LK SHIELDS
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FINANCIAL SERVICES

Legal and Regulatory Update July 2016

by **lk-shields**

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29th July 2016 | by

Investment Funds : Recent Legal And Regulatory Developments

1. Central Bank Consultation Paper On Fund Management Company Effectiveness

On 2 June 2016, the Central Bank issued a further consultation paper on Fund Management Company Effectiveness. The third iteration of Consultation Paper ("**CP86**") contains draft guidance on three further chapters of the Guidance for fund management companies, namely (i) managerial functions (issues concerning compliance), (ii) operational issues (including supervisability) and (iii) procedural matters (the existing Central Bank guidance on the organisation of UCITS management companies is being extended to cover AIFMs also, and includes guidance on the application process for authorisation of these entities). The new rules and guidance, once operational, will apply to UCITS management companies, UCITS self-managed investment companies, authorised AIFMs and internally managed AIFs.

Part I of CP86 sets out the work already undertaken by the Central Bank in relation to the governance of fund management companies (relating to the way in which the directors of fund management companies should perform their roles and guide the company). Parts II and III outline the proposed approach to the areas of compliance (concerning designated persons carrying out their managerial functions in a manner which ensures that the fund management company complies with its regulatory obligations) and supervisability (the capacity to carry out the Central Bank's engagement model without undue constraint and the ability to react in a crisis).

Comments on the proposed rules and guidance have been invited by 25 August 2016.

A transitional period of one year following the completion of the consultation process for fund management companies is envisaged by the Central Bank, after which fund management companies will be obliged to comply with the new rules and guidance.

2. Requirement For UCITS Management Companies And Alternative Investment Fund Managers To Detect And Report Market Abuse Under Article 16(2) Of The Market Abuse Regulations

On 30 May 2016, European Securities and Markets Authority ("**ESMA**") clarified that the obligations to detect and report market abuse under Article 16(2) of Market Abuse Regulations ("**MAR**") (and the implementing technical standards once they are finalised) apply not just to investment firms under MiFID, but also to UCITS management companies, AIFMs and firms professionally engaged in trading on own account (proprietary traders) such as energy trading companies.

Using the definition of "persons professionally arranging or executing transactions" set out in Article 16(2) of the MAR, ESMA considers that the obligation to detect and identify market abuse or attempted market abuse applies broadly, and "persons professionally arranging or executing transactions" will include UCITS management companies and AIFMs.

ESMA also highlighted that detecting and reporting suspicious orders and transactions under Article 16(2) of

MAR should be applied by “persons professionally arranging or executing transactions” through the implementation of arrangements, systems and procedures that are appropriate and proportionate to the scale, size and nature of their business activity.

MAR came into force on 3 July 2016.

3. Market Abuse Regulations Implications For Listed Companies

As outlined above, the Market Abuse Regulations (“MAR”) came into force on 3 July 2016. MAR extends the application of the existing market abuse regime beyond issuers with shares admitted to trading on EU regulated markets, such as the Main Securities Market of the Irish Stock Exchange, to include issuers of securities trading on multilateral trading facilities, including the Irish Stock Exchange's Enterprise Securities Market (ESM) and the London Stock Exchange's Alternative Investment Market (AIM). Of particular significance are the following requirements:-

- Delayed disclosure of inside information: Issuers will be required to make a notification to the Central Bank of Ireland (or other competent authority) if they have delayed the disclosure of inside information and may be required to provide a written explanation of how the conditions for delay were satisfied. These obligations are supported by detailed record keeping requirements.
- PDMR dealings: MAR will prohibit persons discharging managerial responsibilities (“PDMRs”), and those “closely associated with them, from dealing in their company’s securities in a “closed period” (which is 30 calendar days before the announcement of an interim financial report or a year-end report which the company is obliged to make public, unless in exceptional circumstances). The range of permitted exceptions will be narrower than under the current Model Code. Existing rules for the disclosure of transactions by PDMRs will be retained (except the timeline for such disclosure to the Central Bank is reduced to 3 working days from the date of the transaction). No notification of PDMR dealings will be required until an annual de minimis threshold is reached.
- Market soundings: MAR prescribes a protocol for “market soundings” (ie, the “wall crossing” of potential counterparties prior to the announcement of a transaction). Detailed record keeping requirements will be prescribed.
- Insider lists: Insider lists will now be required to include more detailed personal information.
- MAR Training: All personnel in a listed company should undergo MAR training. Documented records of this training should be maintained by the company.
- Written Notification and Acknowledgement of MAR Responsibilities: Following their training, employees and PDMRs should receive a written notification of their MAR obligations and they should be required to acknowledge these obligations in writing. PDMRs are also required to notify any person who is closely associated with them of their MAR obligations and retain a record of these notifications.
- Company’s Internal MAR Compliance Manual: Listed companies will need to update their existing internal market abuse compliance manuals in order to ensure that they reflect the new requirements under MAR. In particular, companies will need to update their internal procedures for identifying and disclosing inside information to the market and the processes in place for delaying disclosure. Existing manuals will also need to be updated to reflect the significant record keeping duties under MAR.
- Website & Record Keeping: Listed companies will need to review their websites in order to ensure that all disclosures of price sensitive information can be retained in an easily accessible location for a period of at least five years following their release. Similarly, records should be stored in a durable medium that allows them to be replayed or copied and must be retained in format that does not allow the original record to be altered or deleted.

