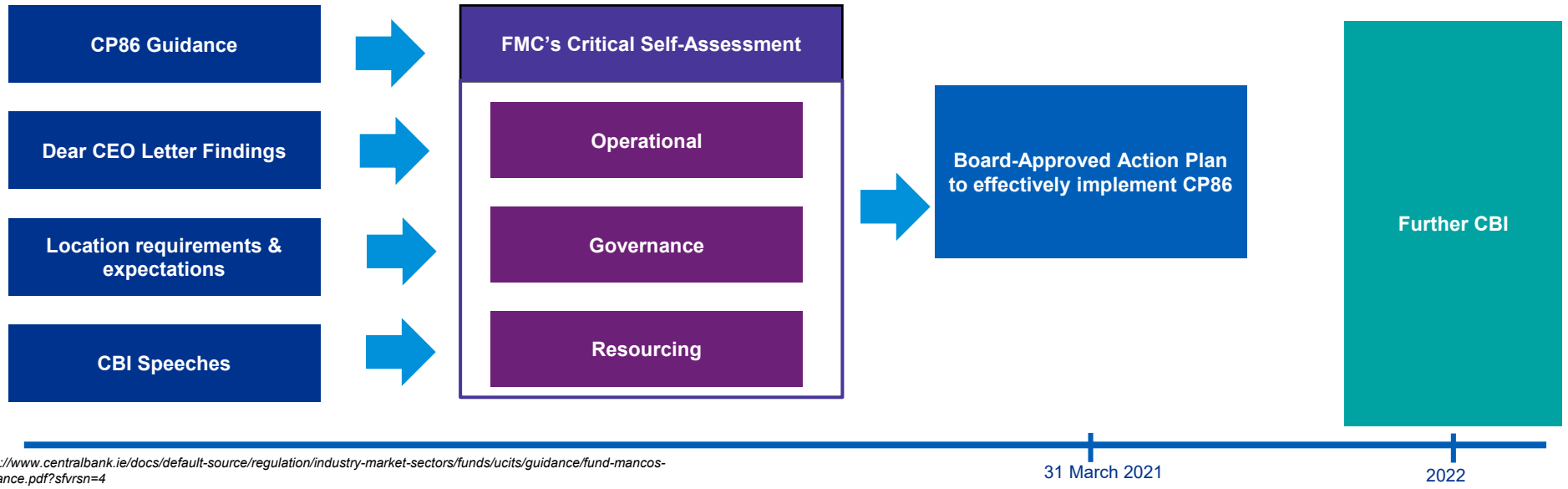
# CP86 Dear CEO Letter

## Background

In December 2016, the Central Bank of Ireland ("CBI") issued guidance to Fund Management Companies ("FMC's") on their organisation[1] commonly known as CP86. This guidance came into full effect on 1 July 2018. It provides the standards to be met in respect of a FMC's governance, resourcing, management and control, including oversight of delegates. The CBI commenced a thematic review on the implementation of this framework in 2019 and has released its findings in a Dear CEO Letter on 20 October 2020.

The Central Bank has satisfied itself that CP86, when correctly embedded, provides a framework of robust governance, management and oversight arrangements. However, it was found that a significant number of firms have not fully implemented this framework to the standard set out by CP86.

All FMC's are required to critically assess their day to day operational, resourcing and governance arrangements against all the relevant rules and guidance, taking into account the findings outlined in the Dear CEO letter. FMC's must implement a time-bound plan for making the changes required to fully and effectively implement CP86. The analysis is to be completed and the action plan discussed and approved by the Board by end Q1 2021. Additionally, where the CBI has identified specific concerns as a result of its findings, some FMC's may be in receipt of a Risk Mitigation Programme.




https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/funds/ucits/guidance/fund-mancos-guidance.pdf?sfvrsn=4

# CP86 Dear CEO High Level Findings

**Board Effectiveness**

- Board minutes are not sufficiently detailed to demonstrate robust discussion and challenge.
- Necessary reviews – Board effectiveness evaluations; Board composition; and INED tenure – are not formally conducted, recorded and reported.
- Lack of Board approval of new funds, or, in some instances being approved too close to launch.
- Gender imbalance at Board level.

