Luxembourg Market Pulse

Regulatory Update

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EY

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Foreword

Dear all,

It's my great pleasure to present the latest edition of the EY Luxembourg Market Pulse Regulatory Update.

In this edition, we provide an update and our views on the following regulatory developments:

1. AIFMD & ELTIF Reviews
2. ESG Developments
3. Third-country Developments
4. Risk Management
5. AML/CFT
6. Flash news
7. Update from the fund registration and distribution practice

We look forward to receiving your feedback and questions as well as discussing the challenges and opportunities with you and our subject matter experts.

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Contents

AIFMD & ELTIF Reviews 4

ESMA letter to the European Commission with respect to the review of the Alternative Investment Fund Managers Directive 4

Public consultation on the review of the Alternative Investment Fund Managers Directive 8

Public consultation on the review of the European Long-Term Investment Fund Regulation 10

ESG Developments 13

Draft Budget Law 2021: Reduced subscription tax for sustainable investment funds 13

ESMA's draft advice to the European Commission on the disclosure of key performance indicators in relation to Taxonomy-aligned activities 16

Third-country Developments 20

Provision of investment services and activities in Luxembourg by third-country firms under MiFID II and MiFIR 20

CSSF Press release 20/26 on the end of the transitional period on 31 December 2020 following the withdrawal of the United Kingdom from the European Union 24

The future UK overseas fund regime 26

Risk Management 28

CSSF Circular 20/752 : ESMA Guidelines on Liquidity Stress Testing in UCITS and AIFs 30

AML/CFT 33

CSSF Regulation 20-05
A deeper insight into the key aspects of the Luxembourg Anti-Money Laundering provisions 33

Flash news 38

Update from the fund registration and distribution practice 40

ESMA letter to the European Commission with respect to the review of the Alternative Investment Fund Managers Directive ("AIFMD")

Background

In the context of the upcoming AIFMD review and a consultation process expected to be launched during the last quarter of this year, the European Securities and Markets Authority ("ESMA") has issued a letter to the European Commission ("EC") on 18 August 2020, highlighting some areas of the current framework where improvements could be made.

The letter builds upon recent opinions, considerations and recommendations published by ESMA, the European Systemic Risk Board ("ESRB") and the International Organization of Securities Commission, taking into account recent and likely developments related to BREXIT and the COVID-19 pandemic, and widespread business models relying on extensive delegation.

Primary Change

ESMA's suggestions are organized around 19 topics and include a specific analysis conducted on the reporting regime and data use. The scope of improvements is very broad and includes proposals to address specific pain points for the industry such as the semi-professional investor status, the external valuer regime, the application of the proportionality principle to remuneration rules and the availability of liquidity management tools across the European Union.

ESMA calls for targeted clarifications in the Directive concerning certain definitions, sub-threshold AIFMs, digitalisation and the application of depositary rules to central securities depositaries.

Fundamental recommendations are also made to foster convergence between the UCITS and AIFMD regimes, to revisit the delegation regime and substance requirements, and to strengthen the regulation and the supervision of loan origination funds, private equity funds, leveraged funds and cross-border entities as well as the discretionary portfolio management, investment advice or marketing activities performed by AIFMs and UCITS management companies.

Key Points

1. Convergence of AIFMD and UCITS frameworks

One of the main objectives overarching ESMA's suggestions is to harmonize both regimes where appropriate, notably in relation to risk management, reporting and delegation requirements.

2. Delegation and substance

ESMA highlights that the UCITS framework lacks the level of detail of delegation rules in the AIFMD level 2 provisions and finds that the allocation of responsibilities lacks clarity with respect to the supervision of structures making extensive use of cross-border delegation.

The letter further develops a number of more concrete considerations based on ESMA's Opinion to support supervisory convergence in the area of investment management in the context of the United Kingdom withdrawing from the European Union[1]. ESMA suggests to:

- Limit more strictly the extent of the delegation by setting a quantitative criteria or a list of core functions which cannot be delegated to third parties.
- Amend the AIFM and UCITS directives to make sure these frameworks are applicable to the delegated activities, irrespective of the type of license or location of the delegates. National divergences are highlighted in respect of the definition and regime applicable, notably the application of MiFID rules to the delegation of investment management.
- Clarify the rules applicable to staff secondment arrangements and whether these rules are in line with the substance and delegation rules.
- Clarify whether delegation rules apply to support tasks (e.g. external research) and to make a clear distinction between such tasks and collective portfolio management functions.
- Address the conflicts of interest and investor protection risks arising from the influence initiators may exercise over white-label service providers and authorized AIFM or UCITS management companies, notably where such initiators perform portfolio management on a delegated basis.