4. CP105: Consultation On Amendments To The Central Bank UCITS Regulations

The Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Undertakings for Collective Investment in Transferable Securities) Regulations 2015 (the “CBI UCITS Regulations”) were published in

October 2015 and came into effect 1 November 2015. The Central Bank undertook to keep the CBI UCITS Regulations under review and, if necessary, to update them periodically.

Consultation Paper 105 (CP105) looks to obtain industry feedback on amendments to the CBI UCITS Regulations that have been identified, namely amendments which are consequential on the implementation of UCITS V and certain technical amendments including correction of typographical errors. The technical amendments include a request for feedback on whether the requirements in relation to disclosure of open derivative positions in annual and half-yearly reports might be amended, particularly in circumstances where the disclosure can be lengthy and technical in nature.

Respondents are invited to comment on the proposed rules and guidance no later than 25 August 2016.

5. Implementation Of The Investor Money Regulations

The Investor Money Regulations came into force on 1 July 2016. The implementation date for the Central Bank (Supervision and Enforcement) Act, 2013 (Section 48(1)) Investor Money Regulations, 2015 for Fund Service Providers (the "Investor Money Regulations") was postponed from 1 April 2016 to 1 July 2016 in order to give industry additional time to take all the necessary steps required to address the new regime.

The Investor Money Regulations introduce a new investor money regime which will have an impact on Irish regulated fund service providers including UCITS management companies, AIFMs, and UCITS and AIFs which are self-managed.

The additional time with which the Central Bank afforded the industry was welcomed as the practical implications of the new arrangements proved more challenging for industry than originally envisaged.

The Central Bank's Markets Directorate has written to individual fund service providers in relation to the potential applicability of the Investor Money Regulations to their business models. Fund service providers are required to provide the Central Bank with a detailed account of the arrangements that have been put in place to comply with the new requirements.

6. Central Bank Publish Revised Guidance On Umbrella Cash Accounts

The Central Bank has published revised guidance on umbrella funds cash accounts holding subscription, redemption and dividend monies (the "Guidance").

The Guidance applies to the holding of cash assets of umbrella funds in a single account at the level of an umbrella (an "umbrella cash account") in the name of the investment fund, the fund management company (on behalf of the investment fund) or the depositary. The Guidance states that an umbrella cash account can only be established where the fund management company and the depositary are satisfied that:

- At all times, the amounts, whether positive or negative, within the umbrella cash account can be attributed to the individual sub-funds in order to comply with the constitutional documents of the umbrella fund; and
- The holding of cash assets in an umbrella cash account will not compromise the ability of the depositary to carry out its safe-keeping and oversight duties and responsibilities in accordance with UCITS and AIFM Regulations.

The Guidance outlines that sub-funds should not participate in an umbrella cash account in any of the following circumstances:

- Where the sub-funds are highly leveraged.
- Where there is an increased possibility that investors subscribing to those sub-funds are likely to make late payments.
- Where the umbrella fund commenced trading before 30 June 2005 and does not have segregated

liability between sub-funds.
- Where the constitutional document does not set out consequences for investors who do not provide subscription proceeds by the stated settlement date.

The Guidance provides that the management company shall, in conjunction with the depositary, establish a policy (which shall be reviewed on an annual basis) to govern the operation of an umbrella cash account and that the policy should require, as a matter of procedure, that specific criteria relating to the umbrella cash account are identified at the outset and are updated on a continuous basis.

The policy shall also implement the following procedures, which are to be agreed between the management company and the depositary:

- A daily reconciliation process, including procedures to apply to the prompt investigation of any money remaining in the umbrella cash account. In circumstances where sub-funds of the umbrella fund do not deal on a daily or weekly basis, the reconciliation process shall be carried out in accordance with the dealing frequency of the sub-funds but at least on a monthly basis.
- The treatment of money in the cash account when calculating the net asset value of the sub-funds.
- The procedure to apply where money will be transferred from the umbrella cash account to an investor money collection account held by a fund service provider in accordance with the Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1) Investor Money Regulations 2015 for Fund Service Providers, where applicable.
- The procedure to apply to the resolution of shortfalls due to a late or non-payment from a subscribing investor, including the cancellation of units if appropriate.
- The reports to be provided to the fund management company in relation to the operation of the umbrella cash account.

The Guidance also addresses the following issues:

- Specific disclosures to be made to investors, relating to the channels through which subscription and redemption monies shall be paid in the umbrella cash account and the additional risks associated with umbrella cash accounts.
- Treatment of subscription, redemption and dividend monies in umbrella cash accounts.
- The process involved in circumstances where one of the sub-funds within an umbrella cash account becomes insolvent.

