

Bridge Consulting Regulatory Update

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Regulatory Update

				
Regulatory Update	18 July, 2019 Central Bank issues industry letter on thematic review of closet indexing	02 August, 2019 Central Bank commences desktop review of implementation of CP86	07 August, 2019 Central Bank issues industry letter on Fund Liquidity Management	09 September, 2019 Central Bank issues Consultation Paper 130
Key matters/issues arising	Review undertaken to identify instances of closet indexing. Findings included; poor governance at Board level, insufficient or inaccurate information to investors and lack of Board assessment of fund performance.	Following the submission of the fund management company questionnaire in early July, the CBI commenced the document request process for a desktop review. A cross section of all management companies was selected. The CBI focussed on Investment Management, Fund Risk Management and Board effectiveness.	Under the remit of Brexit preparedness, the CBI issued an industry letter reiterating the need for a robust liquidity management framework and regular stress testing on all funds. In addition, recent guidance was issued by ESMA on liquidity management.	Arising from an IMF recommendation, the CBI has produced a consultation paper on the treatment, correction and redress of errors. This introduces new concepts in the classification of errors such as “qualitative materiality” and payment of compensation on inadvertent breaches.
Key Dates/Actions	Ongoing – KIID’s should be reviewed with necessary updates applied for the February annual filing. Directors should ensure detailed discussions are held at Board meetings on performance and fees charged.	Ongoing – Documentation for selected management companies has been submitted and we await next steps from the CBI. We recommend Boards consider the focus areas of the review in their oversight going forward.	September 2019 – ESMA guidance must be implemented by September 2019. Boards are advised to discuss liquidity and stress testing models applied to funds as well as seek and receive quarterly liquidity reporting from their Designated Persons or Investment Manager.	09 December – The consultation period remains open until early December 2019. Directors are invited to submit to the process individually or to contribute to Bridge Consulting who will also be submitting a response.

Closet Indexing



Regulatory Update

18 July 2019

Central Bank published findings from a thematic review with the purpose of identifying instances where a UCITS, described as actively managed, is performing close to the performance of an index without proper disclosure to investors.

Risk Mitigation Programmes have been issued to a number of companies arising from this review.

Key Matters/Issues Arising

The regulator's key findings included;

1. Incomplete/inaccurate information to investors in prospectus/KIIDs;
2. Poor governance/control by Boards in approving fees and oversight of strategy and distribution;
3. Lack of Board assessment of fund performance to ensure fees charged are commensurate with active management undertaken;
4. Targeted outperformance of funds was lower than fees charged;
5. "Past performance" in KIID's didn't include benchmark disclosures.

Actions Required

KIID's need to be reviewed and updated in light of the ESMA Q&A update earlier this year and filed Feb 2020.

We also recommend the inclusion of some additional data points in the Board's regular reporting such as "active share" to monitor potential for "index hugging".

The Board should ensure they have appropriate oversight of the performance fee process, investment strategy and distribution.

CP 86 Implementation Review



Regulatory Update

02 August 2019
16 August 2019

Following the submission of the Fund Management Companies Guidance survey, the Central Bank selected a number of companies for the CP 86 thematic review.

A number of documents were requested in two tranches to be submitted via the ONR within 3 weeks.

A cross section of SMIC's and Management Companies were selected of varying sizes.

Key Matters/Issues Arising

The CBI issued the same request to all selected companies focussing on ;

1. Board operations and effectiveness;
2. Investment Management;
3. Fund Risk Management.

Of keen interest were detailed minutes of Board discussions on;

1. New fund launches;
2. Fund Performance, specifically discussions around under-performance;
3. Board Evaluation;
4. Risk frameworks.

Actions Required

Where selected for review, all documentation has been submitted and further action is awaited from the CBI.

Those companies not selected have been issued with a Bridge memo detailing the substance of the desktop review – we recommend reviewing this document and conducting future Board meetings “through the prism of the CP86” and its review, ensuring appropriate discussions take place and are adequately recorded at each meeting.

Onsite inspections are expected to commence in November 2019.

Fund Liquidity Management



Regulatory Update

07 August 2019

As part of ongoing engagement on Brexit preparedness, the CBI issued an industry letter highlighting the importance of “ongoing, effective liquidity management and ensuring compliance with relevant obligations.”

02 September 2019

ESMA published its final guidance regarding liquidity stress testing of investment funds applicable to AIFs and UCITS.

The guidance requires that managers be aware of the liquidity risk of the funds they manage and use stress testing as a tool to mitigate this risk.

Key Matters/Issues Arising

The CBI highlighted the importance of having a robust liquidity risk management framework in place for funds under management taking into account;

1. Dealing frequency;
2. Portfolio composition; and
3. Investor profile.

It further noted liquidity stress testing as a key part of this process as well as the transparent and proportionate deployment of tools such as gating and suspensions.

The responsibility for liquidity risk management and compliance with all legal and regulatory obligations for funds under management rests with the Board of the ManCo, the individual directors and the Designated Persons.

Actions Required

The Board, Directors and DP’s should be assessing, on an ongoing basis, the liquidity position of each fund, ensuring liquidity is aligned with the Fund’s redemption policy and demands.

We recommend enhancing Board reporting where relevant to provide this detail.

Bridge further recommend an annual presentation by the Investment Manager to the Board on the liquidity models applied to the fund with the rationale as to why these are appropriate to the portfolio.

In early 2019, the CBI introduced enhanced liquidity reporting to monitor redemption activity – we recommend the board have sight of these filings in their regular administrator reporting.

ESMA guidance takes effect 30 Sept 2019.