3. Consolidation and harmonization of the existing regime

ESMA is of the view that:

- Certain definitions should be more specific to better delineate the scope of AIFMD. It is recommended, *inter alia*,to establish a clear distinction between holdings and private equity funds and to clarify the treatment of certificates, crypto-assets and joint ventures.
- A specific framework for loan originating AIFs should be created. Such AIFs would have to be closed-ended vehicles only marketed to professional and semi-professional investors and subject to specific prudential requirements, notably in terms of leverage, liquidity stress testing, reporting and diversification.
- The supervision of cross-border entities should be harmonized and the respective roles and responsibilities of the home national competent authority ("NCA") and the host NCA should be clarified, notably with regard to cross-border marketing and management.

[1] ESMA 34-45-344

- There is a need to amend the current reporting of the leverage using gross method calculation, to ensure alignment with the IOSCO recommendations for a framework assessing leverage in investment funds, issued in December 2019. It is also suggested to amend the calculation of the commitment amount by adjusting the notional amounts of interest rate derivative contracts by the duration of the ten-year bond equivalent.
- Reverse solicitation should be clarified since this notion is subject to divergent interpretations across member states but acknowledges the assessment which is due by 2 August 2021 pursuant to the cross-border marketing regulation[2].

ESMA also believes that:

- The definition of significant influence should be harmonized (e.g. expressed in terms of harmonized EU thresholds)
- The calculation of the limit above which the shares carrying voting rights acquired by an investment company or a management company acting in connection with all of the common funds it manages and which fall within the scope of the UCITS directive, would enable it to exercise significant influence over the management of an issuing body should cover:
  - Voting rights stemming from UCITS funds managed by a UCITS management company consolidated with those stemming from AIFs managed by the same fund manager with similar strategies in relation to the exercise of significant influence,
  - Portfolios managed on a discretionary basis by the fund manager and,
  - Where permitted, investments made by the fund manager on its own account.

4. Clarifications and troubleshooting

- ESMA supports the ESRB recommendations to:

  a. establish a common EU framework governing the liquidity management tools to ensure their availability across jurisdictions

  b. clarify the role of NCAs when using their power to suspend redemptions, in particular in situations where there are cross-border financial stability implications

  c. clarify ESMA's facilitation, advisory, and coordination role in relation to suspension of redemptions and subscriptions

- ESMA is of the view that the EC should:
  - Clarify that the proportionality principle applies to the full set of remuneration rules to prevent a disproportionate application of the quantitative variable remuneration thresholds and payout structures
  - Explicitly limit the liability of external valuers to cover only cases of gross negligence
  - Clarify the definition of professional investors under AIFMD and warns that any new category of investors such as semi-professional investors should come with appropriate investor protection rules and that passports should be limited to marketing to professional investors
  - Clarify at level 1 that both the AIFMD and the UCITS directive delegation rules on depositaries apply to investors central securities depositaries ("CSDs") and not to issuer CSDs
  - Study risk and benefits of a passport for both UCITS and AIF depositaries
  - Clarify NCAs' powers to introduce additional national requirements to sub-threshold AIFMs
  - Formally allow NCAs to inform applicants for AIFM authorization in an electronic format

5. Reporting

ESMA is of the view that UCITS reporting requirements should be aligned with the amended annex IV of the AIFMD. The letter highlights in particular that ESMA and NCAs should be able to gather sufficient data to identify large exposures to corporate debt and real estate markets, analyze outflows, performance and use of liquidity management tools for supervisory purposes and for systemic risk monitoring.

