



Breakfast Briefing 6 September 2018

Funds Legal and Regulatory Update Q4 2018

ETFs – An Irish Update

Shane Coveney

What are we seeing in the market?

- ▣ Strong benefit from visibility of trades as a result of MiFID II regime.
- ▣ ‘Active’ managers looking to enter the market and strong increase in M&A activity:
 - ▣ Legal & General’s acquisition of Canvas (2017);
 - ▣ Van Eck’s acquisition of ThinkETF (2018);
 - ▣ PowerShares acquisition of Guggenheim (2018);
 - ▣ WisdomTree’s acquisition of ETF Securities' European exchange-traded commodity, currency and short-and-leveraged business (2018).
- ▣ New entrants into the market
 - ▣ HanETF offering ‘white label’ platform;
 - ▣ JP Morgan Asset Management launch of a UCITS ETF platform.
- ▣ Continued race to lower fees

Potential Guidance to come from the Central Bank of Ireland

- ▣ In May 2017, the Central Bank of Ireland issued Discussion Paper 6 in relation to Exchange Traded Funds. It is anticipated that the 'Feedback Statement' from this industry consultation will be issued later in September 2018.
- ▣ Central Bank of Ireland to revert on specific matters only.
- ▣ More complex matters such as 'transparency' expected to be excluded and left to IOSCO review.

Potential Guidance to come from the Central Bank of Ireland

- ▣ Impact of ESMA's Final Report - Peer review on the Guidelines on ETFs and other UCITS issues which was issued on 30 July 2018.
 - ▣ Potential review of PRISM designations for UCITS ETFs.
 - ▣ Guidelines in relation to fees, costs and revenues arising from EPM including a systematic approach on reviewing costs, fees and revenues relating to EPM to prevent the risk of hidden revenues.
 - ▣ a more prominent role in assessing the risks connected to securities lending, repos and reverse repos.
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Questions & Answers

Any questions?



**The CBI Fund Management Guidelines and 2017
ESMA opinions - the impact on substance
requirements in Ireland**

Etain de Valera

Fund Management Companies – Guidance – A Re-Cap

- ▣ CP86 and CBI Fund Management Companies Guidance
 - ▣ Ireland - well established “delegated model” for fund management companies/SMICs/internally managed AIFs
 - ▣ CBI pre-emptive strike to demonstrate robustness of “delegated model”
 - ▣ Substance = the “letterbox rule” under AIFMD and UCITS Directive
 - ▣ no delegation to the extent that FMC becomes a “letter-box” entity;
 - ▣ retain necessary expertise and resources to supervise the delegated tasks effectively and manage risks associated with delegation;
 - ▣ retain decision making ability in key areas;
 - ▣ retain power to perform senior management functions;
 - ▣ delegation of investment management “cannot exceed by a substantial margin” the functions performed by the AIFM itself.

Fund Management Companies – Guidance – A Re-Cap

- ▣ FMC Guidance sets out a clear framework for compliance with substance requirements
 - ▣ Principles for delegate oversight
 - ▣ Streamlining of management functions – to be discharged by DPs senior and qualified
 - ▣ Directors' Time Commitments
 - ▣ 20 directorships with 2000 plus hours = risk indicator;
 - ▣ Number of sub-funds and complexity ;
 - ▣ Separate time commitment for DP and directorship roles.
 - ▣ Organisational effectiveness
 - ▣ Location Rule
 - ▣ Dependent upon PRISM rating;
 - ▣ Low, 2 Irish resident directors, ½ of Directors and ½ DPs to be located in EEA.

