Bridge Consulting Regulatory Update

Q 2 2020

Elma Boland

Compliance | Risk | Governance Services | Consulting

BRIDGE CONSULTING

Regulatory Update

Regulatory Update	**18 February, 2020** **Central Bank issues correspondence to AIFM's and Management Companies on changes to PRISM rating system**	**06 February, 2020** **Central Bank notify all UCITS fund management companies of ESMA's Common Supervisory Action on UCITS liquidity**	**10 March, 2020** **Central Bank publishes findings from their most recent thematic review on Cyber Security**	**30 March,2020** **Shareholders Rights Directive II comes into effect**
Key matters/issues arising	**Following on from comments made by Michael Hodson in late 2019 and Gabriel Makhlouf in early 2020; the CBI notified the industry that new metrics would be required to enhance the current rating system and regular data returns would be expected of specific regulated entities.**	**ESMA is initiating a review of UCITS liquidity to be undertaken in two stages;** **1. UCITS managers (SMIC's and ManCo's) are required to submit quantitative data via the ONR;** **2. A sample of managers and funds will be selected by ESMA for in depth analyses.**	**The CBI noted that many weaknesses identified in their 2016 guidance still prevailed.** **The Board of Directors' responsibility for developing a culture of strong cybersecurity was highlighted as well as the need for continuous improvement in of the cybersecurity model.**	**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".**
Key Dates/Actions	**26 March 2020 – a filing for data as at 31 December 2019 to be submitted via the ONR to build up historic data set.** **A quarterly return to the CBI will be required going forward.** **Bridge Consulting will assist with the completion and filing of these new returns.**	**25 March 2020 – stage 1 questionnaire is due to be filed with the CBI no later than 4pm.** **Following analysis of this data; it is expected that a sample of firms will be selected for further review.** **Bridge Consulting will keep firms updated on developments.**	**30 April 2020 – findings of review to be brought to the attention of all firms.** **Bridge Consulting recommend that cyber security is maintained as a standing agenda item with at least annual presentations as to cyber arrangements in place. We refer Directors to the report issued by the CBI.**	**30 March 2020 – directive comes into effect in Ireland. A Shareholder Engagement Policy should be in place for any relevant firms.**

New PRISM Rating Metrics

Regulatory Update

03 December 2019

Michael Hodson noted ongoing work in relation to the PRISM impact system at a speaking engagement; "two large internal reviews – one on our Impact models...and the other is on our engagement models..."

12 February 2020

Gabriel Makhlouf; "Despite this model serving us well, there is always the need to adapt to changing circumstances..... We have recently reviewed our framework to ensure that our approach to supervision continues to be robust, risk-based and outcomes-focused."

Key Matters/Issues Arising

Previously, the key driver of impact in these prudential impact models was size but CBI analysis demonstrated that size is generally not the sole determinant of how impactful a financial service provider is.

New metrics now include;

1. Substitutability
2. Connectivity,
3. Scale and spread of financial service provider failure, etc.

Actions Required

26 March 2020

A data return was filed via the ONR to supplement historic data to support the implementation of the new model.

Going forward, quarterly data filings will be required of regulated firms.

Within each impact model, the financial service providers will be ranked in terms of their impact:

1. High
2. Medium High
3. Medium Low
4. Low

ESMA CSA Liquidity Analysis

Regulatory Update

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.

06 February 2020

CBI notified Irish fund management companies of new ESMA Common Supervisory Action to assess UCITS liquidity risk management.

Key Matters/Issues Arising

ESMA intend to carry out this review in two stages;

1. . UCITS managers (SMIC's and ManCo's) are required to submit quantitative for analysis;

2. ESMA will select a sample of managers and funds ESMA for in depth analyses.

ESMA intend to analyse firms' compliance with the UCITS liquidity risk management rules which is key to ensure financial stability, investor protection and the orderly functioning of financial markets.

Actions Required

25 March 2020

Quantitative data must have been submitted by 4pm via the Central Bank's online reporting system.

30 September 2020

ESMA guidance regarding liquidity stress testing of investment funds applicable to AIFs and UCITS comes into effect.

This 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.

Cybersecurity Thematic Review

Regulatory Update

07 October 2019

Michael Hodson noted at a speaking engagement that a thematic review had recently concluded on four asset management firms with Risk Mitigation Programmes being issued to all firms reviewed.

10 March 2020

Central Bank published an industry letter detailing the findings of this most recent thematic review.

Key Matters/Issues Arising

1. Many of the weaknesses highlighted in the Central Bank's 2016 cross industry guidance remain prevalent;
2. Board's haven't adequately prioritised developing a culture of strong cybersecurity throughout their organisations;
3. Cybersecurity incident and response plans did not meet the CBI's expectations – many were incomplete or not adequately tested;
4. The quality and frequency of the reporting on cybersecurity risks was variable with little focus on qualitative factors.