[2] Article 18, Regulation (EU) 2019/1156

Annex II of ESMA's letter suggests introducing the following requirements with regard to the reporting to ESMA/NCAs:

- Acquire and report a Legal Entity Identifier for the AIFM and the AIFs it manages
- Provide detailed information on the composition of assets and liabilities of the funds, counterparties and issuers
- Report monetary values and not percentages, except for specific items such as performance
- Ensure greater standardization and alignment with international standards and other regulatory reporting requirements (MiFIR, EMIR, SFTR, Securitisation regulation, European Central Bank statistics) and remove duplicated items.
- Include key information disclosed in the annual report[3] or disclosed to investors[4] in the report to the NCA
- Consider in the information on valuation, if feasible, the impact of each item on AuM, NAV and leverage metrics
- Apply the AIFMD regulatory reporting rules to all funds, including those distributed under a National Private Placement Regime ("NPPR")
- Include in the ESMA public register information on sub-threshold AIFMs, AIFs distributed under a NPPR and non-EU AIFs managed by non-EU AIFMs
- Report to NCAs on a monthly basis rather than the current quarterly basis to enable monthly update of the ESMA register
- Include leverage at the level of special purposes vehicles in private equity funds' reporting of leverage

ESMA recommends that a reference that ESG factors should be considered in the AIFMD reporting in order to guarantee sufficient flexibility to take account of future ESG disclosures stemming from the regulatory technical standards being developed under the sustainable finance disclosure regulation[5].

Practical considerations

Some of ESMA's suggested areas of improvement have been included for comments in the public consultation which is opened until 29 January 2021, but it is not yet clear to which extent ESMA proposals will materialize in the revised AIFMD framework.

However, a more stringent regime in relation to delegation arrangements and tightened substance requirements could disrupt significantly the business models in place and bring additional costs for initiators and investment fund managers. Third party management companies may also see their business models challenged and will most likely have to provide for stronger investor protection in terms of conflicts of interest management and Chinese walls. Reallocation and internalization of resources would come with a number of challenges in terms of organization. Access to the appropriate expertise and infrastructure in relation to portfolio management or risk management may become more competitive and put additional pressure on margins.

The extent of the suggested harmonization and amendments to the current reporting requirements is likely to carry IT development costs which can only be amortized in the longer term once greater standardization will be achieved.

On the other hand, greater availability of liquidity management tools, limitation of external valuers' liability and the creation of a semi-professional investor status would certainly reduce some of the burdens fund managers are currently facing.

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ESMA letter to the European Commission

[3] Pursuant to article 22, AIFMD
[4] Pursuant to article 23, AIFMD
[5] Regulation (EU) 2019/2088

Public consultation on the review of the Alternative Investment Fund Managers Directive ("AIFMD")

Background

Over recent times, significant research, positions, recommendations[1] and industry advocacy have all contributed to the thinking of the future recast AIFMD. The consultation launched by the European Commission ("EC") is the first deep engagement with all stakeholders and the larger public which could end up bringing significant changes to the current framework.

Timeline

The consultation is open until 29 January 2021. A legislative proposal amending AIFMD is targeted for publication in Q2 2021. The proposal will then go through the inter-institutional negotiation process before a final version can be adopted by the Council and the European Parliament meaning that it should take between two to three years before any new rules become applicable.

Key points

Scope and authorization

In this section, the EC seeks to assess the additional functions an AIFM should be permitted to perform and whether changes are needed in order to ensure a level playing field between AIFMs and investment firms providing competing services. The questions on the introduction of risk-sensitive capital requirements and a supervisory review and evaluation process modeled on banking regulation are not novel ideas but certainly worthy of consideration.

Respondents are also invited to comment on how effective the exclusions are, in particular for securitization vehicles and employee saving schemes.

The level of the assets under management thresholds and whether the absence of passport for the sub-threshold AIFMs impede capital raising in other member states is another point open to discussion.

Investor protection

The consultation raises the issue of AIFMs access to retail investors, currently left to the discretion of member states and seeks feedback on a potential need to structure an AIF that could be marketed to such investors under a passport. The comprehensiveness and the frequency of disclosures to investors as well as the possibility to adapt certain elements to the different types of investors are also discussed.

The consultation pays particular attention to the relationships of depositaries with third parties and whether the flows of information from third party collateral managers or prime brokers are sufficient and appropriate. The long-lasting debates around the qualification of the nature of the relationship with investor central securities deposits and the depositary passport are also given renewed consideration.

The EC takes the opportunity to collect views on the valuation topic and whether the existing rules should be revisited in the light of the lessons learnt from the COVID-19 market turmoil. Respondents are also invited to comment whether it should be possible to combine input from internal and external valuers and to provide concrete examples of aspects triggering liability of an external valuer under the current regime.

International relations

One question looks at gathering input on potential competition distortion issues where non-EU AIFMs access retail investors through national private placement regimes.