ESMA Opinions 2017 – FMC Guidance in Context

- ▣ ESMA Opinion on General Principles to Support Supervisory Convergence in the context of the UK withdrawing from the EU
 - ▣ Clear message from ESMA that there is to be no regulatory and supervisory arbitrage by national competent authorities with respect to delegation and outsourcing post Brexit
 - ▣ Requires NCAs to frame delegation and outsourcing requirements in strict adherence to EU law and ensure coherent implementation and consistent supervision across the EU – Nine Principles including
 - ▣ Special attention should be granted to avoid letter-box entities in the EU27;
 - ▣ Outsourcing and delegation to third countries is only possible under strict conditions;
 - ▣ NCAs should ensure substance requirements are met - The substance of decision making cannot be outsourced or delegated outside the EU;
 - ▣ NCAs should ensure sound governance – ESMA expects directors and senior managers in the Member State of establishment “work there to a degree proportionate to their envisaged role”;
 - ▣ Coordination to ensure effective monitoring by ESMA –Supervisory Coordination Network to promote consistent decisions are taken by NCAs - forum for reporting and discussions among NCAs.

ESMA Opinions 2017 – FMC Guidance in Context

- ▣ ESMA Opinion to support supervisory convergence in the area of investment management in the context of the UK withdrawing from the EU
 - ▣ Sets out principles based on the objectives and provisions of UCITS and AIFMD.
 - ▣ Expands upon many of the principles set out in cross-sectoral opinion as to authorisation, governance and internal control, delegation and effective supervision.
 - ▣ Confirms that delegation requirements set out in the UCITS Directive and AIFMD must be harmonised.
 - ▣ In many respects Opinion reflects those principles already established and enshrined in FMC Guidance.
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ESMA Opinions 2017 – FMC Guidance in Context

- ▣ The Opinions – A “road map” for NCAs
 - ▣ Paragraph 25 – confirms calibration of procedures and organisational structure to nature, scale and complexity of the business and provides assessment criteria for NCAs.
 - ▣ Assessment by NCAs to be carried out on a case by case basis.
 - ▣ Paragraph 26 – *“Authorised entities of significant size and/or entities employing complex investment strategies or having a broad range of business activities could operate with only a minimum operational set-up. Such entities should have a more sophisticated governance structures and internal control mechanisms in place than smaller entities”.*
 - ▣ Paragraph 60 – *“NCAs should apply additional scrutiny to situations where relocating entities even those of smaller size employing simple investment strategies and having a limited range of business activities do not dedicate at least 3 locally-based FTE (including time commitments at both Senior Management and staff levels to the performance of portfolio management and/or risk management and/or monitoring of delegates. NCAs should assess the criteria set out in paragraph 25 in the course of their ongoing supervision and require authorised entities to adapt their needs for human and technical resources as business operations further evolve”.*
 - ▣ Effective Supervision – key tenant of Opinions.

ESMA Opinions 2017 – FMC Guidance in Context

- ▣ Paragraph 25 criteria – nature, scale and complexity
 - ▣ AUM
 - ▣ Number of sub-funds and share classes
 - ▣ Complexity of strategy
 - ▣ Type and range of asset classes
 - ▣ Geographical spread of investments
 - ▣ Use of leverage/efficient portfolio management techniques
 - ▣ Frequency of investment activities
 - ▣ Cross border management/marketing activities
 - ▣ Type and range of ancillary functions performed internally and delegated
 - ▣ Any MiFID add-ons
 - ▣ Number and type of investors, frequency of dealing, geographical distribution of marketing activities
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ESMA Opinions – a change in substance requirements?

- ▣ The ESMA Opinions are having an impact!
- ▣ CBI participation in the Supervisory Coordination Network and ESMA Peer Review
- ▣ Greater scrutiny of all NCA's approach to substance
- ▣ Central Bank has not to date issued any additional guidance or parameters – uncertainty but room for negotiation!
- ▣ Central Bank will continue to examine each application for authorisation for a new entity on a case by case basis having regard to the paragraph 25 criteria
- ▣ AUM, no of sub-funds and complexity of strategy continue to be key risk indicators
- ▣ Recent market experience – increase in DP time commitments dependent upon the management function to be discharged – alignment with concept of “FTEs”? – cost and staffing implications for market participants
- ▣ SMICs safe for now but indication that the CBI will expect “boots on the ground” for new standalone FMC applications
- ▣ Effective Supervision and the Location Rule – will the CBI provide equivalence to Directors and DPs located in the UK ?
- ▣ Two-tier system for Brexit related applications and pre-Brexit structures – can it last?

