Asset Management & Investment Funds Update – March 2019

No-Deal Brexit Developments Continue

Legislative and regulatory developments continue to be made at an EU and Irish level to respond to the impact of a no-deal Brexit. The most recent important measures affecting the asset management industry are set out below.

Ireland Publishes Brexit Omnibus Bill

On 20 February 2019 the Irish government published a Bill (Withdrawal of the United Kingdom from the European Union (Consequential Provisions) Bill 2019) to accommodate a no-deal Brexit scenario dealing with a wide range of matters, including taxation and financial services. The Bill is drafted along similar lines to the general scheme for the legislation that was published on 24 January.

As regards financial services, under the CSD Regulation, Euronext Dublin (formerly the Irish Stock Exchange) would not have been able to continue using its current system (Ireland uses the UK-based CSD 'Crest') as the UK would become a third country. Part 7 of the Bill supports the European Commission's temporary and conditional equivalence decision for UK based Central Securities Depository (CSD) services and CCPs.

Part 7 also introduces measures to protect payments and transfers of securities made by Irish participants by empowering the Minister of Finance to 'designate' a 'third country system' for the purposes of the Settlement Finality Regulations. This will extend the protections of those Regulations to Irish firms using settlement or payments systems in a designated third country (UK).

The Bill has already started its progress through the Houses of the Oireachtas (Parliament) and it is anticipated that it will pass all stages by Friday 15 March 2019. Given the importance, breadth and scope of the Bill, the government has said that it will work closely with all members of the Oireachtas to ensure it passes in a timely fashion.

Money-Market Funds - Central Bank requests Brexit contingency plan for UK bank deposits

The Central Bank has written to Irish authorised money market funds (MMFs) requesting details of any deposits held by these funds in accounts with UK licenced banks, whether for investment and/or operating purposes, and their post-Brexit plans for such accounts. In its correspondence, the Central Bank cites the investment restriction on MMFs to hold deposits only with EU credit institutions or with third-country credit institutions, subject to prudential rules considered by the Commission to be equivalent to those laid down in EU law in accordance with Article 107(4) of the CRR. No equivalence decision in respect of credit institutions established in the UK has been made by the Commission and so, as the Central Bank highlights, "Following the UK's exit from the EU, until the European Commission takes a decision in relation to the UK's supervisory and regulatory equivalence under the CRR, deposits in UK licenced banks are ineligible investments for MMFs".

Industry engagement with the Central Bank on Brexit issues

The industry representative body, Irish Funds, is in continuous engagement with the Central Bank on Brexit related matters and specifically those which impact the national regulatory regime for Irish funds. Currently, a number of matters raised by Irish Funds are under consideration by the Central Bank with responses anticipated on or before 15 March 2019. Chief amongst such items include proposals for;

- the eligibility of UK UCITS (which will become AIFs in a no-deal Brexit scenario) as investments for Irish UCITS and authorised AIFs;
- the expansion of the Central Bank's list of UCITS eligible counterparties to OTC derivatives to include UK entities whose current MiFID licence will expire following the UK's exit from the EU;
- the introduction of a national regulatory fast-track approval procedure for certain Brexit related amendments to retail fund documentation similar to that in place for qualifying investor AIFs (QIAIFs).

ESMA formally announces recognition of UK CSD in event of no-deal Brexit

On 1 March 2019, ESMA announced that in the event of a no-deal Brexit, it will recognise Euroclear UK and Ireland Ltd, the UK central securities depository (UK CSD), as a third country CSD under the Central Securities Depositories Regulation (CSDR). The UK CSD will be recognised to provide its services into the EU, having been assessed as meeting the recognition conditions under Article 25 of the CSDR.

ESMA has adopted this recognition decision to allow the UK CSD to serve Irish securities and to avoid any negative impact on the Irish securities market. This recognition decision was the final step in a well-flagged process to provide continued access to the UK CSD.

