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Asset Management & Investment Funds Update

February 2024

Key Dates & Deadlines: Q1/2 2024

The following are key dates and deadlines in Q1 and Q2 2024 along with possible impacts and action items arising for fund managers.

Date	Source	Summary	Action/Impact
Q1 (exact date TBC)		Individual Accountability Framework (IAF) Consultation on updated business conduct standards was due to be published in December 2023 and is now expected imminently as part of the Central Bank's review of the Consumer Protection Code.	See our dedicated IAF & SEAR site for further details.
Q1 (exact date TBC)		AIFMD/UCITS Review Final AIFMD/UCITS amendments expected to issue on a range of topics including delegation and substance, liquidity management and loan-originating AIFs, following publication of the final compromise texts on 13 November 2023.	Fund managers may prepare for an application date of Q1 2026 assuming retention of the proposed two-year transposition period. See here for further details.
Q1 (exact date TBC)		ESG Ratings Regulation Interinstitutional negotiations to begin following agreement of negotiating mandates by the Council and the Parliament in December 2023.	The ESG Ratings Regulation will provide for the authorisation and supervision of EU and non-EU entities which publicly disclose or distribute ESG ratings and is expected to be finalised in H2 2024 and become applicable in 2025. See here for further details.
12 February		FCA consultation on Implementing the Overseas Funds Regime (OFR) ends	See here for further details.

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		The OFR will provide a streamlined process for marketing non-UK funds to UK retail investors.	
20 February		UCITS KIID annual update filing UCITS which continue to prepare a KIID under UCITS rules must file updated KIIDs with the CBI. The CBI has confirmed to William Fry that there will be no annual filing requirement for PRIIPs KIDs.	Standard annual item for UCITS managers with UCITS KIIDs. See here for further details.
28 February		Filing deadline for annual CBI fund profile return On an annual basis, each sub-fund's Fund Profile V2 return must be reviewed to confirm the profile details and updated to reflect the change(s). The annual Fund Profile V2 return is made through the CBI's Portal.	Standard annual item for sub-funds. See here for further details.
29 February		Filing deadline for annual PCF confirmation return Due to be filed via the CBI's Portal. The CBI's website notes in respect of this return that 'new functionality is under development and will be available shortly'.	Standard annual item for Funds and Fund Managers. See here for further details.
March (exact date TBC)		BMR REFIT proposals Proposals to limit the application of the BMR to significant and climate benchmarks and preclude non-EU administrators from using PAB/CTB labels are planned for adoption by end-March 2024.	Both administrators and users of benchmarks are expected to benefit from the REFIT proposals. See here for further details.
4 March		SFDR Level 2 Revisions End of EU legislative scrutiny period for SFDR Level 2 revisions published by the ESAs on 4 December 2023. If no objections are raised/scrutiny period is not extended, the RTS will adopted as revised SFDR Level 2 measures.	Proposed revisions include to the PAI indicators, DNSH disclosure rule, disclosure templates along with technical adjustments and new disclosure obligations for decarbonisation targets. See here for further details.
20 March		Retail Investment Strategy ECON to vote on the Commission's proposal, following which the proposal will move to trilogue negotiations before being voted on by the Parliament and Council and moving to adoption.	The proposal is scheduled for implementation with a start-up period of 2025-2027 followed by full-scale operation. See here for further details.
Q2 (exact date TBC)		ESMA Funds' Names Guidelines Guidelines on the use of ESG terms in the names of funds are expected to be finalised and published with an application date of 3 months post-	Guidelines are expected to include qualitative and quantitative investment thresholds for funds' use of ESG terms in the fund name. See article on topic

