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# Legal and Regulatory Update January 2017

by **lk-shields**

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## **Corporate Governance for asset managers**

On 8 August 2016, the Financial Stability Board (FSB) launched a peer review on the implementation of the G20/OECD Principles of Corporate Governance (the Principles). The Principles cover a range of areas, including governance frameworks, disclosure and transparency and responsibilities of the board. The Principles, which were most recently updated in 2015, relate to publically traded financial and non-financial companies and include chapters on ensuring the basis for an effective corporate governance framework and the responsibilities of the board.

The purpose of the peer review is to assess how FSB member jurisdictions have applied these Principles to publicly listed, regulated financial institutions including banks, insurers and asset managers, and to identify good practices as well as any gaps or areas of weakness. Feedback was invited from financial institutions, industry associations and other stakeholders and the review consultation period closed on 9 September 2016. It is expected that the results of the peer review will be published during the course of 2017.

## **Consultation on good practices for the termination of investment funds**

On 18 August 2016, the International Organisation of Securities Commissions (IOSCO) published a consultation on good practices for the voluntary termination of investment funds. This Consultation Paper sets out proposed good practices for the voluntary terminations of open-ended and closed-ended investment funds. The scope is not limited to retail investment funds as it also addresses issues of relevance to investment funds for professional investors.

The paper looks to increase investor protection, with fifteen good practice recommendations split into the following sections:

- Disclosure at time of investment
- Decision to terminate
- Decision to merge
- During the termination process
- Specific types of investment funds

The board of IOSCO closed the consultation period on 17 October 2016.

## **Report on good practice for collective investment schemes (CIS) : Fees and Expenses**

On 25 August 2016, IOSCO published its final report on good practice for fees and expenses of CIS. This paper is aimed at CIS whose shares or units are permitted to be sold to retail investors. It outlines common international examples of good practice in:

- Permitted or prohibited costs for a CIS.

- Disclosure of fees and expenses to the investor, including use of electronic media.
- Remuneration of the CIS operator.
- Transaction costs.
- Hard and soft commissions on transactions.
- Fees associated with CIS that invest in other funds.
- Fee differentiation in multi-class CIS.
- Changes to the fees and expenses of a CIS.

This report does not identify all possible regulatory issues concerning the fees and expenses of CIS.

## **UCITS Q&A: Fourteenth Edition Published by the Central Bank**

On 12 September 2016, the Central Bank of Ireland (the Central Bank) published the fourteenth edition of its UCITS Q&A., a copy of which is available [here](#). The new questions, which are described in further detail below, primarily focus on umbrella funds cash accounts.

Q&A 1067: clarifies that the Central Bank's guidance "Umbrella funds cash accounts holding subscription, redemption and dividend monies" does not apply to a segregated account established by an umbrella fund in respect of a sub-fund.

Q&A 1068: confirms that the Central Bank has no objection to the establishment of multiple cash accounts by or on behalf of an umbrella fund, provided that each such umbrella cash account complies with the Central Bank's guidance "Umbrella funds – cash accounts holding subscription, redemption and dividend monies".

Q&A 1069: clarifies that it is only permissible to open an umbrella cash account for a single umbrella fund and only the sub-funds of the single umbrella fund may utilise that account. It is possible to open more than one umbrella cash account for a single umbrella fund.

Q&A 1070: notes that the format of the second half yearly accounts, for a UCITS management company/depositary, should follow that of the first half yearly accounts.

Q&A 1071: notes that pursuant to the Central Bank UCITS Regulations, a minimum capital requirement report is only required for the first set of half yearly accounts and annual returns.

Q&A 1071: confirms, in accordance with the Central Bank UCITS Regulations, that half yearly accounts should be submitted within two months of the period end.

## **Central Bank issues letter following its review of number of directorships held by individuals within the investment funds industry**

Following the Central Bank's thematic review of directors' time commitments in June 2015, the Central Bank issued a letter to all directors on 8 September 2016. The Central Bank has highlighted the need for a further detailed analysis of the sub-funds within a director's portfolio. The Central Bank noted that the amount of time allocated by directors to sub-funds varied significantly from two hours per sub-fund to eleven hours per sub-fund.

