



BRIDGE
CONSULTING

Quarter 2 2017 Regulatory Update

DATE: MAY 2017

1. CP 86 – Consultation Paper on Fund Management Company Effectiveness

Implementation Date: 1 July 2018

On 19 December 2016 the Central Bank of Ireland released its Feedback Statement on the third consultation of the Consultation Paper 86 (“CP86”) process. This concludes the consultation process which the Central Bank began in early 2014 to examine Governance, Compliance and Effective Supervision. The Central Bank also published the Guidance for Fund Management Companies updated for (i) Managerial Functions; (ii) Operation Issues; and (iii) Procedural Matters sections.

The documents published can be found at the following link:

<https://www.centralbank.ie/news/article/central-bank-publishes-outcome-of-third-consultation-on-fund-management-company-effectiveness>

Key Impacts for Fund Boards Resulting from 3rd Consultation

1. **Managerial Functions** – the guidance on the Managerial Functions has been largely unchanged
2. **Internal Audit** – the allocation of Internal Audit remains within the ‘Organisational Effectiveness’ role, however the guidance gives leeway for management companies to allocate differently should they feel it more appropriate
3. **Location Rule** – the most contentious of the proposed rules in the third consultation have been diluted in the final guidance. The final rules are as follows:
 - a. A management company with a PRISM rating of **Medium Low** or above will have as least:
 - i. 3 directors resident in the State or, at least 2 directors resident in the State and one Designated Person resident in the State,
 - ii. Half of its directors resident in the EEA (*replacing the proposed two-thirds rule*), and
 - iii. Half of its managerial functions performed by at least 2 designated persons resident in the EEA
 - b. A management company with a PRISM rating of **Low** will have as least:
 - i. 2 directors resident in the State,
 - ii. Half of its directors resident in the EEA (*replacing the proposed two-thirds rule*) and
 - iii. Half of its managerial functions performed by at least 2 designated persons resident in the EEA
4. **Retrievability of Records** – the guidance outlines its expectations in respect of record retention, archiving and retrievability (with specific response times listed regarding requests for data from the Central Bank). It also refers to the Dedicated Email Address that is required.
5. **Timeline to Comply** – the transition period of 12 months originally signalled in the consultation has been extended to allow existing Fund Management Companies until 1 July 2018 to comply.

New applications post 1 July 2017 must comply. The new rules will be included in the amended Central Bank UCITS Regulations and AIF Regulations.

Fund Management Companies – Guidance

The first three sections of the Fund Management Company Guidance was published in November 2015. The addition of the final three sections of the Guidance for Fund Management Companies results in Guidance consisting of the following sections:

i. Delegate Oversight	iv. Managerial Functions
ii. Organisational Effectiveness	v. Operational Issues
iii. Directors' Time Commitments	vi. Procedural Matters

Note:

- **The dedicated email address needs to be provided to the Central Bank by 28 April 2017 in order for the Central bank to process all updates by its target date of 30 June 2017.**

Impact:

A full gap analysis of CP86 and the full regulatory requirements has been completed by Bridge Consulting. Bridge can use this gap analysis as the basis of an implementation plan for the company where required.

Bridge Consulting is currently producing a series of articles examining the impact of CP86 and these can be found in the Bridge Consulting Documents Library.

<http://bridgeconsulting.ie/regulatory-updates-page/>

2. CBI Letter – Thematic Review of Risk Function

On 5 December 2016 the Central Bank issued a letter outlining its review of risk processes and how risk processes are currently being managed within investments firms, fund service providers and stockbrokers. The Central Bank's focus is on risk frameworks used to identify, measure, mitigate and communicate risks.

The letter emphasises that ultimate responsibility to ensure a proper risk culture and risk framework is in place lies ultimately with the Board of Directors. Staff awareness of the risk culture is an important part of a successful risk framework. In this respect the bank expects an ongoing and continuous review of the risk framework. The Central Bank found notable inconsistencies in how organisations identify, document, quantify and mitigate risk. In some cases, processes outlined in documentation are not being fully implemented.

An appendix of questions which the Central Bank proposes be used to analyse the risk framework was attached to the letter and boards are advised to ensure the appropriate measures are put in place.

