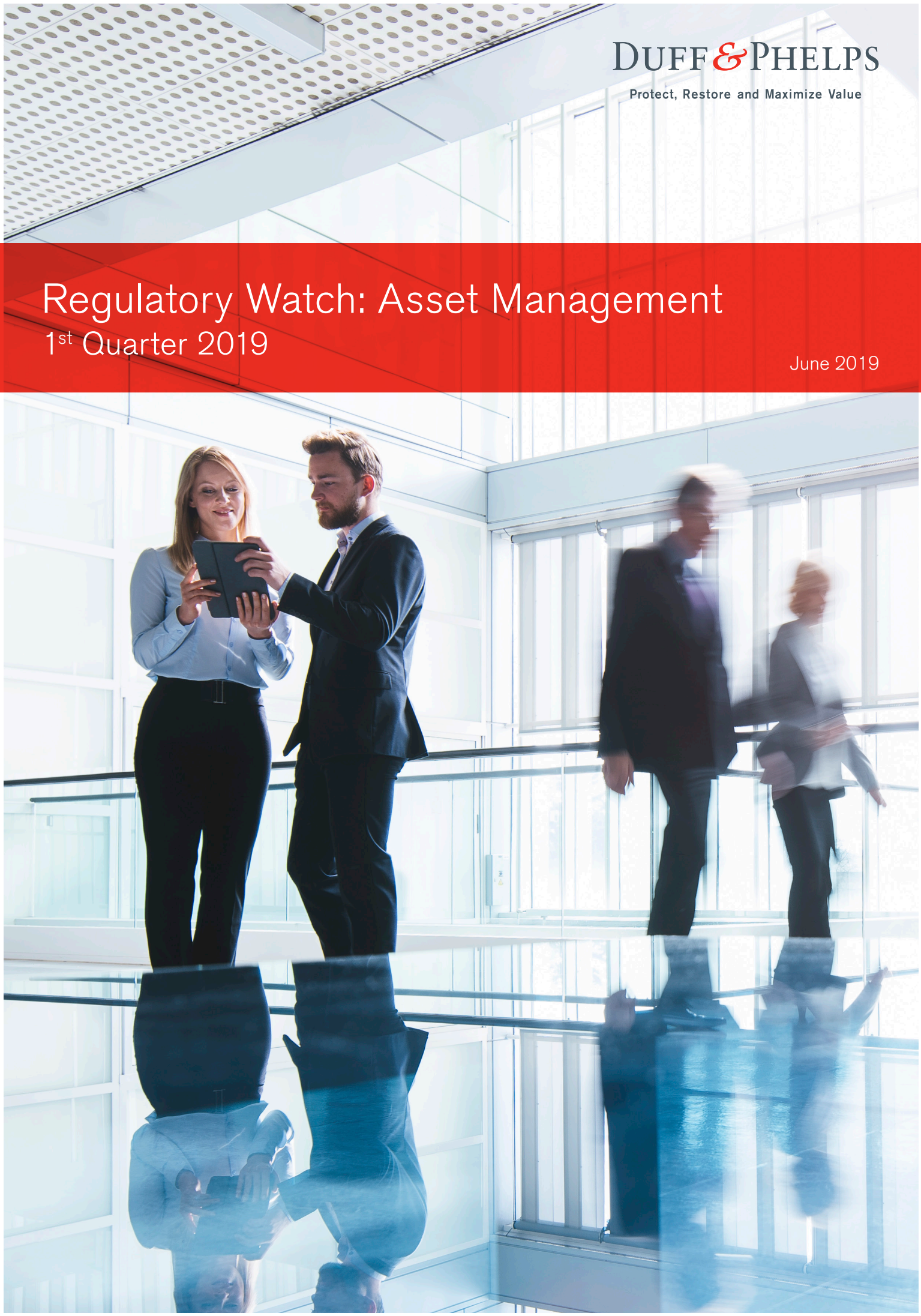
DUFF & PHELPS

Protect, Restore and Maximize Value

Regulatory Watch: Asset Management

1st Quarter 2019

June 2019



SOMMAIRE

France

First lessons from the AMF on AIFM reporting

On 23 January 2019, the AMF published a study on the AIFM reporting of 2017.

This first study of the AMF on the French Alternative Investment Funds provides information on the composition of their portfolios, their exposures and their level of risk. Overall, the majority of AIFs are traditional funds, while the riskiest funds such as hedge funds are few in number. Their exposure, liquidity management and use of leverage seem to be consistent with their investment strategies, both at the aggregate level and on a fund-by-fund basis. This study is intended to better monitor the AIFs and to participate in the revision of European legislation.

Nevertheless, the AMF highlights the constraints of reporting, in particular a classification that does not allow all funds to identify themselves in the range of strategies proposed, and variable data, which makes it difficult to analyse the reportings.

Thus, the AMF indicates to cover more risk indicators, better data coverage and possible revisions to reporting in the future editions.

General update of the AMF doctrine

At the beginning of 2019, the AMF updated a big part of its doctrine, without direct impact on the regulatory and professional requirements of the asset management companies, in particular:

- Position 2004-07 on market timing and late trading practices
- Instruction 2012-01 on Risk management organisation for collective investment undertaking management activities and discretionary portfolio management investment services
- Position-Recommendation 2012-10: Guide relating to employee investment undertakings
- Position-Recommendation 2012-19: Programme of operations guide for asset management companies and self-managed collective investments
- Position-Recommendation 2012-12: A guide to fees

Those modifications, even though they are not introducing new obligations, were subject of a publication on the AMF website.