**Director of Organisational Effectiveness**

- Absence of formalised meetings between OED and Designated Persons.
- Lack of formalised Board reporting by OED.
- Failure to take adequate consideration of conflicts of interest and personal transactions into account.
- Failure to carry out necessary analysis of resources or demonstrate how resource levels are determined.

**Risk Management**

- Absence of entity-specific Risk Management Framework, Risk Appetite Statement and Risk Register.
- Over-reliance on group-wide framework, policies and procedures.
- Deficiencies in Board review of risk management framework as fit for purpose at least annually

**Designated Persons**

- Deficiencies in how Designated Persons discharge their roles, particularly in level of independent verification performed and review of information by Designated Persons and inadequate challenge of delegates.
- Lack of clearly defined thresholds for Board escalation.
- Poor quality of reporting received from delegates.

**Delegate Oversight**

- Inconsistent application of due diligence to delegates, at on-boarding and especially on an on-going basis.
- Over-reliance on group-wide framework, policies and procedures, with a lack of evidence of review.
- Over-reliance of delegate policies and procedures and an absence of review of same.
- Lack of effective engagement with delegates, particularly Investment Managers. Issues not resolved in a timely manner.
- Documented SLA's not in place.
- Lack of evidence of discussion and challenge of proposed new fund strategies/structures.

**Resourcing**

- Lack of traditional governance structures in many fund management companies (including CEO in situ).
- Absence of frequent/scheduled Board member rotation and evidence of excessive INED tenure (over 10 years).
- Time commitments of Directors and Designated Persons are below expectations, with an absence of Board-specific Terms of Reference.
- Resourcing levels – managerial and support staff – lower than expected. Co-mingling of support staff working on both Investment Management Risk Management functions. Lack of documented succession plans.
- Inadequate support available to Designated Persons.

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# Regulatory Horizon

**Evolving regulatory initiatives over the next 18 months**

# Political risks and market influences

The **COVID-19 pandemic** is impacting all areas of financial services. In addition to broader economic impacts, there are significant challenges – in some cases severe – to the financial and operational resilience of firms and market infrastructure, including market volatility, asset valuations, liquidity concerns, disruptions to distribution and client on-boarding, increased communications with clients, staffing issues and remote working risks.

### Climate change & sustainability

- Climate-change risks are increasingly important priorities for the global financial industry
- Enhanced regulatory oversight to address climate-related risks to the financial system
- Calls for broader corporate and social responsibility

### Digitalisation & use of data

- Increasing and diverging digitalised environments
- Data protection and use across jurisdictions
- Increased expectation to manage and maintain Big Data ethically

### Resilience

- Increasing cyber sophistication and threat of state-sponsored cyber attacks pose systemic threats to critical infrastructures
- Oversight and controls of outsourcing, remote working risks and reliance on third-party data management

### Geo-political environment

- Rise of populism and nationalism runs counter to global markets
- Low level of trust in established institutions
- Dominant technology capabilities become a national security factor

### Macro-economic risk

- Continuing global trade tensions and trends towards economic protectionism
- Growth forecasts remain weak across most jurisdictions

### Technological transformation & disruption

- Technology continues to change consumer expectations and behaviours
- Financial innovation encourages new entrants and business models
- AI and machine learning challenge existing decision-making structures
- Concentration risks in few global technology providers

# Regulatory challenges

**In response to the COVID-19 pandemic, regulators gave concessions to existing requirements (such as capital, liquidity and reporting) and delayed implementation of some new measures. Supervisors have also reminded firms of their obligations to customers and expect them to offer specific assistance (such as moratoria on debt repayments, fair pricing, fair treatment of vulnerable customers and an overarching focus on good customer outcomes). The regulators continue to focus on a number of forward-looking themes.**

**Political and macro-economic risks**

- Impact of trade issues
- Cross-border co-operation during the pandemic
- Low-interest rate environment and search for yield
- Consumer protection drivers

**Regulatory framework change**

- Monitoring and reviews of post-crisis regulation, including assessment of COVID-19 impacts
- Expanding regulatory perimeter
- Divergent regulatory approaches
- Post-EU Withdrawal regulatory framework

**Social outcomes**

- Regulation expected to support social objectives, such as on climate change and social issues
- Potential tensions with financial stability and consumer protection objectives
- Shifting consumer priorities

**Governance, accountability & conduct**

- Focus on accountability and risk-taking
- Increasing expectations on culture, conduct and outcomes
- Diversity moves onto some supervisors' agendas