Impact: Funds are recommended to review their risk framework. Bridge is currently working with fund boards regarding the risk framework documentation and implementing the changes required.

<https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/funds-service-providers/fund-administrators/industry-letter--thematic-review-of-risk-function-5-december-2016.pdf?sfvrsn=2>

3. Central Bank Letter – Thematic Inspections on Outsourcing

On 19 December 2016 the Central Bank issued a letter containing its recommendations when reviewing outsourcing arrangements for Investment Funds, Fund Managers and Funds Service Providers. Although the CBI has not yet issued its list of themed inspections for 2017, a review of outsourcing arrangements will most likely form part of this. The areas that the CBI has specifically highlighted are the following;

- Monitoring
- Reporting
- Appraisal
- Business Continuity
- Outsourcing Policy

Reference is also made to the Committee of European Banking Supervisors (CEBS) Guidelines on Outsourcing as a useful guide to effective oversight.

<https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/funds-service-providers/fund-administrators/industry-letter---review-of-outsourcing-of-fund-administration-activities-7-march-2017.pdf?sfvrsn=2>

<https://www.eba.europa.eu/documents/10180/104404/GL02OutsourcingGuidelines.pdf.pdf>

4. Cross Industry Guidance – Information Technology and Cybersecurity Risks

On 13 September 2016 the Central Bank of Ireland released its guidance on IT and Cybersecurity Risks. The document states that “the risks associated with IT and Cybersecurity are a key concern for the Central Bank given their potential to have serious implications for prudential soundness, consumer protection, financial stability and the reputation of the Irish financial system”. It points out that it expects the Boards and Senior Management of regulated firms recognize their responsibilities in terms of IT, cybersecurity, governance and risk management and place these amongst their top priorities. Based on the Central Bank’s supervisory experience to date, firms are not implementing sufficient robust controls and must increase their efforts.

The guidance highlights the Central Bank’s findings in terms of industry shortcomings and it outlines clear expectations of how this subject should be addressed.

The document focuses on requirements during the following 4 headings;

- **Governance:** This section refers to 1) the role of the Board & Senior Management and 2) IT Specific Governance and the Central Bank’s expectations of the Board and Senior Management e.g. IT strategy aligned to the Business Strategy, resourcing, risk management framework, IT updates & reporting and knowledge / understanding of the requirements.
- **Risk Management:** This section refers to 1) Risk Management Framework, 2) IT Disaster Recovery and Business Continuity Planning and 3) IT Change Management e.g. hardware, equipment, software, system support.

- **Cybersecurity:** This section refers to the specific processes required to deal with the threat of cybersecurity e.g. formal planning, staff training, safeguards and processes and recurring assessments.
- **Outsourcing of IT Systems and Services:** This section refers to the framework that should be in place, lines of responsibility for ongoing management and oversight, due diligences required, SLAs that should be in place, exit management strategy, concentration risk and Central Bank inspections.

Impact: Bridge has converted the Central Bank's guidance to a questionnaire format and recommends that Boards receive responses from their delegates to the Central Bank's communication.

5. Beneficial Ownership

Effective Date: 15 November 2016

On 15 November 2016, the Department of Finance published the European Union (Anti-Money Laundering: Beneficial Ownership of Corporate Entities) Regulations 2016 (the "AML Regulations"), which came into effect on the same day. These AML Regulations transpose Article 30(1) of the Fourth Anti-Money Laundering Directive 2015/849/EC ("MLD 4") into Irish law in advance of the 26 June 2017 transposition deadline. In accordance with Article 30(1), Member States, such as Ireland, are required to oblige corporates and other legal entities to obtain and hold adequate, accurate and current information on their beneficial ownership, including details of the beneficial interests held.

The regulations also impact both regulated and unregulated companies so this will include fund vehicles such as ICAVs, UCITS and AIFs as well as those established under the Companies Act 2014. Sanctions will be applied if companies are found to be in breach and not maintaining a register.

Impact: Discussions are ongoing between Irish Funds and the Department of Finance as to the specific requirements for the funds industry. In the meantime, Bridge is recommending a register be established at the fund umbrella level and a review of investors take place to establish if there are investors with over an overall holding of 25% or more.