Commission Proposal to enhance powers of ESAs may be delayed

In September 2017, the Commission published proposals focussed on strengthening the powers of the European Supervisory Authorities (the ESAs) through changes to the role and governance of each of EIOPA, ESMA and the EBA (the ESA Review). Many aspects of the ESA Review were met with broad support. However, concerns have been raised by various stakeholders in relation to certain proposed measures which would give the ESAs a significant role e.g. reviewing delegation and outsourcing arrangements by EU regulated entities to third country entities. Under such measures, the ESAs would be notified and asked for an opinion in specific cases when a financial institutional or market participant intended to significantly outsource, delegate or transfer risks to entities in non-EU countries in a way that would allow it to benefit from the EU passport while essentially carrying out its activities outside the EU. Although the Council confirmed its support for the proposals in February 2019 and invited the Presidency to start negotiations with Parliament as soon as possible, recent media reports suggest that the European legislative bodies have been unable to reach agreement on these 'delegation' measures. This is likely to frustrate the Commission's hope of finalising the ESA Review prior to the European elections in May.

EMIR reporting – Central Bank sets out its expectations for investment funds

The Central Bank is responsible for the supervision of compliance with EMIR by counterparties to derivative trades, including counterparties which are Irish investment funds. Under EMIR, counterparties are required to provide trade repositories (TRs) with information regarding these derivative trades, which is utilised by the Central Bank for supervisory purposes, and to manage and mitigate systemic and contagion risk. During 2018, the Central Bank undertook a series of data quality checks on reported EMIR data for a cross-section of counterparties and on 20 February 2019, it issued a feedback letter to counterparties including boards of fund management companies, investment companies and ICAVs (FMCs).

The letter provides feedback to counterparties on the main issues identified from these data quality checks. The letter largely repeats and follows up on the themes of a feedback letter issued in September 2016 relating to a review of EMIR Regulatory Returns. The recent letter also covers inadequacies in reporting of valuations, collateral and expired/matured contracts and, significantly, also states that compliance with EMIR Reporting should be included as a standing agenda item for all board meetings.

Whilst the Central Bank notes an improvement in the quality of data reported to the TRs, the issues highlighted below remain.

Key findings and recommendations:

- **Delegated reporting**: although a counterparty may have delegated EMIR trade reporting to the other counterparty or to a third party (in the case of an FMC, this will often be the investment manager), the counterparty should take appropriate steps to ensure compliance with the reporting requirements. TRs reject submissions where the data provided does not comply with the reporting standards set out in the validation table published by ESMA. The Central Bank has found instances of counterparties who have delegated reporting and are not aware of rejection reports issued by TRs to the delegates. The Central Bank recommends that:
  - a counterparty using a delegated reporting service should ensure it receives regular reporting from the delegate, to include details of TR rejection reports. This requirement should be included in any delegated reporting agreement entered into by a counterparty;
  - counterparties should reconcile data reported to the TR by its delegate with its own internal systems to ensure that all relevant trading has been reported;
  - counterparties should ensure that remedial action is undertaken to address shortfalls and non-compliance with EMIR requirements;
  - counterparties should regularly review TR rejection reports to ensure that all trade

submissions are successfully reported to a TR, revised correct data submissions are made on a timely basis, and remedial action is taken to eliminate rejected reports in the future.

- **Completeness and accuracy of trade reporting**: a number of recurring issues have been observed with respect to the completeness and accuracy of trade reporting, centred on valuations, collateral and outstanding and expired/matured derivative contracts. The Central Bank recommends that:
  - counterparties should regularly review the completeness and accuracy of their reports to TRs, to ensure that all trade submissions to TRs are complete and accurate;
  - financial counterparties (FCs) and non-financial counterparties + (NFC+s) should submit daily valuations for all outstanding trades/positions;
  - FCs and NFC+s should submit collateral data for all outstanding trades/positions;
  - counterparties should pay particular attention to ensure that where:
    - a trade/position has a maturity date the 'Maturity Date' field is populated;
    - a trade/position is terminated early, the counterparties should submit an early termination message to the TR;
    - a trade is compressed, the relevant compression message should be submitted to the TR;
    - a derivative contract does not have a maturity date due to the nature of the derivative, and the maturity date field cannot be populated, the counterparty sends the relevant message to the TR closing the derivative contract immediately when the contract is closed out.
- **Legal entity identifier ("LEI")**: in reporting to a TR, a report should include a LEI to identify a counterparty which is a legal entity. The Central Bank recommends that:
  - counterparties should share details of their LEI with any entity with which it trades or to which it has delegated reporting;
  - all reviews carried out by the counterparty or its TR data reporting delegate should confirm that the counterparty is correctly identified with its LEI.
  - counterparties should renew LEIs annually. Lapsed LEIs are invalid for reporting purposes. Entities offering delegated reporting services are recommended to monitor the renewal date for a client's LEIs and to notify the client accordingly.
- **Unique trade identifier ("UTI")**: Each derivative contract must be known and identified by all relevant parties by a UTI. If there is no UTI in place, a unique code should be generated and agreed between the counterparties to the contract. The Central Bank recommends that:
  - counterparties should ensure that a UTI, communicated to all relevant parties in advance of the trade being reported to a TR, is applied to individual trades and be in a position to explain how it ensures the UTI is unique;
  - where responsibility for UTI generation is delegated to another entity, the delegating counterparty must ensure that it is advised of the UTI in a timely manner and be aware of how it can be deemed unique.

