Bridge Consulting Regulatory Update

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Regulatory Update

Regulatory Update	**10 June, 2019** **Shareholders Rights Directive II scheduled to be transposed into Irish law**	**Central Bank Discussion Paper on Outsourcing**	**05 July, 2019** **Central Bank of Ireland** **Fund Management Company Questionnaire**	**24 May 2018, European Commission proposed ESG disclosure regulations**
Key matters/issues arising	Asset Managers are obligated to publish a Shareholder Engagement Policy, an annual statement regarding implementation of same and provide detail of "engagement with investee companies".	Significant deficiencies identified in board awareness and understanding of the extant of reliance within their firm on offshore service providers. Major weaknesses were highlighted regarding governance, risk management controls and processes.	21 June 2019, the Central Bank issued a CP86 implementation questionnaire to all Irish authorised Management Companies, AIFM's and SMIC's requesting detail on Directors, staffing, policies and implementation of the recent management company guidance.	As part of the Commission's Sustainable Action Finance Plan; "Disclosure Regulations" relating to sustainable investments and sustainability risks were proposed to apply to "financial market participants" including AIFM's and UCITS ManCo's.
Key Dates/Actions	10 June 2019 – regulation is due to be transposed into Irish law. While transposition is yet to occur, the provisions of the directive is assumed to take effect.	Ongoing – The Business Plan filed with the CBI acts as the Company's outsourcing policy and annual Supervision of Delegates reviews cover any outsourcing engaged or planned during the year.	05 July 2019 – Completed questionnaires must be returned to the regulator no later than Friday July 5th, following review and approval by the Board of Directors. It is expected that following review of responses, the CBI may conduct desktop reviews and onsite visits.	Ongoing – Industry players have requested this be enshrined in European Law which will require agreement from all member states. Bridge will be closely monitoring developments in this area and will provide updates as they are released.

Shareholder Rights Directive II

Regulatory Update

10 June 2019

SRD II seeks to strengthen the position of shareholders, increase engagement and enhance transparency, especially around related party transactions.

This directive extends the scope of Shareholders Rights regulations to include Asset Managers (UCITS management companies, AIFM's, SMIC's and MIFID firms) if they invest (on behalf of funds under management) in EEA companies with listed shares on an EEA regulated market.

Key Matters/Issues Arising

There are three main obligations on asset managers arising from the directive;

1. Companies must publish a Shareholder Engagement Policy on their website, or publish a clear, reasonable explanation as to why it is not doing so.
2. Publication of an annual statement on the implementation of this Shareholder Engagement Policy; and
3. Provide information on engagement with investee companies to institutional investors.

Actions Required

While the directive was due to be transposed into Irish law by June 10th, this has not yet happened.

There is an industry wide expectation that Irish AIFM's and ManCo's will be exempted from some of the provisions with the exception of the listed transparency requirements. As such, many are adopting a "wait and see" approach before taking further steps.

Bridge can assist with drafting a Shareholder Engagement Policy once transposition occurs.

Outsourcing Discussion Paper

Regulatory Update

19 November 2018

CBI issued a discussion paper and emphasised outsourcing and delegation to be considered the same activity.

30 April 2019

Central Bank hosted a conference on outsourcing attended by many independent directors.

24 June 2019

Central Bank fined J.P. Morgan Administration Services (Ireland) Limited €1.6m for regulatory breaches related to outsourcing.

Key Matters/Issues Arising

The discussion paper noted significant deficiencies in board awareness and understanding of the extent of the reliance within their firms on outsourcing.

Three key risks were identified;

1. Sensitive Data Risk
2. Concentration Risk
3. Offshoring Risk

CBI emphasised ultimate accountability for compliance remains at all times with the delegating firms, and particularly, the Board who will be held responsible for any regulatory breaches.

Actions Required

The Business Plan details the delegation model and outsourcing policy of the company. This document is subject to annual review and approval by the Board.

An annual Supervision of Delegates review and visit is conducted (mainly by Designated Persons on behalf of the Board) and a report is issued to the Directors – one of the key points of discussion with delegates is outsourcing.

Company’s risk register should include “outsourcing risks” and mitigating factors.

Fund Management Company Questionnaire

Regulatory Update

21 June 2019

Central Bank issued a Fund Management Company Questionnaire as part of their thematic review of the implementation of Fund Management Company Effectiveness requirements and related guidance (CP86).

The aim of this questionnaire is to identify standards of industry compliance and ensure that the required effectiveness and systems of governance are in place to protect investors' best interests.

Key Matters/Issues Arising

The questionnaire covers 7 areas;

1. Governance and Business Model
2. Delegate Oversight
3. Organisational Effectiveness
4. Directors' Time Commitments
5. Managerial Functions
6. Operational Issues
7. Procedural Matters

Actions Required

By now, all Directors should have been made aware of the receipt of this questionnaire.

Bridge, as Designated Persons, have coordinated completion of the questionnaire for their clients and filed this with the CBI before the deadline of 05 July 2019.