MiFID II suitability requirements

On 6 March 2019 the AMF pubished the new Position-Recommendation DOC-2019-03 on the MiFID II suitability requirements.

This position integrates the ESM guidelines on certain aspects of the MiFID II suitability requirements (ESMA35-43-1163).

These guidelines aim to clarify the procedures that must be carried out by the investment service providers in order to verify the suitability requirements of the MiFID II Directive for the provision of third-party investment advisory or portfolio management services.

From 6 March 2019, this position replaces the Position AMF DOC 2012-13.

Update of the guide to drafting collective investment marketing materials and distributing collective investments

On 3 January 2019, the AMF published the update of the Position-Recommendation 2011-24 on the drafting of collective investment marketing materials and distribution of collective investments.

The updates relate to the following subjects:

- General principles as regards the making of promotional materials, in particular, the accuracy, clarity, and not misleading character of the information, the communication about annualized performance, and the references to past perfomances;
- Information on potential conflicts of interest;
- Marketing features for SOFICA and for authorized private equity funds.

Update of the guide to the monitoring of collective investment undertakings

On 13 March 2019, the AMF updated the Position-Recommendation 2011-25 on the monitoring of collective investment undertakings.

The new sections added are the following:

- Due diligence to be conducted for the monetization of a collective investment undertaking using portfolio insurance techniques;
- Due diligence to be conducted in the monitoring of formula funds;
- Specific case of early dissolution/transfer of a collective investment undertaking implementing a buy and hold strategy;
- Liquidation of ETFs (including in merger operations)
- Increasing the capital of a real estate investment company, forestry investment company or forestry group.

19th training day of RCCIs and RCSIs

On 14 February 2019, the 19th training day of RCCIs and RCSIs (Compiance and Internal Control Officers and Investment Services Compliance Officers) took place. The day was devoted to the regulatory developments, with a focus on the compliance function, on the settlement agreements and the jurisprudence of the AMF's Enforcement Committee. The recordings of interventions and the slides circulated during the day are available on the AMF website.

Update of the guide to regulatory documents governing collective investment undertakings

On 3 January 2019, the AMF published the update of the guide to regulatory documents governing collective investment undertakings.

The updates relate to the following subjects:

- « Buy and hold » management ;
- Benchmark indicator of a UCITS;
- Running costs of UCITS of funds;
- Performance simulations;
- Coupon payments;
- Capped performances;
- Risk and reward profile of private equity funds (retail private equity funds, innovation funds and local investment funds) and formula funds.

Publication of a CNIL guide on GDPR

The CNIL has published a practical guide on GDPR awareness. The guide's objective is to raise the relevant parties' awareness in order to implement their data protection structure, which they are solely responsible for.

Furthermore, the AFG, in cooperation with the CNIL has published a guide, available only for the members, and the AMF has also published a personal data protection policy.

UK

Cooperation between the FCA and the SEC with a view to ensure the stability of financial markets

On 29 March 2019, the FCA published its press release indicating that they updated two Memorandum Memorandums of Understanding with the SEC to ensure continued close cooperation and information sharing in the event of the UK's withdrawal from the European Union.

These two agreements also seek to avoid the market fragmentation, allowing the fund managers to continue to operate on the two markets. These updates promise continuity and stability for the UK and US investors.

Furthermore, the updates:

- Expand the scope of firms covered who operate across national borders, and
- Allows the firms and financial instruments covered by the AIFM Directive and supervised by the FCA and the SEC to continue to operate in the two countries without interruption.

The two agreements will enter into force when the European regulation is not anymore directly applicable in the UK anymore.

Statements of policy on the operation of the MiFID II transparency regimes

On 4 March 2019, the FCA published its Statements of Policy, as well as its Supervisory Statement outlining the operation of the MiFID II transparency regime in case of a no-deal Brexit.

For the moment, this regime was calibrated using trading data from the EU, including the UK, with the ESMA validating data on transactions and performing various calculations to set thresholds.

In case of a no-deal Brexit, the UK regime provides the FCA with a decision-making power, as well as with new obligations to operate a transparency regime. It also includes 4-year-long transitional period to allow the FCA to implement the systems necessary to operate a system similar to the one currently operated by ESMA.