6. AML Update – Political Agreement Reached on AML IV

Implementation Target Date: 26 June 2017

On 20 May 2015, the European Parliament adopted the Fourth Money Laundering Directive (AML IV).

Key provisions of the Directive are as follows:

- **Transparency:** EU Member States for the first time will be obliged to maintain registers with information on the beneficial owners of both corporate and legal entities as well as trusts. In addition to Competent Authorities who will have access to these registers without any restrictions, any person who can demonstrate a legitimate interest, such as investigative journalists or concerned citizens, will also be able to access the central registers.

- The extension of the Politically Exposed Person (PEP) regime to cover domestic PEPs and persons entrusted with a prominent function by an international organisation.
- The removal of the automatic entitlement to apply Simplified Customer Due Diligence (“Simplified CDD”) when dealing with specified customers and products.
- An increased range of sanctions which may be imposed for breaches by Designated Persons of their AML and CTF obligations.
- The introduction of risk assessments at EU and national level. It is proposed that these risk assessments will be shared with Designated Persons to assist them in preparing their own risk assessment of their business and customers.

Impact: Member states must transpose the Directive into national law by 26 June 2017.

7. AML V under Discussion

Implementation Target Date: To be Determined

In December 2016 the European Council published proposed amendments to the AML IV Directive that would form the basis of AML V. This is currently under review within the European Parliament.

8. General Data Protection Regulation

Implementation Target Date: 25 May 2018

On 27 April 2016 the European Commission adopted new legislation to replace the current Data Protection Directive. In Ireland this will replace the Data Protection Acts of 1988 and 2003. This process has taken over 4 years to complete. The current legislation focuses on the protection of individuals with regards to the processing of personal data and the free movement of that data. Whilst the new regulation also focuses on this subject, it goes even further in that it address data processing of any kind. The regulation emphasizes transparency, security and accountability by data controllers whilst at the same time standardising and strengthening the rights of European citizens to data privacy.

More details to follow shortly.

9. Irish Revenue – Update to Common Reporting Standard FAQ

Revised Irish Revenue FAQ Publication Date: 30th September 2016

The Irish Revenue has released an updated FAQ for CRS. The revised publication focuses on areas such as implementation options applicable to Ireland, TIN number collection, TIN number requirements and reporting requirements.

From 2017 onwards CRS/FATCA nil returns will become a tick box exercise, in contrast to the current xml file submission.

Impact: First CRS filing falls due on 30 June 2017.

10. The Regulation on Transparency of Securities Financing Transactions (SFTR)

Implementation Date: 12 January 2016

In continuing to look at ways of improving transparency in non-bank credit provision or “Shadow Banking”, the EU on 12 January 2016 effected the Regulation on Transparency of Securities Financing Transactions (SFTR). There are some transitional periods for certain provisions, including Article 15 regarding the right of reuse of financial instruments under a collateral arrangement. This Article became effective on 13 July 2016.

Scope:

Both financial and non-financial counterparties are in scope. As can be seen in the table below the definition of a "financial counterparty" includes funds, Management Companies and investment firms authorised under MiFID. The rules will affect all existing and future title transfers and security collateral arrangements including ISDAs, Credit Support Annexes/Credit Support Deeds, GMRAs, GMSLAs and prime brokerage agreements. Counterparties to an SFT and also counterparties reusing collateral are in scope. Transactions such as total return swaps, repurchase agreements, securities & commodities lending / borrowing are detailed in the regulation.

The initial reporting period varies depending on the type of institution i.e. from 12 month to 21 months (see below);

Institution Type	Date
Investment Firm / Credit Institution	12 months once effective
Central Securities Depositories / Central Counterparty	15 months once effective
UCITS / UCITS Management Companies, AIFs / AIFMs, Insurance, Reinsurance	18 months once effective
Non Financial Counterparties	21 months once effective

Each party that accepts collateral is obliged to inform their counterparties of the following risks;

- a) Entering into title transfer arrangements or
- b) Granting a right to reuse collateral.

From 13 July 2016 the rights of receiving counterparties to reuse financial instruments received as collateral is subject to;

- i. written transparency being given to the Provider on the risk and consequences involved
- ii. written consent by the Provider to reuse or transfer title
- iii. any exercising of the right must be in accordance with the terms of a signed collateral agreement.