**Systemic risk**

- Government authorities support the economies globally
- Mechanisms to ensure sufficient liquidity in the financial system
- Close monitoring of key aspects of the financial system

**Financial resilience**

- Maintaining robust levels of capital and liquidity
- Climate change risks

**Operational resilience**

- Enterprise ability to prevent, respond to and recover and learn from operational disruptions
- Systemic inter-connectedness including identification of critical business services
- Cyber security, outsourcing and third party risk, pandemics, data compromise, identity theft and fraud

**Technological change**

- Regulators encourage innovation, but are concerned about heightened risks and consumer protection
- Emerging regulation on crypto-assets, robo-advice, AI and machine learning
- Ccnduct rules require adjustment to the digital age

# Regulatory Framework and Approach - International & EU

**In addition to specific proposals on rules and guidelines, there are periodic reviews by regulators of their overall regulatory frameworks, approaches, priorities and work plans. The COVID-19 pandemic is impacting work plans, with delays, re-prioritisation and new issues. However, many regulators continue to progress existing priorities, particularly in the areas of systemic risk, consumer protection, sustainable finance and technology/digitalisation.**

## International

- FSB: assessment of post-crisis reforms, implementation & monitoring
- FSB: identification of & additional measures applying to GSIBs, GSI Insurers and NBNI-SIIs
- Basel framework: implementation of Basel 4 and ongoing monitoring of progress/impacts
- BCBS: AML/CFT guidelines on supervisory co-operation
- BCBS: principles for operational risk and operational resilience
- BCBS stocktake on climate-related financial risks
- IAIS: holistic framework (systemic risk)
- IAIS: Common Framework (supervision of IAIGs)

## EU

- CMU phase 2 action plan: 16 action points, some of which include multiple measures/actions
- Sustainable finance: drafting of Level 2 rules for adopted legislation; amendments to other Level 2 rules; new initiatives on stress testing, green bonds and an EU ecolabel
- Digital Finance Strategy: extensive package of new measures
- Retail Payments Strategy: extensive package of measures
- Approach to third countries & equivalence
- Approach to reviews of post-2008 legislation
- ESAs: use of new powers/scope

# Regulatory proposals and reviews - International & EU

**Thematic area and jurisdictional origin of evolving regulatory initiatives, including new proposals, proposals adopted but not yet implemented, and legislative reviews within the next 18 months.**

– FSB: Consultation on CCP resolution, treatment of CCP equity
– CCP Recovery & Resolution Regulation - adopted
– Delay of CSDR Settlement Discipline
– EMIR2.2 framework for third-country CCPs
– ESMA: MiFID II: Consultation on OTF regime
– Pilot regime on DLT market infrastructure

– MiFID II review: Capital Markets recovery package
– MAD II/MAR review
– Solvency II review

– ESMA: MiFID II: Call-for-Evidence RTS transparency requirements
– ESMA: MiFID II/MiFIR review report on transparency requirements
– ESMA: Consultation on MiFIR reference data and transaction reporting

– Benchmarks Regulation review: Amendments to manage the risk of cessation of critical benchmark (i.e. LIBOR)

– MiFID II review: Clients' best interest rules etc.
– PSD II: Strong Customer Authentication

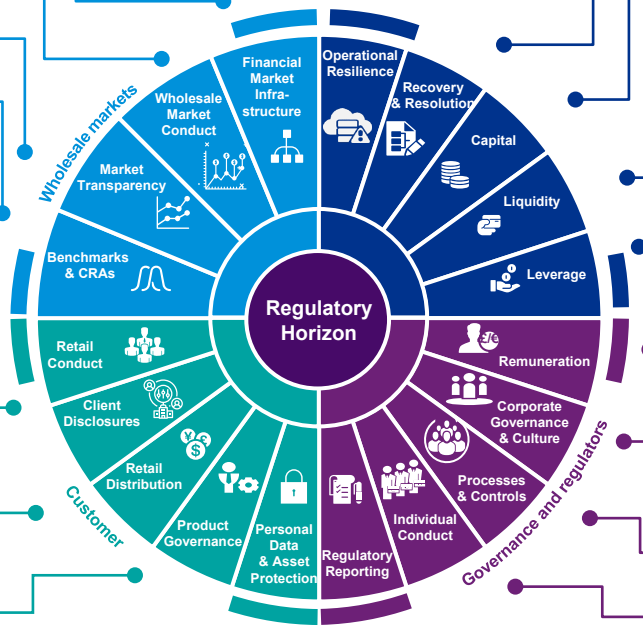
– MiFID II review: Disclosures, investment research
– IDD review: Disclosures
– ESG consultations on MiFID II/UCITS/AIFMD/SII/IDD
– ESAs: Notification to EC on review outcome of PRIIPs KID
– UCITS KID transition to PRIIP KID
– EIOPA: Final PEPP Regulation
– SFDR: ESG disclosures re: services & products