		publication and a 6-month transition period for existing fund names.	in this month's update for further details.
Q2 (exact date TBC)		SFDR Level 1 Revisions Commission expects to adopt SFDR proposals taking account of feedback from Q4 2023 industry consultation on compliance issues, alignment with other sustainable finance measures and reform proposals.	See here for further details.
29 April		EMIR REFIT reporting rules Delegated measures for reporting under EMIR Refit and associated ESMA Guidelines applicable.	Key changes to TR reporting and regulatory notification of errors include increase in reportable fields, new reporting format, new rules for UTI generation, phased expansion of reconcilable fields and clarifications of the regulatory notification requirements for reporting errors.
28 May		T+1 Settlement US transitions to T+1 settlement cycle one day after Canada, which transitions on 27 May 2024.	See article on topic in this month's update for further details.
31 May		FCA Anti-Greenwashing Rule FCA's anti-greenwashing rules and associated guidance under the UK Sustainability Disclosure Requirements (**SDR**) come into effect.	See here for further details.
30 June		FCA ESG Rules/TCFD First entity-level and (if applicable) public product-level disclosures due for firms with £5-50bn AUM under the UK SDR.	See here for further details.
End-Q2		CSA Asset Valuation Deadline for completion of review of asset valuation frameworks by fund managers, as required by the Central Bank in its 'Dear Chair' letter detailing findings from the CSA on Asset Valuation.	The Central Bank expects fund managers to evaluate the adequacy of their asset valuation control frameworks, take any necessary steps to strengthen arrangements where weaknesses are identified following a review of the Central Bank's CSA findings published on 14 December 2023. See here for further details.

ESMA: SDG funds particularly prone to impact-washing

In its 1 February 2024 report on an analysis of sustainability impact investing (the **Report**), ESMA concluded that funds claiming positive contribution to the achievement of the UN Sustainable Development Goals (**SDGs**) are no more aligned with the SDGs than non-SDG or other ESG funds. This has raised investor protection concerns for ESMA which queries how funds, which claim contribution to the SDGs through their name, investment strategy or investor disclosures (**SDG funds**), can legitimately deliver on those claims. In ESMA's view this can not be achieved by 'simply excluding [investments] based on sectoral or geographical characteristics [but] should also consist of the active and careful evaluation and selection of assets that have proven to contribute concretely to specific SDGs'.

SDGs

As noted by ESMA in its Report, the UN SDGs are one of the most popular sustainability frameworks used by funds targeting a positive real-world sustainability impact (**impact funds**), to measure and disclose on such impact to investors. Indeed, SDGs are the cornerstone of many funds' sustainable investment frameworks established in accordance with SFDR.

The SDGs include 17 goals with 160 targets and 248 indicators spanning the full range of ESG topics. However, the Report casts doubt on the appropriateness of their use to guide and measure impact funds contribution to sustainability objectives including because of:

- the SDGs' broad scope,
- the SDG framework being primarily formulated for sovereigns and consequentially the inherent difficulty in assessing the extent to which a single entity can help contribute towards SDG targets, and
- the absence of harmonised and standardised private sector reporting requirements against the SDG targets.

According to ESMA, the above challenges can result in investors being misled as to SDG funds' sustainability impact claims. In its May 2023 progress report on greenwashing (see here for further details), ESMA identified impact-washing, including from the misuse of the SDGs, as a key investor risk and confirmed it is analysing the extent to which SDG funds' claims hold true. ESMA's final report on greenwashing is due in May this year.

Results from ESMA analysis of SDG v non-SDG portfolios

In its analysis of SDG funds, ESMA compared the portfolio holdings of a sub-set of SDG funds (EU active equity, bond, mixed SDG funds with >3 holdings and none older than 2021) with those of non-SDG funds, focussing on holdings (i) in UN Global Compact (**UNGC**) participants, as a measure of corporate investments' SDG-alignment, (ii) in the SDG Index, as a measure of investee countries' SDG performance, and (iii) exposure to SFDR principal adverse impact (**PAI**) indicators .

ESMA's findings include:

1. SDG funds do not clearly spell out how their investment strategy aligns with the SDG goals meaning investors struggle to assess concrete contribution to achieving the SDGs.
2. SDG funds are no more aligned with the UNGC than non-SDG funds.
3. SDG funds perform slightly better than their non-SDG funds on the proportion of the portfolio involved in violation of UNGC/OECD Guidelines, but a higher share of their portfolio has a lack of UNGC compliance mechanisms
4. On average, SDG funds invest slightly more in sovereign debt issued by countries with a high SDG Index score, however the difference is limited and does not hold true across all SDGs e.g., non-SDG funds have higher average index scores for SDG 12 (responsible consumption and production) and SDG 13 (climate action).
5. Fewer SDG funds compared to non-SDG funds hold at least one bond issued by a development bank.
6. SDG funds perform worse than non-SDG funds on SDG-relevant PAI indicators in absolute terms and SDG funds have, on average, higher GHG emissions than non-SDG funds, with SDG funds having 50% more scope 3 emissions compared to non-SDG funds

Next Steps

The Report concludes with ESMA noting that clearer rules and requirements are necessary to ensure SDGs are not misused as a reference tool for sustainability objectives. The Report is available here on ESMA's website.