There are very few new observations / recommendations in the Central Bank's February 2019 feedback by comparison with the September 2016 feedback. However, it is a timely reminder of EMIR reporting obligations of investment funds and how they must be fulfilled. Boards may need to review the contractual arrangements with their relevant trade reporting delegates to ensure that all relevant matters are covered and undertake an exercise to ensure that the contractual obligations are discharged in the manner expected in the feedback. A prudent approach for FMCs would be to undertake an exercise to ensure that the Central Bank findings and recommendations are being addressed by trade reporting delegates / service providers to the FMC and appropriate reviews / validation being carried out on its behalf by the management or designated persons and appropriate reporting / escalation to the board and confirmation / interrogation at board meetings.

Trustees Required to Establish Beneficial Ownership Register

With effect from 29 January 2019, trustees of express trusts are required to maintain certain information in respect of the trust's beneficial owners.

These requirements were introduced by way of the European Union (Anti-Money Laundering: Beneficial Ownership of Trusts) Regulations 2019 (S.I. No. 16 of 2019) (the Regulations). The purpose of the Regulations is to give effect to certain provisions of the 4th EU Anti-Money Laundering Directive (AMLD4).

These Regulations are distinct from the beneficial ownership regulations relating to corporates that were published in November 2016. At present, there is still no obligation for either corporates or trustees to submit beneficial ownership information to a 'central register' of beneficial ownership maintained by the State. It is expected that this obligation will be introduced in a phased manner during 2019.

What is a "beneficial owner"?

"Beneficial owner" means any natural person(s) who ultimately owns or controls the customer and/or the natural person(s) on whose behalf a transaction or activity is being conducted and includes at least, in the case of trusts, the settlor, the trustee(s), the protector(s) if any; and:

(i) the beneficiaries, or, where the individuals benefiting from the legal arrangement or entity have yet to be determined, the class of persons in whose main interest the legal arrangement or entity is set up or operates;
(ii) any other natural person exercising ultimate control over the trust by means of direct or indirect ownership or by other means; and

there is no 25% qualifying threshold in relation to establishing the beneficial ownership of a trust as there is with corporate entities.

What types of trust are in scope?

The Regulations apply to express trusts whose trustees are resident in the State or which are otherwise administered in the State.

Maintaining a beneficial ownership register

A trustee of a trust must take **all reasonable steps** to obtain and hold adequate, accurate and current information in respect of the trust's beneficial owners. This includes:

- Name
- Date of birth
- Nationality
- Residential address

The Regulations do not set out what steps a trustee must take to comply with this obligation.

The beneficial ownership information obtained by the trustee must be kept on the trust's internal beneficial ownership register, which is referred to as an "express trust (beneficial ownership) register" in the Regulations.

The beneficial ownership register must also include details of:

- the date on which the natural person was first added to the beneficial ownership register as a beneficial owner; and
- the date on which the natural person ceased to be a beneficial owner.

The beneficial ownership register must be kept up to date. Where a natural person ceases to be a beneficial owner of the trust or there is any change in the particulars of a natural person entered on the register, the trustee of the trust must make the appropriate alterations or deletions.