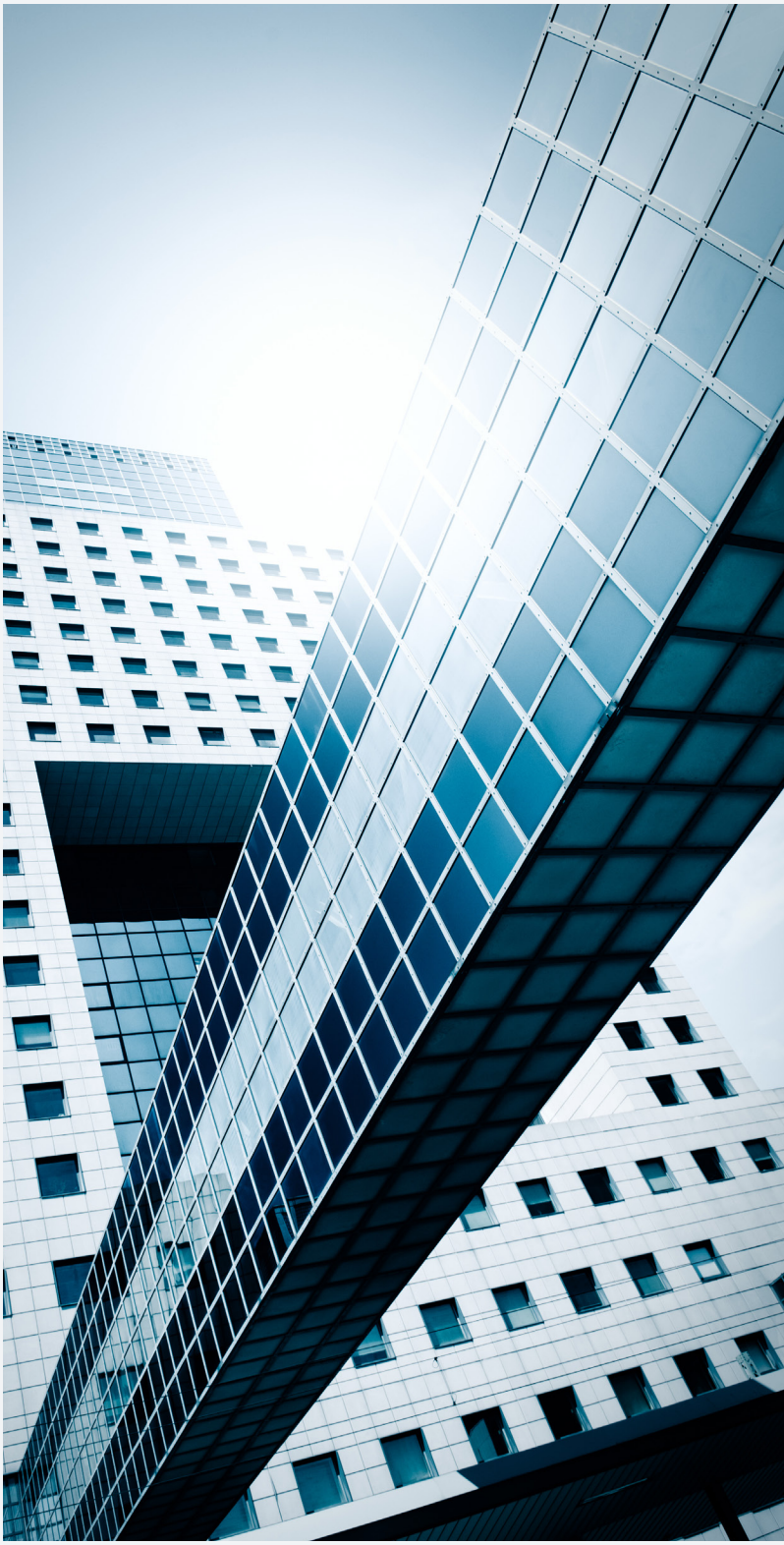
This policy aims to outline the way the FCA will use these new powers, and to give further clarity to market participants about the FCA's approach in advance of Brexit.

Investment bank fined for transaction reporting failures

On 28 March 2019, a global investment bank was fined by the FCA £34.3 million for failing to provide accurate and timely reporting over a period of almost 10 years.

Between November 2007 and March 2017, the bank failed to provide accurate information in relation to 220.2 million of transactions. In addition, the FCA found that the bank failed to take reasonable care to organize and control its affairs responsibly and effectively in respect of its transaction reporting.

The bank has accepted to resolve the case quickly, which made it possible to receive a 30% discount in the overall penalty. Without this discount, the amount would have reached £49 million.



EUROPEAN UNION

ESMA report reveals performance of retail investment products strongly affected by fees

On 10 January, 2019, ESMA published its first annual statistical report on the performance and cost of retail investment products in the EU. This report covers the UCITS and AIF funds, and the structured retail products.

The report documents that the costs have a significant impact on the final returns that the retail investors make on their investments, for example:

- the charges for UCITS funds, taken all together, reduce their gross returns by one quarter on average;
- the cost impact varies widely, especially depending on the choice of product, asset class, fund type; and
- management fees and other on-going costs constitute over 80% of investors costs, whilst entry and exit fees have a less significant impact.

ESMA updates Q&A on Benchmark Regulation

On 30 January, 2019, ESMA has issued an update of its Q&A on the European Benchmark Regulation, in particular Question 4.5 on the scope of application of the Commission Delegated Regulation 2018/67 supplementing the Benchmark Regulation 2016/1011.

In the Q&A, the updated answer indicates the benchmark regulation's and the Commission Delegated Regulation's applicable and not applicable articles for different types of benchmarks:

- Regulated-data benchmarks,
- Interest-rate benchmarks,
- Commodity benchmarks,
- Significant benchmarks,
- Non-significant benchmarks.

In case of each benchmark, the relevant articles and obligations are clarified.

Update of ESMA Q&A: benchmark disclosure obligations for UCITS

On 29 March 2019, ESMA has updated its Q&A regarding the application of the UCITS Directive in the context of the Benchmark Regulation.