7. UCITS Q&A - Thirteenth Edition Published By The Central Bank

On 2 June 2016 the Central Bank published the thirteenth edition of its UCITS Q&A. Some new questions have been added that address the following issues:

- Q&A 1063 (UCITS Management Company - organisational effectiveness) which clarifies that, except in rare cases where unique and unusual circumstances apply, an organisational effectiveness review should, at a minimum, be conducted on an annual basis.
- Q&A 1064 (share class hedging) clarifying that over-hedged positions should be included in calculations when leverage is calculated as the sum of the notionals, where a UCITS uses a VaR approach to calculate global exposure; in calculations of counterparty risk; and, in calculations of concentration exposures.
- Q&A 1065 was previously issued in the form of a general information note and included in the Markets Update published on 12 June 2015 restating that the CBI does not require UCITS management companies, alternative investment fund managers, AIF management companies, fund administrators, depositaries and investment firms to convert to Designated Activity Companies (DACs) under the Companies Act 2014.
- Q&A 1066 Companies Act 2014: confirming that the Central Bank does not require UCITS management companies, alternative investment fund managers, AIF management companies, fund administrators, depositaries and investment firms which are taking action to re-register as a company

type recognised under the Companies Act 2014 to submit amendments to their constitution. However, where companies re-register as DACs a copy of the new certificate of incorporation should be submitted.

In addition, an existing question, Q&A 1013, which deals with past performance data, has been amended and the title of this section has been revised accordingly.

8. Central Bank Publishes Feedback Statement Following Consultation On Changes To The AIF Rulebook

On 2 June 2016, the Central Bank published the Feedback Statement on Consultation Paper 99 – consultation on amendments to the AIF Rulebook (the "Feedback Statement").

Many of the proposed amendments are technical in nature. The Feedback Statement gave an overview of the responses received to the issues raised in Consultation Paper 99 and the Central Bank's comments.

The Central Bank confirmed in the Feedback Statement that it is proceeding with the preparation of Central Bank AIF Regulations.

In many cases, the proposed policy changes in Consultation Paper 99 seek to align the AIF Rulebook with the recently published Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Undertakings for Collective Investment Transferable Securities) Regulations 2015 (the "CB UCITS Regulations"), which replace the Central Bank's UCITS Notices. The following is a summary of some of the key proposed policy changes in Consultation Paper 99;

- Requirement for Depositaries to provide quarterly reporting to the Central Bank on non-Irish funds to which they provide depositary services. Currently, depositaries are not required to provide data in respect of any fund which is already included in the return provided by other entities such as that fund's AIFM.
- Revision of the Minimum Capital Reporting requirements applicable to AIFMs and AIF Management Companies to align them with the CB UCITS Regulations, i.e. the updating of the list of expenses which can be deducted from the total expenditure figure and the removal of the template reporting form to reflect the fact that reporting is made online through the Central Bank's Online Reporting System.
- Clarifying that the exemption from the minimum subscription requirements for investments in a Qualifying Investor Alternative Investor Fund ("QIAIF") is available to the AIFM of that fund, and directors, employees or group entities of the AIFM.
- Extension of the list of requirements which apply to Registered AIFMs managing QIAIFs.

9. Central Bank Publishes Updated AIFMD Questions And Answers (Q&A)

On 2 June 2016, the Central Bank published an updated edition of its AIFMD Q&A. The updated Q&A contains new questions on the following topics:

- The Central Bank confirms in the Q&A that there is no obligation on AIFMs, administrators or depositaries to convert to Designated Activity Companies under the Companies Act 2014.
- The Q&A confirmed at new question ID 1104 that the person responsible for Organisational Effectiveness in a fund management company should conduct an organisation effectiveness review annually, at a minimum.
- Retail Investor Alternative Investment Funds ("RIAIFs") or QIAIFs pursuing a venture capital, development capital or private equity strategy do not need to conform to the rule prohibiting QIAIFs and RIAIFs from acquiring shares carrying voting rights that would enable them to exercise significant influence over the management of the issuing body for the proportion of assets invested under those

strategies.

10. Consultation On Cross-Border Distribution Of Investment Funds

On 2 June 2016, the European Commission (the "Commission") launched a consultation on the cross-border distribution across the European Union (EU) of investment funds, including AIFs.

The purpose of the consultation is to provide the Commission with information on the main barriers to the cross-border distribution of investment funds. The Commission is seeking to increase the number of funds marketed and sold across the EU to efficiently allocate capital and increase competition across the EU.

The consultation lists a number of specific areas it is seeking feedback on:

- Marketing restrictions of EU funds;
- Distribution costs and regulatory fees;
- Administrative arrangements;
- Distribution networks;
- Notification processes; and
- Taxation.

Responses to the Consultation must be received by the Commission by 2 October 2016.

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