The first wave of thematic reviews have been sent with a cross section of Management Companies and SMIC's selected; Bridge with assist with coordination of responses to this review where necessary.

Areas selected for review are;
Investment Management;
Fund Risk Management; and
Organisational Effectiveness.

ESG Disclosure Regulations

Regulatory Update

24 May 2018

European Commission presented measures as part its Sustainable Action Finance Plan including proposals applicable to "financial participants offering financial products as environmentally sustainable investments or as investments having similar characteristics".

The aim of the proposed regulations is to prevent "greenwashing".

Key Matters/Issues Arising

Draft regulations were presented on;

1. Establishing a unified EU classification system of sustainable economic activities (taxonomy) to prevent greenwashing for competitive advantage;

2. Improving disclosure requirements on those who integrate environmental, social and governance (ESG) factors in their investment decision making process;

3. Creating a new category of benchmarks which compare carbon footprint of investments.

Actions Required

These proposed regulations will apply to financial market participants including AIFM's and UCITS management companies.

Publication online of policies regarding incorporating sustainability in investment decision making will be required.

No immediate action is required by Boards. Bridge will closely monitor this area and include developments as they arise in future regulatory updates.

Talking Points – UCITS Liquidity

07 August 2019, Central Bank of Ireland issue a "Dear CEO" letter to the industry emphasising the "importance of ongoing, effective liquidity management and ensuring compliance with relevant legislative and regulatory obligations for UCITS and AIFs."

It is important that the execution of the liquidity risk management framework for each fund under management is appropriately calibrated to take into account;

- dealing frequency;
- investment strategy;
- portfolio composition; and
- investor profile,

on an ongoing basis.

Responsibility for liquidity risk management, including compliance with all legislative and regulatory obligations in relation to liquidity of each fund under management rests with the board of the fund management company, directors and designated persons.

05 February 2019, ESMA launches a industry consultation on draft guidance regarding liquidity stress tests of AIFs and UCITS.

Consultation was open for feedback until April 2019 and a final report is expected from ESMA in the coming months.

Regulation 68 (2) A UCITS may hold ancillary liquid assets but shall not—

(a) invest more than 10 % of its assets in transferable securities or money market instruments other than those referred to in paragraph (1), or

(b) acquire either precious metals or certificates representing them.

(3) An investment company may acquire movable or immovable property which is essential for the direct pursuit of its business.

Regulation 104 (1) Subject to Regulation 63(2), a UCITS shall redeem or repurchase units at the request of the unit-holder.

(2)(a)(i) Notwithstanding paragraph (1), a UCITS may in the cases and according to the procedure provided in its trust deed, deed of constitution or articles, temporarily suspend the repurchase or redemption of its units.

(ii) Suspension may be provided for only in exceptional cases where circumstances so require and suspension is justified having regard to the interest of the unit-holders.

(b) The Bank may require the suspension of the repurchase or redemption of units in the interests of the unit-holders or the public.

(c) A UCITS which acts in accordance with subparagraph (a)(i) shall without delay communicate its decision to the Bank and to the competent authorities of the Member States in which it markets its units.

Mark Carney Bank of England Governor *on investment funds that hold illiquid assets but allow unlimited withdrawals*

"These funds are built on a lie, which is that you can have daily liquidity, and that for assets that fundamentally aren't liquid,….that leads to an expectation of individuals that it's not that different than having money in a bank. You get a series of problems, you get a structural problem but then you get a consumer issue."

"On this broader systemic point around the structure of these funds, this is a big deal," Carney said. "You can see something that could be systemic."

Conclusion: Under the remit of monitoring Brexit preparedness, the CBI introduced enhanced reporting for funds, especially in cases of larger redemptions and further issues correspondence detailing the need for a liquidity risk management framework for all funds.

Boards are advised to consider and seek comfort around the general liquidity of funds as well as the eligibility of assets held for that structure and regular stress testing to be carried out and reported by the Investment Manager.

Boards need to seek a clear and transparent overview from Trustees and Investment Managers assuring the liquidity of funds and ability to meet redemption requests per UCITS regulation 104.

Any fund or management company's risk framework should include fund risk profiles which monitor a fund/sub-fund's liquidity.

Recent Developments in the market & key dates

31 July 2018 – Tim Haywood of GAM is suspended leading to panic and a rush on their ARBF funds

19 December 2018 – CBI issue new reporting requirements to monitor investment fund liquidity.

February 2019 – GAM's market value has plunged by two thirds (£2 bn)

June 2019 – Neil Woodford blocks redemptions from the £3.7 bn Equity Income Fund

27 June 2019 – At UK Treasury Committee Bank of England Governor references "potential systemic issue" with fund liquidity.