– MiFID II review: Suitability, advice, inducements
– IDD review: Suitability, advice, inducements
– ESG consultations on MiFID II/UCITS/AIFMD/SII/IDD
– Distance Marketing Directive review
– EC: Consultation on intra-EU investment protection and facilitation

– MiFID II review: Product governance and target market
– IDD review: Product governance & target market
– UCITS review: Product regulation
– ESG consultations on MiFID II/UCITS/AIFMD/SII/IDD
– EC: AIFMD review
– ESMA: Guidelines on stress test scenaria for MMFs to be updated
– ESG: EU Green Bond Standards & EU Ecolabel

– EC: Consultation on European data strategy
– EIOPA: Expert group on data ethics
– EU Deposit Insurance Scheme (EDIS)
– EBA: Consultation on TS specifying the prudential treatment of software assets
– EIOPA: Consultation on re-insurance value chain and new business models arising from digitalisation

– FSB: Consultation on effective practices for cyber incident response and recovery
– BCBS: Consultation on principles for operational risk and resilience
– FSB: Proposal for revisions to AML/CFT standards
– EC: Consultation on action plan for an AML policy
– EC: Proposed regulation on digital operational resilience




– FSB: Guidance on Key Attributes Assessment Methodology for the insurance sector
– FSB: Consultation on guidance for CCPs to support CCP resolution
– Implementation of BRRD2/SRMR2 revisions (including MREL requirements) by Dec 2020
– CCP Recovery & Resolution Regulation - adopted

– BCBS: Basel 4 proposals – implementation 2023
– BCBS: Final targeted adjustments to CVA risk framework
– EC: Consultation on Solvency II review
– EC: CRR "Quick fix"
– EC: CRR3/CRD6 proposal expected December 2020
– EIOPA: Advice on Solvency II Review (due end Dec 2020)
– EBA: Consultation on Guidelines for data inputs in shortfall risk measure under IMA

– BCBS: Basel 4 proposals – implementation 2023
– FSB: Haircuts on non-centrally cleared SFTs extended (implementation 2023-2025)
– EC: Consultation on Solvency II review
– EC: AIFMD review
– EC: CRR "Quick fix"
– ESMA: Guidelines on liquidity stress testing in UCITS and AIFs

– BCBS: Basel 4 proposals– implementation 2023
– IOSCO: Funds & calculation of leverage
– EC: AIFMD review
– EC: CRR "Quick fix"

– EC: AIFMD review

– EBA/ESMA: Consultation on joint Guidelines for assessing the suitability of senior management
– EC: Consideration of diversity quotas

– EC: Consultation on action plan for an AML/CTF policy
– EC: ESG Consultations on MiFID II/UCITS/AIFMD/SII/IDD
– SFDR: ESG investment process

– ESAs: New F&P powers
– EC: Expansion of supervisors' assessment of F&P

– ESMA: Consultation on Guidelines on calculation of positions under SFTR
– EC: AIFMD review
– ESMA: Consultation on MiFIR reference data and transaction reporting

# Regulatory proposals and reviews - UK

**Notwithstanding the impact and implications of COVID-19, the UK regulatory landscape is changing due to the UK's EU Withdrawal. Whatever the outcome of the negotiations, there is likely to be an on-going need for firms to comply with at least some elements of EU regulation in order to continue to conduct business with and within the EU.**

**The illustration includes new proposals, proposals adopted but not yet implemented, and legislative reviews within the next 18 months. Also for reference, the UK Financial Services Regulatory Initiatives Forum updated Grid of proposed initiatives.**