The informations to be disclosed in the context of the Benchmark Regulation:

- In the KIID, indication whether the strategy is active or passive (Question 8a)
- The role of benchmark in the strategy (multiple examples are provided in Question 8b)
- Indication of how actively managed the UCITS is, compared to its reference benchmark index (Question 8c)

On the past performances, the information to be disclosed:

- Where the funds name a target in their investment objectives and policies, the performance should be disclosed against the target, even if the comparator is not named a 'benchmark' (Question 4c)
- The performance disclosed in the KIID regarding a benchmark index should be consistent with performance disclosure in other investor communications. (Question 4cbis).

Update of ESMA Q&A on the Market Abuse Regulation (MAR)

On 29 March 2019, ESMA updated its Q&A on the Market Abuse Regulation (MAR). This update clarifies the meaning of parent company and related undertakings, as well as the disclosure of inside information concerning emission allowances.

The following questions were updated:

- Q5.6: it gives further clarification on the disclosure of inside information by a collective investment undertaking without legal personality
- Q5.7: it clarifies the potential cases of inside information in relation to collective investment undertakings without legal personality voluntarily admitted to trading or traded on a trading venue
- Q11.2 and Q11.3: they clarify the meaning of parent company and related undertaking, as well as their obligation to disclose inside information concerning emission allowances

Update of ESMA Q&A on EMIR data reporting

On 4 February, 2019, ESMA updated its Q&A on the EMIR Regulation. This update modifies the question TR 34 and 38, and adds the question TR 50.

Question TR 34 confirms that in case of contracts with no maturity date, the counterparties can report the opening of a new contract with action type “Position Component” if the trade is included in a position on the same day.

Question TR 38 clarifies that if an early termination occurs before the reporting deadline, an action type “new” and an action type “early termination” report shall be submitted.

Question TR 50 clarifies details on the usage of the value “N” for the “Confirmation Means” field.

Update of ESMA Q&A on the AIFM Directive

On 29 March 2019, ESMA updated its Q&A on the application of the AIFM Directive. This update modifies Section VII on the calculation of leverage by adding Question 6 and 7.

Question 6 confirms that the calculation of leverage exposure of an AIF resulting from a short-term interest rate future should not be adjusted for the duration of the future.

Question 7 clarifies that an AIFM should calculate the leverage of each AIF that it manages as often as is required to ensure that the AIF is capable of remaining in compliance with leverage limits at all times.

ESMA sanctions a credit rating agency for breaches of conflict of interest requirements

On 20 March 2019, ESMA has announced a fine of €5.132.500 against three credit rating agencies belonging to a credit rating agency group for failure to comply with requirements of the Credit Rating Agencies Regulation (CRAR) related to conflicts of interest:

- €3,195,000 for the UK subsidiary for negligently committing the following infringements:
  - Between 2013 and 2015, the UK subsidiary issued four new ratings on instruments issued by a listed entity while the shareholder of the credit rating agency sat on the Board of this entity;
  - The UK subsidiary failed to immediately assess the need to re-rate or withdraw ratings previously issued with regards to another entity, where the Shareholder of the credit rating agency sat on the Board of this entity; and
  - Until March 2017, the UK subsidiary did not set, at a centralized level, adequate procedures and internal control mechanisms with respect to conflicts of interest.
- €812,500 for the French subsidiary for negligently committing the following infringement:
  - The French subsidiary failed to disclose conflicts of interest regarding existing ratings of an entity, while the Fitch Shareholder sat on the Board of this entity.
- €1,125,000 for the Spanish subsidiary for committing the following infringement:
  - Between 2013 and 2015, the Spanish subsidiary negligently issued eight new ratings on instruments issued by a listed entity while the Shareholder of the credit rating agency sat on the Board of this entity; and
  - The Spanish subsidiary also failed to disclose that the existing ratings of the same listed entity were potentially impacted by the board membership of the Shareholder of the credit rating agency, however, ESMA imposed no fine as this infringement was committed without negligence.

Update of ESMA Q&A on MiFID II et MiFIR market structure and transparency topics

On 2 April 2019, ESMA updated its Q&A regarding market structures and transparency issues under the Market in Financial Instruments Directive (MiFID II) and Regulation (MiFIR).

In the market structures Q&A:

- In section 3 on Direct Electronic Access and algorithmic trading, Question 30 clarifies the modalities of tests identifying high frequency trading techniques.
- In section 5 on multilateral and bilateral systems, Question 30 clarifies the conditions on the operation of systematic internalisers by an EU branch of a third-country firm.

In section 6 on access to central counterparties and trading venues, Question 7 gives further details on the request of access to an EU central counterparty by a third country trading venue in the absence of an equivalence decision.

In the transparency Q&A:

- In section 3 on equity transparency, Question 3 on the applicable transparency parameters in the absence of guidance from ESMA or national competent authority was updated.
- In section 3, Question 5, and in section 4 on non-equity transparency, Question 15 on large in scale (LIS) thresholds were newly added.

ESMA reports published on accepted market practices under MAR

On 16 January 2019, ESMA published its annual report on the application of accepted market practices in accordance with the Market Abuse Regulation (MAR). The report provides an overview on the establishment and application of accepted market practices, with particular reference to accepted market practices established on the basis of the Market Abuse Directive, and also the practices established under MAR.

The report includes ESMA's views on the application of accepted market practices, as well as its recommendations to National Competent Authorities.