Consultation Paper 130



Regulatory Update

09 September 2019

Currently, Irish Funds has a long standing guidance in place on the treatment of breaches and errors for the fund’s industry.

Following an International Monetary Fund (IMF) recommendation to the Central Bank that the regulator have its own published rules in relation to fund errors, the CBI has launched a consultation process on the treatment, correction and redress of errors.

Key Matters/Issues Arising

The consultation paper introduces a number of new concepts;

1. The introduction of a “qualitative threshold”; taking into account circumstances of the error, duration and repetition of a persistent error – this asks for a more informed assessment of errors regardless of materiality.
2. “Dual reporting” requirements.
3. In the case of advertent breaches it is suggested that redress is paid in all cases, regardless of materiality and redress payable on inadvertent breaches where considered appropriate by the Depositary.

Actions Required

The consultation process remains open to submissions until 09 December 2019.

Stakeholders are requested to respond to the questions posed in the Consultation Paper.

Bridge Consulting will be contributing to the process and invite comments from delegates and directors before 08 November 2019.

Talking Points

<p>Central Bank of Ireland public statements</p>	<p>The spirit of challenge and responsibility – Michael Hodson, Director of Asset Management and Investment Banking</p>	<p>Regarding CP86; “Based on our analysis of the questionnaire responses, we have now progressed to the desk-based review phase and following on from this, we expect that a series of onsite inspections will commence in November 2019 which will continue into Q1 2020. This work is also a direct result of the uplift in authorisation cases we have been presented with since the Brexit vote in 2016.</p> <p>Reviewing these applications for authorisation, against the backdrop of a funds sector that continues to grow in nature, scale and complexity, has given us a more detailed insight as to what is required of Designated Persons and boards under CP86. As a result, this has accelerated the need to undertake the review this year. In order to do this, it is necessary to show that any delegation, including the delegation to an investment manager, can be carried out in such a way that the management company is able to robustly oversee the activities of the delegate and challenge if any deviation from the requirements emerge. If a funds domicile cannot demonstrate that, then it will not be successful in convincing European peers that the funds can operate effectively, to a high standard, on a cross border basis.”</p>	<p>https://www.centralbank.ie/news/article/speech-michael-hodson-ineds-07-october-2019</p>
	<p>Central Bank Deputy Governor concerned some insurance companies not Brexit-Ready: 'There is no excuse'</p>	<p>“Nonetheless, it is also true to say that not all regulated financial services firms are adequately prepared. There is no excuse for this, even accepting that there remains considerable uncertainty as to what will happen at the end of October and thereafter. So, I continue to urge you to make sure your firms are prepared – to make sure that Brexit fatigue and uncertainty does not lead to risks not being sufficiently mitigated. It is critical that regulated firms have considered all the impacts that Brexit could have on their businesses and that they have developed and fully tested their contingency plans in respect of these. You owe all your stakeholders, including most importantly your customers, a duty of care to ensure that you are prepared.”</p>	<p>https://www.centralbank.ie/news/article/press-release-some-insurance-companies-not-brexit-ready-27-september-2019</p>
	<p>Preventing Money Laundering and the Financing of Terrorism Can Help Save Lives – Director General, Financial Conduct Dervile Rowland</p>	<p>“.....firms must adopt a risk-based approach to fulfilling their obligations and ensure that their controls, policies and procedures are fit for purpose, up-to-date, tested and kept under constant review and scrutiny. Financial institutions must know their customers, understand their customer profiles, monitor the way accounts are used and make reports of suspicions to An Garda Síochána, and the Revenue Commissioners where appropriate. It is important to note that An Garda Síochána investigate money-laundering cases, not the Central Bank,” she added.</p> <p>The 2018 amendments to the Criminal Justice Act (2010) provided for enhanced customer due diligence of domestic Politically Exposed Persons (PEPs), their immediate families and known close associates. This comes on top of the existing requirement to perform enhanced due diligence on PEPs who reside outside the state.”</p>	<p>https://www.centralbank.ie/news/article/press-release-director-general-rowland-launches-aml-cft-guidelines-06-sept-2019</p>
	<p>Diversity and Inclusion: why it matters for the Central Bank – Vasileios Madouros, Director of Financial Stability</p>	<p>“So, from the Central Bank’s perspective, a diverse team is likely to be better able to understand the economy and financial system and, so, develop better policies to serve the public good. Indeed, a lack of cognitive diversity was one of the factors contributing to the global financial crisis.</p> <p>We expect regulated financial institutions to meaningfully address diversity and inclusion in the boardroom, at the executive level and in the pipeline of talent needed to run the organisation in the long-term.</p> <p>We review the policies that are put in place to achieve this.</p> <p>And we analyse data on outcomes, both for individuals firms and the sector as a whole.</p> <p>So we take diversity and inclusion within the financial services industry very seriously and it is something that we will continue to focus on in our role as supervisors.”</p>	<p>https://www.centralbank.ie/news/article/speech-vasilios-madourous-diversity-and-inclusion-04-sept-2019</p>

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 Q4 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.
Q3 2019	ESMA Guidelines on liquidity stress testing in UCITS and AIFs	30 September 2020, new Guidelines on liquidity stress testing in UCITS and AIFs will apply in addition to the existing requirements on liquidity stress testing set out in the Alternative Investment Fund Managers Directive (AIFMD) and the Undertakings for Collective Investments in Transferable Securities (UCITS) Directive.
2020	Securities Financing Transactions Regulation	Implementation Regulation published providing effective date for reporting obligation of 11 October 2020.
2020	5 th AML Directive	19 June 2018, 5 th 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