Who is impacted?

- EU entities
- An EU entity's non-EU branch that is a party to the Securities Financing Transaction
- A non-EU entity that is party to an SFT or engaging in collateral reuse; if the SFT is concluded or effected by a non-EU entity's EU branch or the reuse concerns financial instruments that fall under a collateral agreement with an EU entity or an EU branch.

Similar to EMIR, both counterparties are required to report such transactions. A UCITS Man Co or AIFM will be responsible for reporting (however this can be delegated). Information should be added to semi-annual and annual accounts for both UCITS and AIFs. References should also be added to a UCITS Prospectus and the disclosure by the AIFM to investors.

Article 13 of the regulation imposes a requirement by UCITS Management Companies to inform investors of the use of securities financing transactions (SFTs) and total return swaps (TRS) in the half yearly and annual report of the UCITS. Article 13 became effective from 13 January 2017.

Impact: The SFTR requirements are due to become effective from the 13th January 2017. Current disclosures in Financial Statements should be reviewed with the fund Auditors to ensure they comply with the new requirements.

11.EMIR – Margin Rules

Implementation Date: March 2017

Background

EMIR rules have recently come into effect governing the exchange of collateral between parties to non-cleared OTC derivatives. These require you to have in place risk management procedures for the exchange of collateral in relation to your non-cleared OTC derivatives. In accordance with Article 2(2) of the EMIR Margin Rules, the risk management procedures must specify or provide for a number of matters generally relating to arrangements for the exchange of collateral for non-cleared OTC derivatives, including (amongst other matters) the eligibility of collateral, the calculation and collection of the amount of collateral due and the valuation of collateral collected from the counterparties applying appropriate haircuts, in each case, in accordance with the EMIR Margin Rules.

Timeline

1. Initial margin

Where both counterparties have, or belong to groups each of which has, an average notional amount of non-cleared OTC derivatives over a threshold of €3 trillion, they have been required to exchange

variation margin since 4 February 2017. The initial margin requirements are being phased-in between February, 2017 and September 2020 when the threshold will be €8 billion.

2. Variation margin

1 March 2017 is the deadline for the application of variation margin.

In February 2017 the CFTC advised that it would allow swap dealers a six-month grace period to comply with the 1 March 2017 variation margin rules deadline that was applicable in the U.S.

Exemptions

Chapter II of the EMIR Margin Rules provide for the following exemptions from the requirement to collect and post variation and initial margin in relation to non-cleared OTC derivatives;

- a) Minimum transfer amount.
The maximum permissible minimum transfer amount that may be applied under the EMIR Margin Rules is EUR 500,000 (or its equivalent in another currency).
- b) Exemptions from the initial margin requirement
 - (i) Specific FX contracts (physically settled FX forwards and swaps, cross currency interest rate swaps involving the exchange of notional amounts)
 - (ii) Below threshold notional amounts (currently €8 billion)
 - (iii) Below threshold initial margin amounts (currently €50 million)

Next steps

Counterparties (including CIS) will need to update risk management procedures to allow for the efficient transfer of appropriately calculated collateral for in scope OTC derivatives. This should include a policy on acceptable collateral, parties responsible for calculation, valuation and timely exchange of collateral. The policy should allow for periodic review of the arrangements in place to ensure compliance with the EMIR rules.

Counterparties are expected to adhere to the ISDA 2016 variation margin Protocol or update their existing ISDA CSAs to reflect the new rules.

12. EMIR Q&A

On 2 February 2017 the European Securities and Markets Authority (ESMA) issued an update of its Q&A on practical questions regarding the European Markets Infrastructure Regulation (EMIR).