The Central Bank considers the responsibilities associated with managing a high numbers of sub-funds to be significant. Therefore, the board should consider the following to ensure a director has the overall time capacity to be an effective director to the sub-funds:

- Ensure that the documentation in place is sufficiently detailed and provides the sub-fund information necessary to perform the role of director.
- Sub-fund numbers must be evaluated when conducting portfolio planning and assessing future directorships.

- The nature of the sub-fund and level of sub-fund monitoring must be carefully considered and included in overall time capacity.

The Central Bank also made reference to individual director professional time commitments. As previously outlined, time commitment in excess of 2,000 hours a year, including commitments to at least twenty fund boards, will mean the individual director will be classed as a high risk of being unable to perform his or her functions to an appropriate standard. The Central Bank will exercise its regulatory and enforcement powers if it finds a director is not fulfilling his or her obligations.

The Central Bank noted in closing that responsibility for compliance with all regulatory obligations and related guidance ultimately rests with the board and individual directors, who are also responsible for ensuring their number of directorships is acceptable and manageable.

## **Market Abuse Regulation Q&A: First Edition Published by the Central Bank**

On 12 September 2016, the Central Bank published the first edition of the Market Abuse Regulatory Framework Q&A, a copy of which is available to view [here](#). The questions included are outlined below.

- ID1001: clarifies that persons discharging managerial responsibilities (PDMRs) and persons closely associated (PCAs) may not use the relevant issuer's online reporting (ONR) account in order to notify the Central Bank of transactions under Article 19 of the Market Abuse Regulation (MAR). Accordingly, the Central Bank requires the relevant PDMR and the PCA to apply for access to the ONR.
- ID1002: clarifies that an individual who qualifies as a PDMR for multiple issuers does not have to register for separate ONR accounts
- ID1003: clarifies that while third parties may, on behalf of issuers, PDMRs or PCAs, apply to the Central Bank in order to access the ONR, the Central Bank will only revert to the nominated contact person within the issuer, or the PDMR or the PCA, for the purposes of setting up the account.
- ID1004: notes that an issuer, PDMR or PCA may delegate notification requirements under MAR to a third party, but notwithstanding any such delegation, the issuer, PDMR or PCA remains legally responsible for complying with the obligations imposed by MAR.
- ID1005: notes that transactions should only be notified and made public once the €5000 threshold has been reached. Therefore, notifications should not be submitted to the Central Bank until the threshold has been reached.

## **Central Bank issues guidance in respect of information technology and cybersecurity risks**

On 13 September 2016, the Central Bank issued guidance in relation to information technology and cybersecurity governance and risk management by regulated firms in Ireland. A copy of the guidance is available to view [here](#). The Central Bank has noted that IT related risks are a key concern. The guidance note sets out the supervisory issues identified to date and what steps should be taken to counteract the threat. Guidance has been broken down into four main sections:

- Governance
- Risk Management
- Cybersecurity
- Outsourcing of IT Systems and Services

The Central Bank notes that the board of directors and the senior management of regulated firms are responsible for IT and cybersecurity governance and risk management. The Central Bank notes that firms should consider the issues outlined in the paper when reviewing their existing IT related governance and risk management arrangements and use this guidance to inform future development of their IT risk management frameworks.

## **ESMA consults on asset segregation and custody services under AIFMD and UCITS**

ESMA has published a call for evidence on asset segregation and custody services under the Alternative Investment Fund Managers Directive (AIFMD) and the Undertakings for Collective Investment in Transferable Securities Directive (UCITS Directive).

ESMA first consulted on asset segregation under AIFMD in December 2014 (Guidelines on asset segregation under AIFMD). At the time, the majority of respondents to ESMA's initial consultation strongly objected to ESMA's proposed approach. Given the fact that the UCITS V Directive recently introduced asset segregation requirements which are broadly aligned to AIFMD, ESMA decided to carry out a further consultation. This call for evidence had a broader scope than the initial consultation as it also covered asset segregation rules under the UCITS Directive and well as dealing with any residual uncertainty on how the depositary rules should apply to central securities depositories.

The consultation closed on 23 September 2016 and ESMA's aim was to finalise its work on asset segregation by the end of 2016. Responses received to the consultation are available to view [here](#).