ESMA supervision to focus on data, Brexit and cybersecurity in 2019

On February 19th, 2019, ESMA has published its 2019 Supervision Work Programme, which details the main areas of focus for the upcoming year.

For the Credit Rating Agencies (CRA) and Trade Repositories (TR) in the EU, ESMA uses a risk-based approach to establish its annual Supervision Work Programme, considering the main developments per industry and per registered entity.

For 2019, the supervisory priorities will include:

- TR data quality and access by public authorities;
- TR business continuity planning, IT process and system reliability, and information security function;
- CRA portfolio risk and quality of the rating process;
- CRA Cybersecurity;
- Recognition of UK CCPs in a no-deal Brexit scenario; and
- Assessing the pending applications for recognition as TC-CCPs (19) and TC-CSDs, including risk monitoring.

There are areas where common issues exist across TRs and CRAs on which ESMA will perform further work including Brexit, fees charged by Credit Rating Agencies and Trade Repositories, the effectiveness of internal control systems, and the use of new technologies.

USA

SEC sanctions lawyer for market abuse

On 13 February 2019, the SEC sanctioned a former lawyer of a multinational technology company whose duties included ensuring compliance with market abuse regulations.

The lawyer had privileged information because he had been informed of documents relating to potential profits. The lawyer made a profit of $382,000. The SEC noted that the lawyer was responsible for ensuring the company's compliance with market abuse rules and for ensuring that employees were properly informed of these rules.

The SEC ordered him to return the sum of his profit plus interest and penalty. In addition, a criminal sentence will be imposed, as the SEC's investigations have not yet been completed.

Company settles unregistered ICO charges after self-reporting to SEC

On 20 February 2019, the SEC charged a company with conducting an unregistered initial coin offering (ICO).

According to the SEC, the company raised approximatively 12,7 million dollars in digital assets to finance its plan to develop a network for renting spare computer bandwidth to defend against cyberattacks and enhance delivery speed.

The company self-reported its failure to the SEC in the summer of 2018 and cooperated with the investigation. The SEC did not impose a penalty because the company self-reported the conduct, agreed to compensate investors and to register the tokens as a class of securities.

SEC announces fraud charges against investment fund scheme operators

On 26 February 2019, the SEC has announced fraud charges and an asset freeze against the operators of an investment fund scheme.

The SEC claims that the fund operator company, its president, and the CEO have defrauded investors out of 3.6 million dollars. The company falsely represented to investors that it had hundreds of millions of dollars invested in local businesses and that the investments are fully insired and bonded by two insurance companies, while they had no relationship with the company and did not authorize it to use their logos in sales materials.

The SEC alleges that the president and the CEO misused investor funds to pay personal expenses and transferred other funds to business they controlled and to family members.