Individual Accountability: a reminder to review Directors & Officers Insurance

As a result of the new Individual Accountability Framework (**IAF**), persons in key functions within regulated firms will face greater personal exposure. In this article, we examine how corporate indemnities and D&O insurance may assist in mitigating these new personal risks.

The IAF, including within it the Senior Executive Accountability Regime (**SEAR**) for relevant regulated financial firms, took effect on a phased basis from 29 December 2023. The regime bolsters the Central Bank's fitness and probity regime, affecting PCF (pre-approval controlled function) and CF (controlled function) holders. For firms within the scope of SEAR, responsibility mapping and related elements mean directors and other PCF holders must be identified individually as 'owners' of aspects of a firm's business. More generally across all regulated financial firms, there are new conduct standards and additional conduct standards. The full cohort of C-suite and, potentially, a broad range of other individuals (PCFs and CFs) at various operational levels must adhere to the applicable standards.

Personal Exposure

The IAF and SEAR are designed to enable greater personal exposure for persons in key functions. This is underscored by the breaking of the so-called “participation link”. Relative to the new requirements, enforcement action may be sought by the Central Bank directly against individuals without the regulator necessarily having first pursued a regulated firm itself for breach. Distinct from other sanctions, such as restriction or prohibition of a person in taking on future financial services roles, the monetary sanction against an individual can be up to €1 million.

The developments heighten distinctions between the position of directors and officers, on the one hand, and that of the regulated firm itself. The IAF and SEAR lead to some greater personal focus on how directors and other officers within affected firms, distinct from the company itself, can fully defend themselves were an alleged breach to arise. In this article, we examine how company indemnities and directors’ and officers’ insurance (**D&O Insurance**) can assist PCF and CF function holders in mitigating personal risks.

While the article uses the term ‘officer’ (persons beyond directors) a reader, depending on the business, may need to construe it widely. Persons across broad functions in a firm may occupy CF roles of one kind or another. All are potentially affected by the IAF’s conduct standards. Cover under appropriate insurance may need to be available now for what is therefore a large cohort of affected individuals (i.e. no longer just a narrow ‘C-Suite’).

Tailoring

The exposures which a director or other PCF or CF officer faces under the IAF and SEAR are complex. Similarly, the structures through which an affected individual gets comfort that there are measures in place capable of performing in an exposure scenario are technical. It means, for example, that directors or other senior role holders (the areas with the highest risk exposure) always need to be suitably informed. This may extend to a need for personal advice. From a company perspective, as well as working with officers to ensure there is appropriate knowledge, the holding of D&O Insurance will usually include the use of a specialist insurance broker. D&O Insurance is a tailored product. It will need to sit “side-by-side” with other measures. That includes, for example, the extent to which a company itself is capable of giving corporate indemnities through which it can hold harmless, to the extent permitted, an officer should an event arise.

Corporate Indemnities

A first ‘layer of defence’ before looking at D&O Insurance is going to be any indemnification or other contractual comfort a company can have in place for its directors and officers. Companies can offer some, though perhaps not total, protection to directors and officers through the giving of an indemnity. This is typically found in the company constitution. It may also be provided within a stand-alone document between a director or other officer and the company (e.g. including within an employment contract). Directors and officers are advised to check what may be in place.

Whereas the receipt of a corporate indemnity from a firm in which a director or officer is engaged is going to be helpful, it is however not without its limitations. There are public policy grounds on how far a company can absolve its directors and officers from wrongdoing and use of company funds, for example, if there is ultimately a finding of guilt. Section 235 of the Companies Act 2014 states that an indemnity in respect of any negligence, default, breach of duty or breach of trust of a director or officer will be void. Having said this, an indemnity can cover the funding of defence elements. This can extend to civil or criminal proceedings and includes regulatory enforcement action (such as might involve the Central Bank). However, again, in the event of a final finding of guilt, indemnity amounts paid to an officer may come to be refundable to the company. There is also the risk that, when called upon to pay, a firm may prove incapable or unwilling to honour obligations.