## **Change to redemption gate procedures for UCITS Funds**

UCITS funds may apply a redemption gate where the amount of redemption requests received for anyone dealing day relate to shares representing more than 10% of the net asset value of the UCITS/sub-fund. Previously, redemption requests which were not satisfied due to the application of a redemption gate were carried forward to the next dealing day and dealt with in priority to redemption requests received subsequently.

However, from 1 November 2016, where a UCITS applies a redemption gate, unsatisfied redemption requests may no longer receive priority to subsequent requests and must be dealt with on a pro rata basis. This provision was introduced by the Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Undertakings for Collective Investment in Transferable Securities) Regulations 2015, subject to a transitional period which ended on 1 November 2016.

The Central Bank clarified, in its feedback statement on CP77, that it is of the view that applying priority to redemption requests which have been subject to a gate, may materially prejudice investors, particularly small investors.

## **ESMA final remuneration guidelines**

On 14 October 2016, ESMA published final guidelines on sound remuneration policies under UCITS and AIFMD which amend ESMA's previous guidelines issued under AIFMD (ESMA/2013/232).

The guidelines apply to “identified staff” of management companies and investment companies that have not designated a management company. “Identified staff” include senior management, risk takers, control functions and any employee receiving total remuneration that falls into the remuneration bracket of senior management and risk takers, whose professional activities have a material impact on the management company’s risk profile. The AIFMD amendment relates the application of the remuneration rules in a group context and is intended to acknowledge the potential outreach of the Capital Requirements Directive rules in a banking group.

The guidelines apply from 1 January 2017 across the EU.

## **CP86 Update**

On 19 December 2016, the Central Bank of Ireland published the final guidance (the Guidance) for fund management companies on managerial functions, operational issues and procedural matters. The Central Bank also published a feedback statement on Consultation Paper 86 (CP86), third consultation, (the Feedback Statement) which outlines the rationale for the final position taken on certain matters in the Guidance and which also includes new rules for fund management companies on the effective supervision requirement and on the retrievability of records.

This concludes the work of CP86 which has been ongoing since 2014 and comprised three separate consultations which focused, in particular, on Governance, Compliance and Effective Supervision.

### **Next steps and transitional arrangements are as follows**

#### Central Bank management company guidance

- The Central Bank published the first three chapters of its Fund Management Company Guidance in November 2015 on (i) delegate oversight; (ii) organisational effectiveness; and (iii) directors’ time commitments. The Central Bank has now issued both the initial three chapters and the final three chapters of its guidance which now also covers (i) managerial functions; (ii) operational issues; and (iii) procedural matters.
- Divergence from the guidance will not be a regulatory breach. However, the Central Bank’s supervisors will have reference to this guidance when forming a view as to whether a fund management company has complied with its regulatory obligations.

#### Transitional arrangements

- Fund management companies must comply with the new rules introduced by CP86 by 1 July 2018. These new rules relate to the streamlining of managerial functions to 6 managerial functions, the Organisational Effectiveness role, the retrievability of records rule and the effective supervision requirement.
- The Central Bank will only approve applications for authorisation from any new fund management company submitted on or after 1 July 2017 where the fund management company will be organised in a way which complies with the new rules introduced by CP86.
- The new rules will be included in the amended Central Bank UCITS Regulations and in the forthcoming Central Bank AIF Regulations.

Significantly, the Central Bank has relaxed its original proposed approach which was to require management companies to have at least two thirds of their fund directors based in the EEA. Fund management companies have welcomed the fact that the new location rules, as outlined below, provide more flexibility on the location of directors and designated persons than the Central Bank had previously proposed.

The location rule is summarised as follows:

Where a management company has a PRISM impact rating of Medium Low or above, the management company shall have at least:

- three directors resident in the State or, at least, 2 directors resident in the State and one designated person resident in the State,
- half of its directors resident in the EEA, and
- half of its managerial functions performed by at least 2 designated persons resident in the EEA,  
or

Where a management company has a PRISM impact rating of low or above, the management company shall have at least:

- two directors resident in the State,
- half of its directors resident in the EEA, and
- half of its managerial functions performed by at least 2 designated persons resident in the EEA.

Further analysis of the Guidance and Feedback Statement is available [here](#).

**If you would like further information, please contact any member of the [Financial Services](#) Team.**

*The material in this update is for information purposes only. Professional legal advice should be sought in relation to any specific matter.*

## About the Author