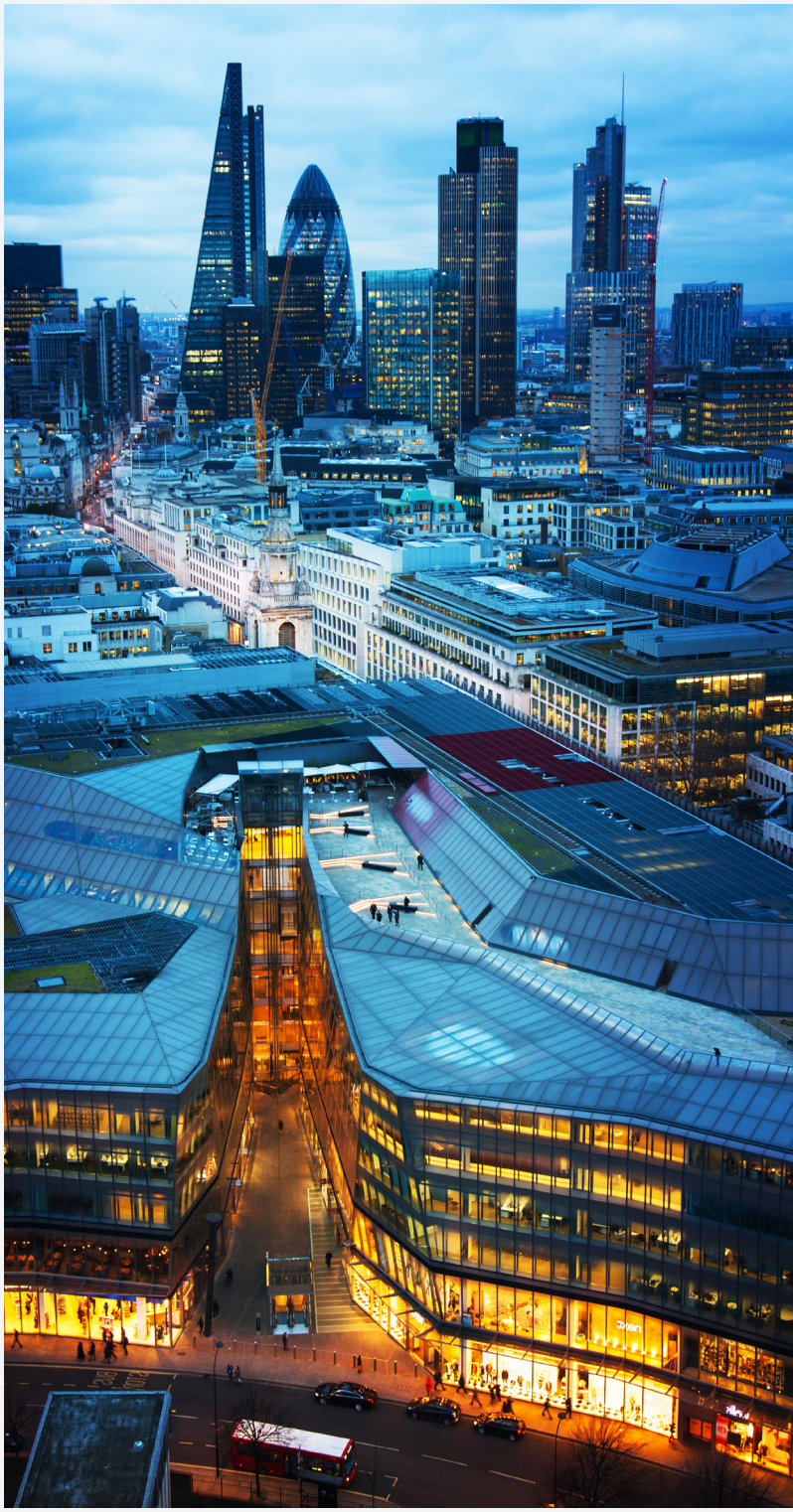
BREXIT

ESMA and EU securities regulators agree on no-deal Brexit MoUs with FCA

In February 2019, ESMA and the European securities regulators have agreed on two Memorandums of Understanding (MoUs) with the FCA. The MoUs form part of authorities' preparations should the UK leave the EU without a withdrawal agreement, they will therefore only take effect in the event of a no-deal Brexit scenario. The MoUs are similar to those already concluded on the exchange of information with many third country supervisory authorities.

The MoUs are:

- a MoU between ESMA and the FCA concerning the exchange of information in relation to the supervision of credit rating agencies (CRAs) and trade repositories (TRs). This MoU will allow ESMA to continue to discharge its mission and meet its mandate regarding investor protection, orderly markets and financial stability in the EU; and
- a multilateral MoU (MMoU) between EU/EEA securities regulators and the FCA covering supervisory cooperation, enforcement and information exchange between individual regulators and the FCA. It will allow them to share information relating to, amongst others, market surveillance, investment services and asset management activities. This, in turn, will allow certain activities, such as fund manager outsourcing and delegation, to continue to be carried out by UK based entities on behalf of counterparties based in the EEA.



Brexit – what we expect firms and other regulated persons to do now

On 1 February 2019, the UK Treasury has published a draft legislation that will give the FCA temporary powers to make transitional provisions in relation to financial regulation in case the UK leaves the EU without a withdrawal agreement in place.

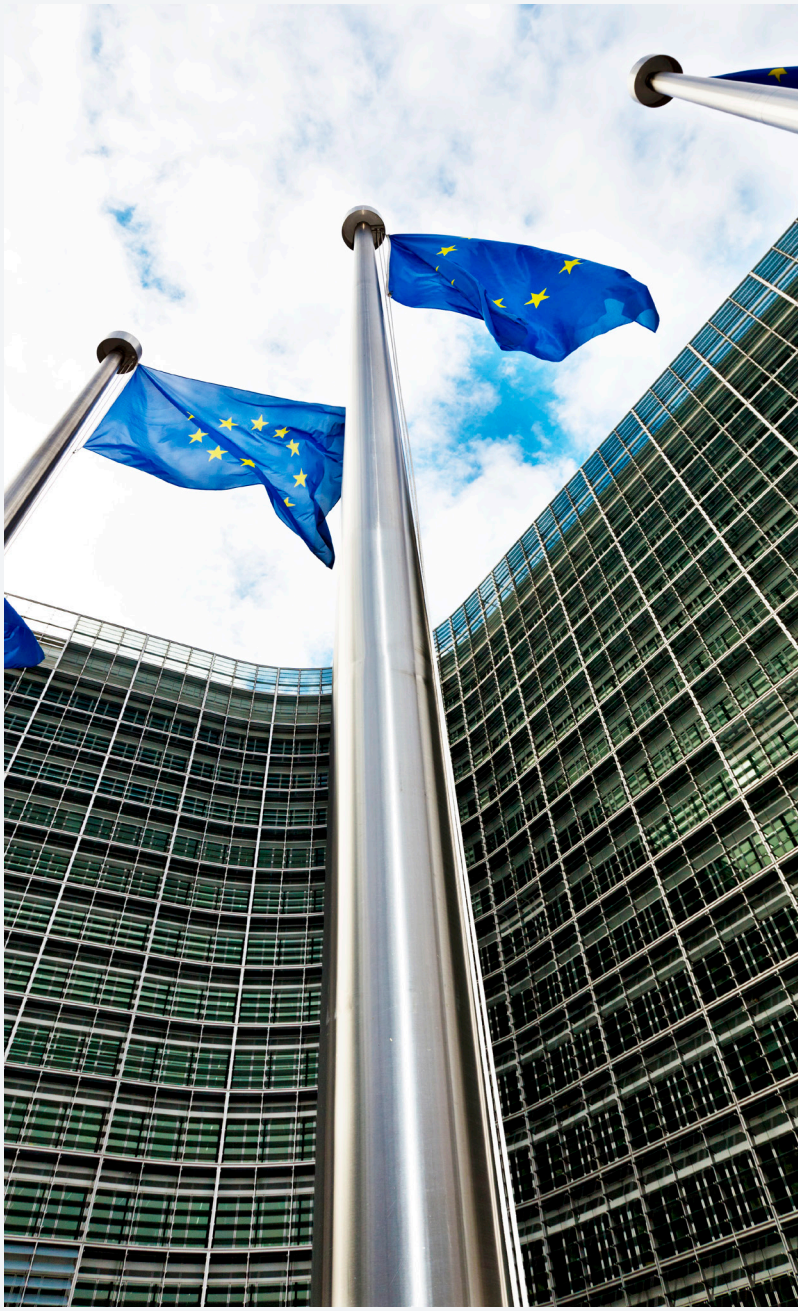
The FCA has stated that it intends to use this power broadly to ensure that firms and other regulated entities can generally continue to comply with their regulatory obligations as they did before exit day for a temporary period. This means that firms will not be expected to prepare now to meet changes in their regulatory obligations arising from Brexit.