D&O Insurance

As a company is unlikely to be able to fully insulate directors and officers through indemnification alone, D&O Insurance is used. Directors and officers will know that, with insurance in place, there can be a claim made by an officer directly on the insurer where a loss event arises. It means therefore, beyond ensuring that the firm has paid for the policy to be in place, there is going to be direct comfort should an issue arise.

Directors and officers need to query with firms that an appropriate policy is in place, and it may extend to including the requirement within, for example, a contract of employment. Section 235 of the Companies Act 2014 expressly allows a company to pay for D&O Insurance. In the context of sophisticated businesses, as will be the case across financial services activities, D&O Insurance is usually viewed as essential. Upon proposed appointment, a director or other key officer may often enquire as to the level and nature of cover in place within a company or group.

What is D&O Insurance?

D&O Insurance provides cover to directors and officers when faced with claims arising from the performance of a role, including breaches of directors' duties or fiduciary duties, negligence, default, misrepresentation, errors and omissions and non-compliance with regulation. Given the public policy dimension and ensuring cover is not being invoked in an inappropriate way, intentional fraudulent and criminal actions will not be covered. However, a broad range of risks can be. The policy is usually paid for by the company or group itself.

Claims against directors and officers can be from various directions including shareholders, investors, and the firm of which a person is a director or officer as well as from third parties such as a regulator like the Central Bank under its Administrative Sanctions Procedure (as amended by the application of the IAF regime).

Typical Cover

D&O Insurance can protect past, current and future directors and officers as well as provide insurance cover for the company (or a group) itself. The cover protects the personal assets of the insured individual and can also protect the assets of the company or companies in a group. It can cover the defence costs of a claim, any award arising out of the claim, settlements and other costs. This can include regulatory investigations and proceedings. As well as direct recourse by a director or officer, a company will be reimbursed under the policy where it indemnifies a director or officer for liabilities. It may also recover itself then to the extent of being directly pursued.

Considering the incoming IAF and SEAR regimes, firms need to review D&O policies to ensure that actions taken by the Central Bank as a regulator are covered and that existing policies are fit for purpose relative to the new requirements. Points for focus may include, for example, cover where the Central Bank alleges a failure of a duty of responsibility for which a PCF holder (director or other officer) has prescribed or inherent responsibility as well as other areas. Cover under the policy may be required where the Central Bank conducts a regulatory investigation against the individual to whom the IAF/SEAR applies, meaning cost is incurred in the taking of legal or other advice. It may extend to initial regulatory interviews or similar. Individuals will also want to have cover for defence and related costs where the person is ultimately named a defendant in administrative sanction proceedings taken by the Central Bank.

D&O Insurance Structure

D&O Insurance is put in place to perform relative to quite complex risks and is itself a relatively complicated insurance product. Appropriate advice needs to be taken by the firm putting the cover in place as well as, in relevant scenarios, by the insured directors and officers themselves (e.g. sufficiency and structure of cover).

Part of the complexity of D&O Insurance is that it will have different features depending on the company or companies for which the cover is extended. It is therefore structured in different ways. The most common approach is where the cover is divided into two and, potentially, three separate components. These are known as Side A, Side B, and Side C. For a typical Irish financial services firm (unlisted), Sides A and B will be usual. The breakdowns are as follows:

- *Side A* – cover is for directors and officers directly (i.e. an officer makes a direct claim against the insurer, without necessarily involving the firm itself).
- *Side B* – cover is for the firm itself, i.e. so it can be reimbursed for a director's or officer's legal costs and liabilities which it indemnified (i.e. through extending to its officers the corporate indemnities described earlier).
- *Side C* – cover for more bespoke elements, especially securities law recourse such as where a company is publicly listed and there may be allegations of misrepresentation or misstatement of financial accounts should shareholders suffer a loss leading to claims.