The consultation asks whether the delegation rules are sufficiently clear to prevent creation of letter-box entities and appropriate to ensure effective risk management. Quantitative criteria, or a list of core functions which cannot be delegated are possible changes presented by the EC to complement the current rules. The application of AIFMD standards to delegates regardless of the location of the third-party, consistent enforcement and the application of some elements of the AIFM framework to UCITS are also discussed.

Financial stability

There is a solicitation of views on the harmonization of the AIFM reporting with other regimes and the opportunity to align UCITS reporting with the AIFM regime.

A significant number of new reporting fields are suggested, aiming at providing more detailed information on portfolios, liquidity, leverage and loans originated by AIFs.

The appropriateness of leverage calculation methods and metrics is also questioned as is its potential harmonization at EU level and across the UCITS and AIFM regimes.

Some options are presented to regulate loan originating AIFs at EU level. Specific product regulation could allow only closed-ended AIFs to originate loans, impose additional organizational requirements, or limit connections with other financial intermediaries. The consultation also foresees safeguards for borrowers or limitation of marketing to professional investors.

Leverage limits and investment rules such as diversification and concentration requirements are also discussed.

[1] See for example:
- European Systemic Risk Board considerations regarding the AIFM, 3 February 2020, EY Alert
- Report assessing the application and the scope of AIFM, 10 June 2020, EY Alert
- ESMA Letter to the European Commission on the review of the AIFMD, 18 August 2020, EY Alert

Investing in private companies

In this section the EC wants to gather feedback on the adequacy and proportionality of rules imposing reporting on the financing of an acquisition of control over a non-listed company. The EC also asks if asset stripping rules are effective and proportionate or require further improvement.

Sustainability

Going beyond the provisions included in the draft delegated regulation integrating sustainability factors and risks in the AIFMD, the consultation asks if AIFMs should be required to quantify sustainability risks and integrate principal adverse impacts in such quantification as well as in their investment decision making processes, alongside the interests and preferences of investors. View are solicited whether the taxonomy should play a role in these processes.

Centralized supervision and harmonized rule book

The last section looks at different options to grant ESMA with additional competences and powers as regards to certain types of AIFMs, cross-border supervision, sanctioning regime and overall proportionality, efficiency and effectiveness of the current framework. It also asks if UCITS and AIFMD frameworks should be merged into a single rulebook.

Practical considerations

It is still difficult at this stage to predict what will be the final form of the recast AIFMD and if it will carry any significative legislative changes in level 1 or level 2.

The adoption of regulatory and supervisory standards rooted in banking regulation could make the implementation of high-risk strategies more capital intensive and could increase scrutiny over the bigger AIFMs with significant cross-border activity. Should this come along with increased direct supervision from ESMA and/or joint supervision, considerations of member states which are large distribution markets and/or have a local competing fund/asset management industry could materialize in a more intrusive manner in AIFMs' cross-border management or distribution activities. However, such additional burden could be balanced by an easier access to retail investors should harmonized (product?) rules be implemented.

If provisions were to be included to require AIFMs to integrate non-financially material factors in their investment decision process, best interest rules could potentially conflict with sustainability impacts. Should no protection be given by law to safeguard IFMs from disgruntled investors which have been harmed financially, careful consideration should be given to contractual arrangements to both comply with the regulatory framework and exclude or limit IFM's liability in certain circumstances.

Please see our previously issued alerts about the ESRB letter, the EC report and the ESMA letter for comments on the other areas covered by the consultation.

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Visit the public consultation page

Public consultation on the review of the European Long-Term Investment Fund (ELTIF) Regulation[1]

Background

The ELTIF regime was launched in 2015 with the intention to facilitate investment in longer term real economy investments such as social and infrastructure projects, real estate and small and medium-sized enterprises ("SMEs") by pension funds, insurance companies, professional and retail investors. However, the market failed to develop with only 22 ELTIFs estimated to be currently marketed.

Under article 37 of the ELTIF Regulation, the European Commission ("EC") is mandated to review the framework and submit a report to the European Parliament and the Council assessing the contribution of ELTIFs to the development of the Capital Market Union ("CMU") and to smart, sustainable and inclusive growth.