Actions Required

Cybersecurity should remain a standing agenda item for all board meetings with an annual presentation on cybersecurity also provided by all delegates.

A review of the firm's risk framework and the inclusion of cybersecurity risks and how they are reported is also recommended.

We draw your attention to the Bank's point regarding lack of focus on quantitative factors when it comes to cybersecurity reports and also the requirement for ; "sufficient skill set on the Board to challenge and oversee the strategy. "

Shareholder Rights Directive II

Regulatory Update

30 March 2020

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.

The directive takes effect in Ireland from 30 March 2020.

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

Bridge Consulting will assist firms in the drafting of a Shareholder Engagement Policy where relevant. This policy must be made publicly available.

Disclosures to institutional investors are now required detailing;

- Risks in portfolio composition
- Investment decisions
- Conflicts of interest; and
- Investment strategy and its contribution to the fund's long term performance.

Talking Points

Central Bank of Ireland statements and publications	The Importance of Diversity in the Financial Services Sector - Director General Derville Rowland	"The government has **found the percentage of women on the boards of major companies in Ireland remains "significantly lower than that of EU Member States and other international high performing global economies"** Women account for 19% of directors at listed companies overall - **8.5% of executive directors and 23% of non-executive directors**. In particular, the Central Bank expects regulated firms to: • show more ambition, including in **targets and measures**; • pay **more than lip service** to diversity programmes; • build **better pipelines** of talent; and • identify and **reduce barriers to change.**	**https://centralbank.ie/news/article/speech-diversity-in-the-financial-services-sector-derville-rowland-11-feb-2020**
	PRISM Impact Review – Revised Prudential Impact Models	"The revised prudential impact models represent an enhancement of those models, as the majority include new metrics which better represent the actual impact of financial service provider failure. Previously, the key driver of impact in these prudential impact models was size. However, analysis demonstrated that **size is generally not the sole determinant of how impactful a financial service provider is**. As a result, new metrics were introduced to many of the impact models to capture the various dimensions of impact such as **substitutability, connectivity, the scale and spread of financial service provider failure**, etc. Within each prudential impact model, the financial service providers are ranked in terms of their impact: High, Medium High, Medium Low and Low.	https://www.centralbank.ie/docs/default-source/regulation/how-we-regulate/supervision/prism/prism-impact-review-revised-prudential-impact-models.pdf
	The Decade Ahead – Governor Gabriel Makhlouf	"We do not operate a zero failure regime. Our approach provides a structured and outcomes-focused framework for supervision. Despite this model serving us well, **there is always the need to adapt to changing circumstances**. In fact, all businesses and **regulators should be looking to adapt their models, policies, and approaches to the changing financial landscape.** We **have recently reviewed our framework** to ensure that our approach to supervision continues to be robust, risk-based and outcomes-focused. And today, we are publishing a paper which sets out an update of the prudential impact component of our framework."	https://www.centralbank.ie/news/article/speech-the-decade-ahead-governor-makhlouf-12-february-2020
	Industry Letter on Cybersecurity Thematic Review	"The Board has responsibility for overseeing a clearly defined strategy for cybersecurity to enable the firm to achieve a desired state of resilience and protection. **There should be a sufficient skill set on the Board** to challenge and oversee the strategy."The Board and Senior Management **should prioritise the development of a strong organisational culture of cybersecurity**. This is key in supporting effective identification, monitoring, reporting and mitigation of cyber risks. However, many **firms failed to demonstrate sufficient focus on the development of a *culture of cybersecurity*** during the Inspection." "Preparedness for a cybersecurity incident is crucial to enhancing resilience to an attack or event. However, **weaknesses were identified in firms' vulnerability identification and management processes**........risk indicators used were overly focused on qualitative indicators with insufficient utilisation of quantitative indicators. **Robust risk reporting, including to the Board, is a critical tool to support effective assessment of a firm's cybersecurity risk exposure**. However, cybersecurity is a practice that remains underdeveloped in the Asset Management industry. Firms must give more consideration and support to identifying and managing the different threats they are exposed to, whilst recognising that the inherent risks of IT are continuously increasing. Firms must focus on **increasing the maturity of their cybersecurity model by driving a process of continuous improvement**."	https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/investment-firms/mifid-firms/regulatory-requirements-and-guidance/thematic-inspection-of-cybersecurity-risk-management-in-asset-management-firms-march-2020.pdf?sfvrsn=5

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.
Q12020	Shareholders Rights Directive II	30 March 2020, SRD II comes into effect in Ireland.
Q2 2020	Additions and changes to Pre-Approved Control Funcstions	CBI have added a new PCF role; Chief Information Officer as well as splitting PCF-39 (Designated Persons) into six distinct PCF roles aligned to specific managerial functions. https://www.centralbank.ie/docs/default-source/regulation/how-we-regulate/fitness-probity/news/notice-of-intention---additions-to-the-list-of-pcfs-february-2020.pdf?sfvrsn=4
Q3 2020	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