24 July 2019 – MSCI complete a review of UCITS funds to find 7 of 400 reviewed face Woodford style liquidity risks.

07 August 2019 – Central Bank of Ireland issue "Dear CEO" letter highlighting important of ongoing liquidity monitoring.

Talking Points (cont'd)

Liquidity	Seven UCITS funds face Woodford-style liquidity risk, warns MSCI	"Applying its LiquidityMetrics tool, MSCI found that **seven funds out of around 400 breached a 15% limit** in terms of illiquid assets, when checking them against a 5% trading scenario. **MSCI applied the US Securities and Exchange Commission's (SEC) 15% restriction on illiquid assets** in open-ended funds noting that the Ucits regulation do not specify such restrictions..... It said that, in short, **the liquidity profile of these funds may be misaligned with anticipated redemption requests** with a risk they could face trouble, were a large investor to redeem."	**https://expertinvestoreurope.com/seven-ucits-funds-face-woodford-style-liquidity-risk-warns-msci/**
	Asset management: inside the scandal that rocked GAM	"For the rest of the industry, the firm, has become a lesson in the potential pitfalls of the frenetic search for higher returns in an era of record-low interest rates..... Across the industry, fixed income fund managers have been feeling the pressure. As central banks responded to the financial crisis by buying trillions of dollars of bonds and pushing down interest rates to record lows, investors had to cast further afield for yield. **Often they looked to less liquid assets that can offer higher returns but may be harder to price or sell in a downturn.**"	https://www.ft.com/content/56e5b0ba-39ed-11e9-b856-5404d3811663
	Woodford affair shines spotlight on assets put in 'trash' bucket	"UCITS management companies should make any changes to the KIID in order to incorporate this additional guidance **as soon as practicable**, or by the **next KIID update following the publication of this Q&A.** In accordance with Article 79(1) of the UCITS Directive and to ensure **fair, clear and not misleading communications**, the information disclosed in the UCITS KIID should be consistent with the UCITS' Investment Objective in the Prospectus."	https://www.ft.com/content/d22fbce8-892f-11e9-97ea-05ac2431f453
	Britain's investment funds face scrutiny as Bank of England's Carney blasts liquidity 'lie'	"These funds are built on a lie, which is that you can have daily liquidity, and that for assets that fundamentally aren't liquid," Carney told a parliamentary committee on Wednesday. "That leads to an expectation of individuals that it's not that different than having money in a bank. You get a series of problems, you get a **structural** problem but then you get a consumer issue."	https://www.cnbc.com/2019/06/27/britains-funds-face-scrutiny-as-bank-of-england-blasts-liquidity-lie.html
Outsourcing	"Boards must get to grips with outsourcing risks" – Director General Derville Rowland	"Ultimate **accountability for compliance remains with regulated firms, particularly the boards** of those firms. Where a firm chooses to outsource a regulated activity, that firm will be held responsible for any regulatory breaches that occur. Indeed, the Central Bank has taken enforcement action regarding the failure by regulated firms to ensure that outsourced regulated activities are compliant with the relevant regulation including the Consumer Protection Code."	https://www.centralbank.ie/news/article/boards-must-get-to-grips-with-outsourcing-risks-director-general-derville-rowland
	Enforcement Action: J.P. Morgan Administration Services (Ireland) Limited reprimanded and fined €1,600,000 by the Central Bank of Ireland for regulatory breaches relating to the outsourcing of fund administration activities	The Central Bank's investigation identified serious failings in the Firm's outsourcing framework including: 1. **Failure to obtain the prior approval** of the Central Bank to outsource fund administration activities. 2. **Failure to have adequate control systems** to ensure that the Firm satisfied the Central Bank's outsourcing requirements for fund administrators.	https://www.centralbank.ie/news/article/press-release-enforcement-action-jp-morgan-26-june-2019

Regulatory Developments

Implementation Deadline	Regulatory Event	Regulatory Update/Actions Required
Probable 2020	Revised UCITS Regulations	Central Bank expected to represent a consolidation of all Central Bank UCITS Regulations to date and take account of regulatory and technical updates which were consulted on in 2018.
Probable Q3 2019	Shareholders Rights Directive II	10 June 2019, Ireland are due to transpose SRD II into Irish law. Companies will need to approve a Shareholder Engagement Policy.
Probable Q4 2019	4th AML Directive	Criminal Justice Act, 2018 signed into law 14 November 2018. The Central Bank published a consultation paper December 21, 2018 and responses were welcome until April 2019. Changes regarding maintenance of a beneficial ownership register remain uncertain as the industry engages with regulators.
2020	Securities Financing Transactions Regulation	Implementation Regulation published providing effective date for reporting obligation of 11 October 2020.
2020	5th AML Directive	19 June 2018, 5th Money Laundering Directive published in the Official Journal of the EU. Member states have until 2020 to set up centralised ownership registers (January & March 2020) and automated mechanisms (September 2020).
Probable 2020	Investment Firms Directive/Regulation	Announced 7 January 2019 that COREPER endorsed a new regulatory framework for investment firms designed to make “the rules applicable to investment firms more proportionate and more appropriate to the level of risk which they take”. Under the new framework, many investment firms would no longer be subject to rules originally designed for credit institutions (the largest and most systemic investment firms would however remain subject to the existing prudential framework).
TBC	Sustainable Finance Plan – Disclosure Requirements	Draft regulations presented by the European Commission – TBC