Primary Change

If deemed necessary, the EC should propose legislative amendments to improve the effectiveness of the regime and the role of ELTIFs as the conduit of choice funding long-term investment projects, while maintaining adequate investor protection. Following the recommendations of the High-Level Forum on CMU, the EC seeks to gather feedback on the provisions needed to reduce barriers and broaden the scope of eligible assets and investments which are often described as the causes of its limited attractivity for sponsors. Contributions have to be submitted by 19 January 2021 through the online questionnaire.

Key Points

The below key questions and facts to consider summarize the consultation points which are the most critical, according to fund sponsors and managers, to improve the attractiveness of the ELTIF regime.

1. Assets side constraints

Questions are raised, *inter alia*, around the following elements of the ELTIF framework:

- The definition of long-term investment assets contributing to the objective of smart, sustainable and inclusive growth, generating an economic or social benefit: these criteria which are challenging to delineate, giving rise to different approaches across the EU, may benefit from additional guidance.
- The minimum 70% proportion of long-term investments: This high mandatory threshold is constraining ELTIF's liquidity profile and diversification and may partially explain limited appetite from sponsors and retail investors for ELTIFs.
- The level of the market capitalization threshold defining an SME equity or debt issuer: The current 500,000,000 EUR threshold is more than two times lower than the MSCI Europe Small Cap index average capitalization, suggesting there is room to increase the maximum permitted capitalization.
- The minimum value of 10,000,000 EUR for eligible real assets: The question here is whether such minimum should be lowered, withdrawn or replaced by another criteria. The consultation also asks whether further guidance is needed, notably in relation to investments in such real assets.
- The prohibition to invest in financial undertakings: This rule currently prevents investment in start-up companies offering technology-enabled services. The EC also asks whether the universe of eligible investments should be extended to:
  - Investments in innovative technologies
  - Investments in green/sustainable projects
  - Investments in projects that classify as Taxonomy-aligned activities
  - Post-COVID recovery related projects
  - Financial assets with long-term maturities
  - Investments in digital assets and infrastructure
  - Investments in social infrastructure and social cohesion
  - Investment in energy infrastructure and energy efficiency
  - Any real estate assets including commercial and residential
  - Real estate without a perceived economic or social benefit under the EU's energy, regional and cohesion policy

[1] Regulation (EU) 2015/760 of the European Parliament and of the Council on European long-term investment funds

- The 10% issuer/borrower concentration limit: Consideration is given to whether such limit would be too low, in particular during the accumulation phase.
- Rules concerning investments in third-country undertakings: These include the notion of "benefit to the European economy" which is subject to inconsistent interpretations among national competent authorities and undermine certainty for sponsors.
- The conditions applicable to investment in other funds: The eligible funds are currently restricted to ELTIFs, European Venture Capital Funds ("EuVECA") and European Social Entrepreneurship Funds ("EuSEFs"), provided they have not invested more than 10% of their capital in ELTIFs. Since the universe for such funds is limited, fund of fund strategies would be facilitated by broader eligibility criteria, possibly including limited partnerships and alternative investment funds investing in eligible assets.
- Conflicts of interest rules, including ban on co-investment: The provision banning co-investment does not enable "skin in the game" and may be considered as hindering fund raising and underlying investment terms negotiation capabilities of the ELTIF managers.
- Cash borrowing limits: The limit of 30% of the NAV may be considered as too low, in particular during the fund ramp-up phase. The same 30% limit applied to the portion of assets which can be encumbered may limit further down the amount which can be borrowed since it is common market practice for lenders to require security that exceeds the amount borrowed. The obligation to borrow in the same currency is also a point open to discussion.

2. Liability side constraints

- The EC asks stakeholders whether the requirement of a fixed maturity of the ELTIF vehicle, which is not a familiar feature of investment funds targeting retail investors, should be relaxed to allow for regular redemptions or an evergreen structure approach.
- The specific distribution rules applicable for retail investors, such as the additional requirements in terms of suitability tests and investment restrictions or the obligation to make facilities available for subscription, which have been reported as being burdensome and expansive, are subject to a couple of questions. Respondents are also asked to report any issues arising from divergent national supervisory practices. This may encompass varying interpretation of details of suitability tests or additional national requirements hindering functioning of the ELTIF passport. However, the EC will also consider parallel consultations and review processes of the AIFMD[2] and the MiFID[3]/MiFIR[4]. This may be an opportunity to remove duplicate processes or improve alignment in terms of investor categorization between regimes.
- The minimum entry ticket, net worth requirements and 10% investment limit for retail investors are also questioned. It may be considered whether product diversification rules are sufficient to ensure adequate retail investor protection.