The updated Q&A includes a new answer in relation to transition to the revised technical standards on reporting, which will become applicable on 1 November 2017. The Q&A clarifies that the reporting entities are not obliged to update all the outstanding trades upon the application date of the revised technical standards and that they are required to submit the reports related to the old outstanding trades only when a reportable event takes place (e.g. when the trade is modified). Furthermore, the Q&A explains how those reports will be validated by the Trade Repositories.

https://www.esma.europa.eu/sites/default/files/library/esma70-1861941480-52_qa_on_emir_implementation.pdf

13. Money Market Fund Regulation

Estimated Implementation Date: Q2 2018

After 3 years of contentious debate, on 14 November 2016 both the EU Council and European Parliament agreed draft wording for Money Market Funds Regulation. The final wording will undergo a “technical review” in Q1 2017 and it is hoped that this will be finalised by the end of Q1 2017. If the timing goes to plan the new MMF Regulation will be published in the Official Journal of the EU in Q2 2017 and become effective around Q2 2018.

The new regulation provides for 3 types of MMF;

- 1) Low Volatility MMF (LVMMF)
- 2) Public Debt Constant NAV MMF
- 3) Variable NAV MMF

The Public Debt Constant MMF is similar to the Constant NAV funds serviced in the Irish market today (Ireland being a leading domicile for such funds with over €478 billion in MMF assets) and maintaining Constant NAV MMFs has been welcomed by the Irish industry association i.e. Irish Funds.

The new regulations will mean changes in the rules governing MMF liquidity and diversification. Areas such as eligible assets will also change as will credit assessment, risk management, stress testing, disclosures and regulatory reporting.

14. PRIIPS Regulation

Revised Implementation Date: 1 January 2018

On 8 March 2017 the European Commission provided revised regulatory technical standards (RTS) for the production of Key Information Documents (KIDs). This was provided to the Council of the EU and the European Parliament. The previous RTS was rejected on 14 September 2016 by the European Parliament. The RTS provides details on the content to be published, when they need to be published and by whom.

Impact: Some UCITS, QIAIFs and RIAIFs will be impacted in January 2018 deadline (depending on their investor base). The majority of UCITS will not need to comply until 31 December 2019.

15. Investment Firms Regulations 2017 + Q&A

On the 13 March 2017, the Central Bank published the Central Bank Investment Firms Regulations 2017. This is targeted at MiFID Investment Firms and certain business firms authorized under the Investment Intermediaries Act 1995. Fund Administrators are included with particular references to Organisational requirements, Outsourcing Requirements, Own Funds and Capital Requirements. To coincide with this the Central Bank has also published the 1st edition of the Central Bank Investment Firms Regulations Q&A.

<https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/investment-firms/mifid-firms/regulatory-requirements-and-guidance/central-bank-investment-firms-regulations-qa.pdf?sfvrsn=2>

16. Irish Funds receive enhanced access to Chinese securities through RQFII and Stock Connect

Irish Funds (the industry's representative body in Ireland) issued a press release on 21 December 2016 announcing that Ireland has received a quota of RNB 50 Billion under the RQFII scheme. This is couple with the prior announcement that the CBI is now accepting applications for UCITS and AIFs for investment in China through the Shenzhen-Hong Kong Stock Connect ("Shenzhen Connect") programme.

UCITS

17. Central Bank Updates UCITS Q&A

On 13 March 2017 the Central Bank published the 16th edition of its UCITS Questions and Answers document.

The change introduced provides an update on the following;

- The current Central Bank legislation applicable to fund administrators of UCITS funds i.e. Part 2 to 5 of the Central Bank (Supervision and Enforcement Act) 2013 (Section 48(1)) (Investment Firms) Regulations 2017 (Question 1056).

AIFMD

18. Central Bank Updates its AIF Rulebook and Q&A on AIFMD

On 13 March 2017, the Central Bank released a revised AIF Rulebook March 2017 and also published the 24th edition of its AIFMD Questions and Answers document.

The most recent Q&A includes an update on the following;

- The conditions on which an Irish authorized entity can provide safekeeping and oversight to a non-EU AIF under AIFMD (Question 1021).

19. Amendment to the AIF Rulebook for Loan Originating QIAIF

Effective Date: 3 January 2017

The AIF rulebook has been amended to allow loan originating QIAIFs invest in other investments linked to the loan origination strategy, a policy that is used for other funds such as European Long Term Investments Funds. They will allow loan origination funds invest in debt and equity securities of companies the QIAIF is lending to or which are held for treasury, cash management or hedging purposes.

The change has been welcomed by the industry.