However, there are certain areas in which making transitional provisions would be contradictory to the FCA's statutory objectives, and the FCA expects firms to begin preparing to comply with changes to their UK regulatory obligations in these areas now:

- MiFID II transaction reporting
- EMIR reporting obligations
- EEA Issuer rules
- Contractual recognition of bail-in
- Short selling notifications
- Use of credit ratings for regulatory purposes
- Securitisation

The FCA has made it clear that even though it is expected from firms and other regulated entities to work towards complying with the relevant changes by exit day, they are conscious of the scale, complexity, and magnitude of some of these changes and consequently intend to act proportionately. Therefore, where the firms can demonstrate that reasonable steps were taken to achieve compliance, the FCA will not take a strict liability approach if not all requirements have been met immediately.

The firms should refer to the statement's annex for more detailed information on the areas outlined above.



FCA releases updated guidance on EU departure preparations

On 27 February 2019, the FCA has published updated information to help support regulated firms in finalising their preparations for as smooth a transition as possible when the UK leaves the EU.

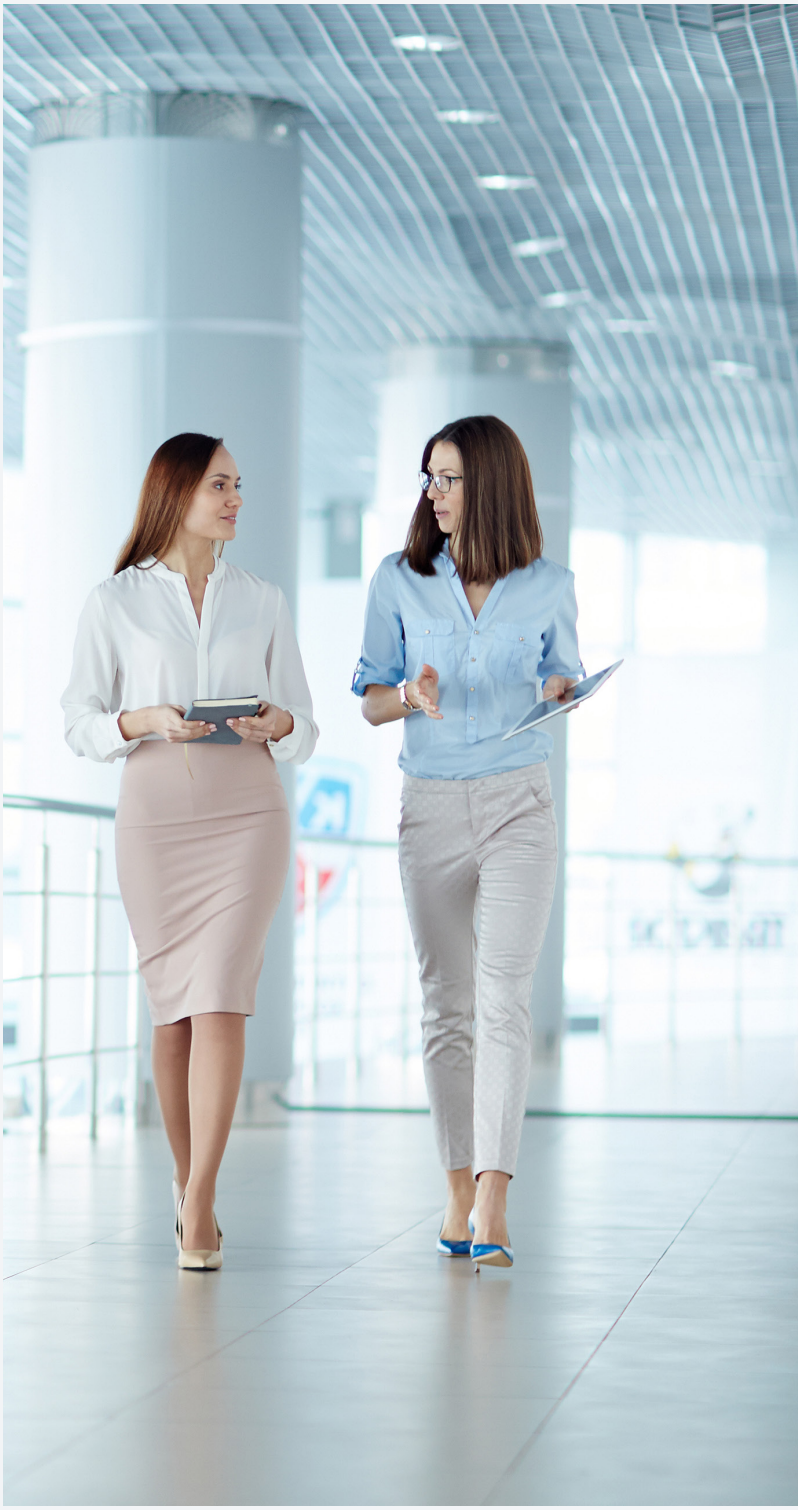
The FCA invites firms to ensure they are making any necessary changes to protect customers from negative impacts of leaving the EU, whatever the outcome of negotiations – for instance, in the event of a no-deal Brexit. Firms are also being reminded to consider what information needs to be communicated to their customers, and how this will be done in a way that is clear, fair and not misleading.