3. Tax considerations

The last question touches potentially discriminatory or adverse national taxation regimes reducing the attractiveness of ELTIFs vis-à-vis other national vehicles. Progress may prove difficult in an area which requires unanimous decision from member states, but it is nevertheless common thinking that a more favorable treatment in respect of tax on dividends or capital gains and tax neutrality of the ELTIF vehicle would be beneficial to its success.

Adjustments may also be needed to the provision which requires that third country investments are only possible where there is an OECD model tax convention between the third country, the ELTIF's domiciliation country and any country where the ELTIF is intended to be marketed since it involves expansive assessment and limit further pan-EU marketing.

The way forward

The need for financing long-term assets may be even greater now than before to support post-COVID economic recovery and shift towards a more sustainable and digital economy. Properly calibrated adjustments facilitating marketing to retail investors, improved flexibility in terms of investment rules and a more favorable tax treatment may have the potential to invigorate interest of sponsors, managers and investors in the ELTIF structure.

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Visit the public consultation on the review of the ELTIF regulatory framework

[2] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers

[3] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments

[4] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments

Draft Budget Law 2021: Reduced subscription tax for sustainable investment funds

Background

Tax incentives may play an important role in accelerating the shift towards sustainable finance. The bill of law n°7433 tabled in Parliament in 2019 already foresaw a reduced subscription tax rate for sustainable undertakings for collective investment ("UCIs"). However, the bill of law was rejected by the Council of State and the Commission on Finance and Budget put further amendments on hold anticipating the legislative proposal from the government.

Primary change

Unlike the bill of law n°7433, the draft budget law 2021 clearly links the definitions of sustainable investments with the definition of sustainable economic activities in the EU Taxonomy Regulation[1], with the objective to minimize risks of greenwashing and reducing fiscal income. To this end, the draft budget law does not provide for a blanket exemption for all sustainable UCIs but reduced subscription tax rates for UCIs or individual compartments of such UCIs that invest a specific portion of their net asset value in determined sustainable economic activities, as defined in the EU Taxonomy Regulation.

[1] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

Key points

Scope

The proposal only impacts certain types of UCIs under the regime of the Law of 17 December 2010, as amended. Institutional share classes, specialized investment funds and reserved alternative investment funds already benefit from a subscription tax rate at 0.01% which is the floor rate foreseen in this new regime.

The following scale is foreseen:

Percentage of the net asset value invested in qualifying sustainable economic activities	Subscription tax rate
At least 5%	0.04%
At least 20%	0.03%
At least 35%	0.02%
At least 50%	0.01%

Verification

The portion of the net assets invested in qualifying economic activities at the year end date of the UCI must be audited by an independent auditor as part of the annual audit of the financial statements, or, alternatively, an independent auditor can issue a separate ad hoc assurance report in accordance with International Standard on Assurance Engagements. The portion, as well as the percentage this portion represents of the total net assets of the UCI/sub-fund, should be included in either the annual report of the UCI, or the separate ad hoc report.

An attestation certified by the independent auditor must furthermore be transmitted by the UCI to the tax administration in charge of collecting the subscription tax (*Administration de l'enregistrement, des domaines et de la TVA*). The portion of net asset value invested in sustainable economic activities will be used as the basis to determine the taxation rate applicable to these assets.

Timeline and transitory measure

These provisions should apply from 1 January 2021. A transitory measure provides for a derogation to the obligation to file subscription tax returns electronically in respect of the declaration of the portion of total net assets qualifying to a reduced tax rate. UCIs will be authorized to use a form provided by the tax administration to rectify their quarterly electronic reporting until 1 January 2022.

Practical considerations

In a rapidly evolving environment where the first high-level sustainability-related disclosures will kick in as from 21 March 2021 while granular disclosures[2] will only apply from 1 January 2022, the reduced subscription tax rate and its early application represent further financial incentive for UCIs targeting a qualification as products that promote environmental characteristics (light green products) or with a sustainable investment objective (green products).

While rewarding the first movers, these provisions come with significant challenges for the UCIs willing to benefit from these new rules as soon as possible since they need to source sufficient quality data and obtain reasonable assurance that their investments comply with the minimum criteria established in the taxonomy.