Questions & Answers

Any questions?



BREXIT

Planning Ahead for Investment Funds

Donnacha O'Connor

Timeline to Exit

- ▣ 18-19 October, 2018 EU Council Summit – finalisation of the Withdrawal Agreement?;
 - ▣ 13-14 December, 2018 – last EU Council Summit of 2018 – seen as last practical date for deal on Withdrawal Agreement, possible emergency Summit sooner;
 - ▣ January to March, 2019 – European Council to approve the Withdrawal Agreement;
 - ▣ To March, 2019 – European Parliament votes on the Withdrawal Agreement;
 - ▣ 29 March, 2019 - UK ceases to be a member of the EU with or without agreement – time extension to continue negotiations only possible with unanimous EU member state consent;
 - ▣ 30 March, 2019 – UK in transition/implementation period; Single Market and Customs Union rules continue to apply. Trade talks to begin.
 - ▣ 31 December, 2020 – transition/implementation period ends.
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UK firms providing investment services to Irish funds

- ▣ In the event of a deal involving transitional maintenance of status quo (i.e. internal market rules continue to apply to UK); transition to December 31, 2020;
 - ▣ Impact of a no-deal Brexit in March, 2019;
 - (A) UK firm acting as AIFM;
 - (B) UK firm acting as investment manager by delegation;
 - (1) UCITS, AIFMD and CBI rules on delegation;
 - (2) EU investment services regulation; and
 - (3) Irish investment services regulation;
 - (C) Distribution of financial products by UK firm into EU investor markets
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Transitional arrangements under MIFID II

- ▣ Commission positive equivalence decision in accordance with Article 47(1) of MIFIR – ESMA can grant permission to individual UK firms to passport investment services to professional investors around EU.
- ▣ In the absence of an equivalence decision:
 - ▣ **Article 46(4) of MIFIR:**
 - ▣ *Member States may allow third-country firms to provide investment services or perform investment activities together with ancillary services to eligible counterparties and professional clients within the meaning of Section I of Annex II to Directive 2014/65/EU in their territories in accordance with national regimes in the absence of the Commission decision in accordance with Article 47(1) or where such decision is no longer in effect.*
 - ▣ **Regulation 5(4) of the European Union (Markets in Financial Instruments) Regulations, 2017;**
 - ▣ an investment firm shall not be regarded as operating in the State if the firm provides investment services or performs investment activities, with or without any ancillary services, to eligible counterparties or to [per se] professional clients; AND
 - ▣ (a) the firm is subject to authorisation and supervision in the third country where the third-country firm is established and the third-country firm is authorised so that the competent authority of the third country pays due regard to any recommendations of FATF in the context of anti-money laundering and countering the financing of terrorism, and
 - ▣ (b) co-operation arrangements that include provisions regulating the exchange of information for the purpose of preserving the integrity of the market and protecting investors are in place between the Bank and the competent authorities where the third-country firm is established.

Alternative solutions

- ▣ UK AIFMs wanting continued marketing access for their AIFs;
 - ▣ Wait for third country passport.... OR
 - ▣ Re-organise so that AIF appoints EU AIFM, which delegates to UK as investment manager
 - ▣ UK UCITS management companies wanting to continue to act as management companies to EU UCITS
 - ▣ Re-organise
 - ▣ UK investment managers wanting to provide investment management services to EU per se professional clients or EU retail clients
 - ▣ Country by country analysis of Article 46(4) MIFIR inspired national rules or reverse solicitation or re-organise if retail clients
 - ▣ UK investment managers wanting to distribute funds in the EU
 - ▣ As above
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Questions & Answers

Any questions?



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