– BoE: Consultation on operational resilience for FMIs

– FCA: Call for input on accessing and using wholesale data
– CSDR Settlement Discipline delay until Feb 2022 – UK will not implement

– BoE, FCA, UK Risk Free Rates Working Group: Guidelines on LIBOR transition
– HMT: Amending the transitional period for third-country benchmarks

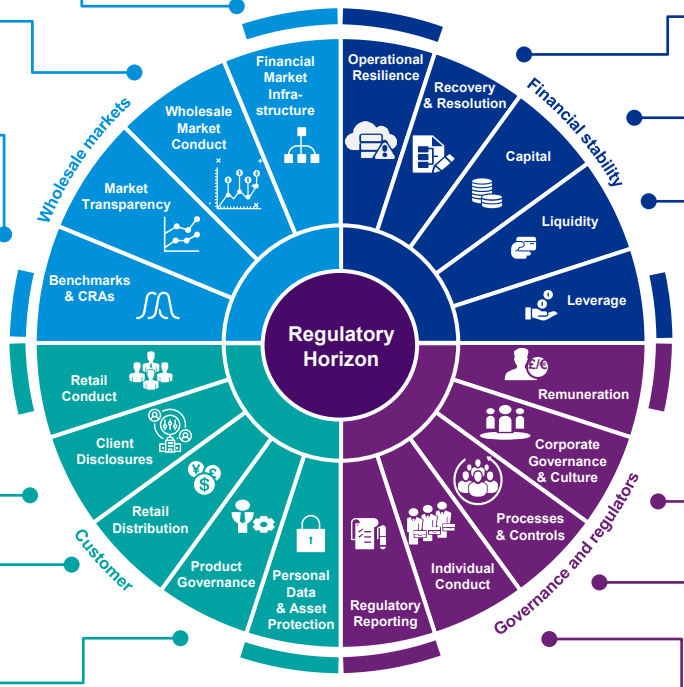
– FCA: Treatment of vulnerable customers (GC)
– FCA: Call for Input - Consumer investments (CfI)
– FCA: Call for Input - Open Finance (CfI)
– FCA: Enhanced requirements for pension transfers (PS)
– FCA: Branch and ATM closures or conversions (FG)
– FCA: Travel insurance disclosure (PS)

– FCA: Monitoring the design of and disclosures of 'green products'
– FCA: CP on new climate-related disclosures extended
– HMT: Policy on amendments to PRIIP KID Regulation
– FCA: Motor finance commission model and disclosure (PS)
– FCA: Travel insurance disclosure (PS)

– FCA: Call for Input - Consumer investments (CfI)
– FCA: Consultation on GI pricing remedies (CfI)

– FCA: Call for Input - Consumer investments (CfI)
– FCA: Consultation on GI pricing remedies (CfI)
– FCA: Permitted links changes (PS)
– FCA: Motor finance commission model and disclosure (PS)

– FCA: Strong customer authentication (SCA) implementation on e-commerce extended (PS)




– BoE/PRA/FCA: Consultations on operational resilience
– PRA: Consultation on outsourcing & 3rd party risk management

– PRA: Consultation on Simplified Obligations for recovery planning
– HMT: Consultation on transposition of BRRD2 by end-2020

– PRA: Review of P2A methodologies by 2024 (post-Basel 4)
– PRA: Consultation on implementation of CRDV
– PRA: Consultation on non-systemic UK banks
– PRA: Credit Risk policy: PD and LGD (effective 1 Jan 2022)
– PRA: Expectations for managing financial risks of climate change
– BoE: Climate risk scenarios for BES (2021 BES on hold)
– FCA: DP on Investment Firms Directive & Regulation

– PRA: Updated SS on approach to supervising liquidity and funding risks
– FCA: Liquidity risk management in authorised funds

- FCA: Remuneration Code for dual-regulated firms
– FCA: Incentives (as part of culture)

– PRA: Board diversity
– PRA: Expectations for external auditors on SII-matching requirement

– FCA: CP on AML/CFT amendments for professional body supervisors
– HMRC: AML/CTF Guidance to money service business

– FCA: Observations on F&P assessments
– FCA: First F&P assessment extended to 31 Mar 2021
– FCA: Consultation on GI pricing remedies

– BoE: DP on engagement on transforming data collection
– PRA: s166s on regulatory reporting

# Questions & Answers