For UK-based firms, particularly those operating within the European Economic Area (EEA), the FCA information highlights the FCA's approach to changes to UK legislation, implications for cross-border data sharing, and the consequences of the loss of passporting as some of the main issues that have to be dealt with.

Specific information is available for firms operating in the UK in 5 key sectors:

- banking and payments,
- life insurance, pensions and retirement income,
- general insurance,
- retail investment,
- wholesale banks, markets and asset managers.

For more information, visit the FCA's dedicated webpage on preparing your firm for Brexit.



Brexit in the absence of agreement: impacts for the asset management sector

With a view to a possible exit from the European Union without the United Kingdom's consent, the AMF assists asset management players in anticipating the consequences that would result.

Transitional measures

Faced with the possibility of a Brexit without agreement, Act No. 2019-30 of 19 January 2019 empowered the Government to take measures by an ordonnance to prepare for the United Kingdom's withdrawal from the European Union. On this basis, Ordonnance No 2019-75 of 6 February 2019 provides a set of provisions specific to the financial services sector that will enter into force as from the date of the United Kingdom's withdrawal from the European Union, if this is actually done without agreement.

Article 4 of this ordonnance, specified in particular by an order of 22 March 2019 fixing the adjustment period granted following the withdrawal of the United Kingdom from the European Union, gathers several measures concerning asset management and aimed at allowing management companies to spread the effects of Brexit over time.

The purpose of these transitional measures is to help actors exposed to regulatory risk in the event of Brexit without agreement to make a smooth transition in the best interests of investors. The time limits granted should therefore allow management companies, where necessary, to adjust their investment strategy and assets under management in order to prevent non-compliance risks at the end of the transition period.

A first set of measures concerns the equity savings plan (PEA) and the equity savings plan for financing small and medium-sized enterprises and mid-cap companies (PEA-PME):

- Live British securities duly subscribed or acquired before the date of a Brexit without agreement remain eligible for the PEA or the PEA-PME for 15 months;
- Units of collective investment undertakings remain eligible for the PEA or PEA-PME for 15 months after the date of a Brexit without agreement if their management company decides no longer to comply with the exposure ratios to EU companies (75% of the assets) and thus waives eligibility for the PEA or PEA-PME at the end of this period;
- Units of collective investment undertakings remain eligible for the PEA or PEA-PME for 21 months after the date of a Brexit without agreement if their management company decides to comply with the exposure ratios to EU companies (75% of the assets) and thus remains eligible for the PEA or PEA-PME at the end of this period;
- Units or shares of British UCITS, regularly subscribed or acquired before a Brexit without agreement, remain eligible for the PEA for 15 months.

Management companies of collective investment undertakings must inform the account holder, within 3 months of the date of a Brexit without agreement, of their intention to remain or not eligible for the PEA or the PEA-PME.

As for the account holder, he must inform the holder of the PEA or PEA-PME within 4 months in the event of loss of eligibility of the security.

Another set of measures concerns private equity funds:

- For venture capital mutual funds (FCPR): a transitional period of 12 months during which securities admitted to trading on a United Kingdom market and issued by companies with a market capitalisation of less than €150 million, subscribed or acquired before 30 March 2019, remain eligible to be included in the assets of these funds under the conditions of III of Article L. 214-28 of the Monetary and Financial Code, i. e. within the limit of 20% of the 50% quota of unlisted securities;

- For innovation mutual funds (FCPIs) and community investment funds (FIPs): a grandfather clause for securities, subscribed or acquired before 30 March 2019, and issued by British companies meeting, on 7 February 2019, the conditions set out in I of Article L. 214-30 applicable to FCPIs and I of Article L. 214-31 applicable to FIPs. In other words, these securities will remain eligible, without any time limit, for inclusion in the assets of the FCPI and FIP respectively within the 70% quota. This grandfather clause is also applicable to the current account advances mentioned in the aforementioned articles, under the same conditions.

These two transitional measures will also apply to professional private equity funds (FPCIs) by virtue of the references provided for in Article L. 214-159 of the Monetary and Financial Code.

These transitional measures only concern the stock of assets, i.e. assets subscribed or acquired before the date of a Brexit without agreement. The assets that could be subscribed or acquired after this date

DUFF & PHELPS

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