Points to Consider

The Central Bank's new IAF and SEAR requirements heighten risk exposures and, consequently, the need for D&O Insurance to be in place. Adequate D&O Insurance coverage will be viewed as essential for many types of activity, including financial services firms. The following are some points to remember:

- Levels of cover can be expensive. It means a level of "trade-off" on what may be available and that a firm is willing to fund within reason. This needs discussion and broker input on what is market standard.
- D&O Insurance is subject to quite extensive limitation and exclusion clauses. There is a need for careful review of the policy wordings, e.g. what is included within the definition of "wrongful act" and how it is potentially curtailed. This is at the core of the policy. For financial services firms in scope for

IAF and SEAR, cover broad enough for regulatory action must be included. A general 'corporate' policy suitable for other types of company activity is likely to be insufficient.

- D&O Insurance is written on a "claims made" basis. Cover is only available for claims made and reported to the insurer during the policy period (i.e. typically, a one-year window) regardless of when the alleged "wrongful act" occurred. After the policy period, the D&O Insurance is usually no longer available for a claim (unless the circumstances giving rise to the claim were notified to insurers during the policy period). Ensuring ongoing cover each year will be important.
- Which officers have cover needs attention. The policy should extend to prior directors and officers given, for example, the extensive Central Bank look-back period on alleged IAF/SEAR breaches. The Central Bank may come to pursue PCF or CF holders potentially many years after they ceased in a role or working with a firm. Individual "run-off" cover may also be sought for exiting directors or officers in given scenarios.
- D&O Insurance typically includes an aggregate maximum level of recoverable under the policy (i.e. a claims cap). A policy may "exhaust" as recourse is sought by individuals, for example, where there are multiple defendants comprising directors or officers in the context of a single enforcement matter. The claims cap limit may also be shared with the company or other companies within a group structure, increasing the risk of rapid depletion of the aggregate amount of funds available. As such, the cap should be reviewed to ensure that the annual aggregate claim limit is adequate to meet any potential IAF/SEAR risks.
- Thought can be given to likely eventualities. One area is the order in which recourse to cover will arise. Circumstances often mean that the executive directors are first to be affected and claim under a policy. If not properly constructed, as concerns the non-executive directors or others, it means by the time of notifying a claim that the policy limit is spent. D&O Insurance can be designed to include a separate excess cover extension for non-executive directors and others.
- Relative to the IAF and SEAR, 'heat mapping' the exposures by reference to the constituency of PCFs and CFs and, for example, inherent and prescribed responsibilities they have under SEAR, will assist in determining cover levels and potentially a ring-fenced recoverable for individual recourse. Recognition needs to be given that the new IAF regime is likely to lead to greater direct enforcement. As referenced above, a personal sanction could be in a monetary amount of up to €1 million plus all associated defence and other costs.

Conclusion

The phased roll-out of IAF and SEAR will commence throughout 2024. A 'bedding-in' period can be expected before potential enforcement action by the Central Bank takes place against firms. The regulator has indicated its application will be based upon proportionality, predictability and reasonable expectations. Experiences in similar jurisdictions, such as the UK, indicate restraint in the use of similar measures.

We anticipate D&O Insurance written in the Irish market for affected financial services firms will adapt as firms work with brokers on the IAF and SEAR risks identified for each key officer. The existence and the nature of cover in place will be an important agenda item for boards.

Impact of U.S. Move to a T+1 Settlement Cycle

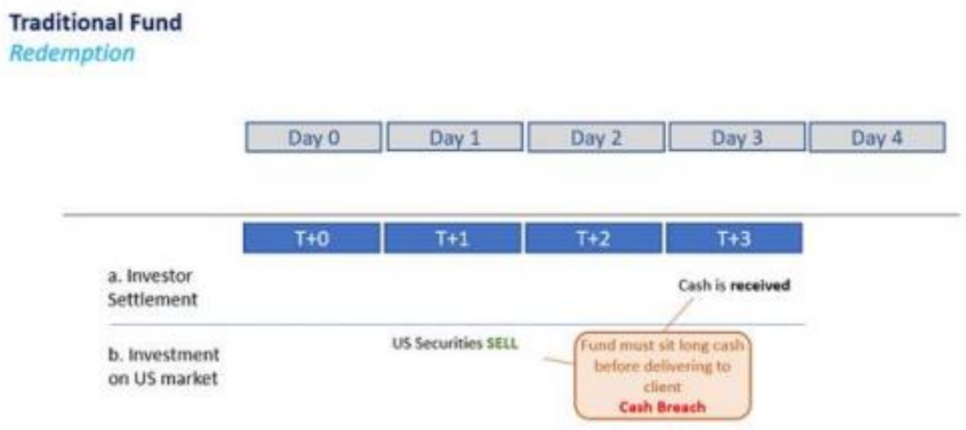
Post May 2024 U.S. securities markets move to a T+1 settlement cycle. This move will impact the application of certain UCITS rules around investment and borrowing, in particular Article 52(1) and Article 83(2) of the UCITS Directive.