While the Regulations require trustees to take all reasonable steps to obtain information on the beneficial ownership of the trust, in contrast with the beneficial ownership regulations relating to corporate entities, there is no obligation on trustees to issue notices to persons they believe are beneficial owners of the trust. In addition, there is no provision made for a scenario where it is not possible to identify the beneficial owners, as there is in the regulations dealing with corporates, by inserting the name of the "senior managing official(s)" of the entity. Also, in contrast to those earlier regulations, there is no obligation on the beneficial owners themselves to inform the trustee of their status as such.

Trusts which are Investment Funds

In the case of a trust which is an investment fund i.e. a UCITS under the UCITS Directive or an AIF, as defined under the AIFM Directive, the definition of trustee in the Regulations "includes the manager or operator" of the investment fund. This reflects the fact that in the case of most investment funds, the role of the depositary (which also acts as "trustee" in the context of an investment fund formed as a trust) is quite separate and independent from the role of manager (management company). It is typically the management company which either itself or, more often, through a delegate administrator, will act as a transfer agent and registrar of the investment fund, and carry out KYC/AML/CTF checks in respect of the investors in the investment fund. In the case of an investment fund established as a trust, a prudent approach would be to regard both the depositary and management company of the investment fund as a trustee for the purposes of the Regulations. The investment fund would have a single beneficial ownership register and contractual arrangements would need to be entered into between the depositary and management company setting out the practical aspects/roles as regards relevant information gathering, the establishment and maintenance of the register (with input from the administrator/transfer agent of the investment fund) and with both the depositary and management company having access to the register.

Providing access to register

A trustee must provide the Revenue Commissioners or any State competent authority with timely access, on request, to the trust's beneficial ownership register.

A State competent authority may share information contained in the beneficial ownership register of a trust with corresponding competent authorities in other EEA Member States.

Obligations when entering business relationships

Where a trustee enters into a transaction to which customer due diligence measures must be applied with a "designated person" (within the meaning of anti-money laundering legislation) or forms a business relationship with such a designated person, the trustee must inform the designated person in writing that it is acting as trustee and, on request from the designated person, provide the designated person (without delay) with information identifying all the beneficial owners of the trust. In the case of a class of beneficiaries, this information may be provided by specifying the class of persons who are beneficiaries or potential beneficiaries under the trust.

Where, during the course of the business relationship, there is any change in the information provided to the designated person, the trustee of the trust must notify the designated

person of the change and the date on which the change occurred no later than 14 days from the date on which the trustee became aware of the change.

Retention of records

The trustee of a trust must keep records of the reasonable steps they have taken to identify beneficial owners of the trust and retain those records for at least 5 years after the date on which the final distribution is made under the trust. The trustee must also make arrangements for those records to be deleted at the end of that 5 year period, unless there is a particular reason to maintain them.

Sanctions

Failure by a trustee to comply with any of the above obligations is a criminal offence and can result in the imposition of a fine of €5,000 on summary conviction.

Timing and future developments

The Regulations are operative from 29 January 2019 and so trustees will need to take immediate action to ensure they are in compliance with their new obligations under the law.

AMLD4 (as amended) requires information on beneficial ownership of trusts to be submitted to a central register maintained by the State by March 2020. Access to this register must be granted to competent authorities, financial intelligence units (**FIUs**) and obliged entities (without restriction) and, on a more limited basis, any natural or legal person that can demonstrate a "legitimate interest" in the information.

Further legislation will be required to establish this central register and set parameters around the "legitimate interest" ground of access.

Related to this, legislation to establish a central register for beneficial ownership of corporate entities is expected shortly. Ireland is obliged to grant full public access to the information on the central register for corporate entities.

FATF – Public Consultation on the Draft Risk-Based Approach Guidance for Trust and Company Service Providers

On 25 February 2019, FATF announced that it is developing guidance to assist countries, competent authorities and professionals in the trust and company service providers legal and accountancy sectors in the application of a risk-based approach ("RBA") to AML/CFT. The guidance is intended to provide support both to the private sector and public authorities, by focusing on money laundering/terrorist financing risks and associated mitigation measures.

FATF opened a consultation with private sector stakeholders, and wishes to receive views and specific proposals before the guidance is finalised on the text of the guidance documents including FATF-RBA Guidance for Trust and Company Service Providers.

The deadline to provide comments is 8 April 2019 and FATF intends to adopt the final guidance at its June 2019 plenary meeting.