Impact of Move to T+1

Article 52(1) reads as follows:

"A UCITS shall invest no more than 20% of its assets in deposits made with the same body."

Breaches of this Article may become a much more regular and frequent event with the U.S. move to T+1. The type of cash breach which could occur is illustrated below:



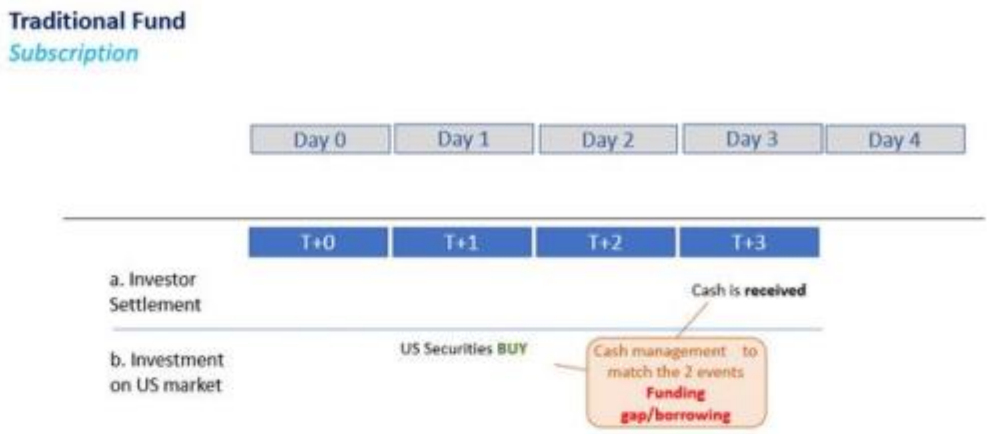
EFAMA 'Impacts of US T+1 Settlement on EU Regulation, November 2023

Regulatory sanctions for breaches of Article 52(1) differ from jurisdiction to jurisdiction. Many industry players, such as EFAMA, have asked that asset managers are given regulatory forbearance and that there is a harmonized approach across the EU to any temporary exemptions.

Article 83(2) reads as follows:

"By way of derogation from paragraph 1, a Member State may authorise a UCITS to borrow provided that such borrowing is: (a) on a temporary basis and represents: in the case of an investment company, no more than 10% of its assets…."

The following graphic illustrates the funding mismatch which could lead to a breach of this Article:



EFAMA 'Impacts of US T+1 Settlement on EU Regulation, November 2023

Approximately 43% of all EU equity funds domiciled in Europe, are composed of U.S. securities, giving an idea of the frequency of a funding gap in the portfolios that European asset managers manage. EFAMA (the industry body for EU asset managers) have asked that UCITS be given an exemption from the 10% NAV borrowing limit when the breach is due to a settlement mismatch.

Position adopted by Irish Depositaries and the Central Bank ("CBI")

The initial position of Irish depositaries had been that they would likely treat the breaches described above, particularly breaches of Article 52(1), as inadvertent breaches but that view is now shifting. The CBI has been visiting depositaries in recent weeks and making clear that the CBI's current position is that the breaches described above are advertent breaches on the grounds they are foreseeable. Fund management companies and funds will of course equally need to consider how to treat/report such breaches. As yet, there are no plans for industry to engage with the CBI around leniency and it is hoped that developments at a European level may shape the CBI view.

EU & T+1

In a keynote speech delivered in Brussels on 25 January 2024, Commissioner McGuiness noted ESMA's work (see here for further details) and that *'When it comes to T+1, the question is no longer if, but how and when it will happen here in the EU. And it won't be in the next few months. But it's the way that all major markets are headed. So this is the mindset we should have …We should all assume that the move to a shorter settlement cycle will happen. [But] how we can make it work and how we can minimise the costs involved."*