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Draft budget law 2021

[2] Complying with upcoming technical standards under the Regulation 2019/2088 on sustainability-related financial disclosures, see EY alert

ESMA's draft advice to the European Commission on the disclosure of key performance indicators in relation to Taxonomy-aligned activities

Objective

The *Regulation (EU) of 18 June 2020 on the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088* ("Taxonomy regulation") requires companies and asset managers that fall in scope of the Non-Financial Reporting Directive ("NFRD") to disclose key performance indicators ("KPIs") in relation to the portion of their activities which are Taxonomy-aligned.

Very few asset managers report under the NFRD at the moment due to current thresholds[1]. However, the on-going NFRD review could bring more asset managers in scope. The draft advice also gives a flavor of the principles investee companies will have to follow in reporting these KPIs. The data reported will be pivotal, notably for Luxembourg funds promoting environmental characteristics[2] and for those with an objective of sustainable investment[3] who will be required to report the portion of their Taxonomy-aligned assets and may be eligible to a reduced subscription tax rate pursuant to the budget law 2021.

Primary Change

The draft advice clarifies the definitions and the criteria non-financial undertakings should use for the calculation of the portion of turnover, capital expenditures ("CapEx") and operational expenditures ("OpEx") associated with economic activities that qualify as environmentally sustainable. For both CapEx and OpEx, the cost incurred should be part of a plan which must meet certain conditions. The draft advice also specifies the elements of accompanying disclosures in respect of the methodology used to calculate the KPIs and their presentation in a standardized table format.

The draft advice also clarifies how asset managers are expected to calculate the portion of their Taxonomy-aligned asset on the basis of turnover. It also suggests to develop a methodology to allow a calculation covering investments in companies which are not in scope of NFRD reporting requirements.

KPIs for asset managers

Definition

The KPI should be a ratio of eligible investments that are taxonomy-aligned.

The numerator should sum the value of green bonds complying with the EU Green Bond Standard and the weighted average of the value of the investments invested in taxonomy-aligned activities of investee companies measured by turnover. Additional calculations for CapEx and OpEx may also be provided.

The denominator should consist of the value of the total eligible investments (equity and fixed income assets) in investee companies held by the asset manager's funds.

[1] entities that are public interest entities (i.e. listed companies) with an average of 500 employees or more during the financial year
[2] Article 8 of Regulation (EU) 2019/2088 of 27 November 2019 on sustainability-related disclosures in the financial sector
[3] Article 9 of Regulation (EU) 2019/2088 of 27 November 2019 on sustainability-related disclosures in the financial sector

Methodology

ESMA considers a specific methodology should be developed to address data gaps arising from investments in companies not reporting under NFRD. A coefficient derived on a sector basis under a common methodology would be used to quantify the extent of the taxonomy-aligned activities for such companies and enable asset managers to calculate a KPI covering the whole universe of their eligible investments.

The KPI calculation should not cover derivatives but allow the netting methodology used to calculate net short positions set out in the Short-Selling Regulation.

Presentation

The environmental objective the investments contribute to should be identified. Where possible, the activities invested in should be identified for each investment objective.

Appropriate side information should be presented in the vicinity of the standard table, including a link, if relevant, to the disclosure on the principal adverse impacts of investment decisions on sustainability factors[4].

[4] pursuant to article 4 of the Regulation (EU) 2019/2088 of 27 November 2019 on sustainability-related disclosures in the financial sector

KPIs for non-financial undertakings ("entities" in the table below)

KPI		IFRS	GAAP	Disclosure	Accompanying disclosure
Turnover	Definition	Article 2(5) Accounting Directive IFRS15 and IFRS16	Article 2(5) Accounting Directive national GAAP provision	▸ Per activity and total per KPI across economic activities at the level of the entity or group ▸ For identified enabling and transitional activities ▸ Per environmental objective along with a total at the level of the entity or group across all objectives ▸ In relation to activities which are covered by the taxonomy including activities where the relevant criteria are not met, and activities which are not covered by the taxonomy ▸ Where an activity contributes to more than one objective, explain how the issue of double counting was addressed and the reasons for choosing to attribute the relevant turnover/CapEx/OpEx to the specific activity	Reference to the requirement[5] to provide information to the extent necessary for an understanding of the entity's development, performance, position and impact of its activity relating to, *inter alia*, environmental matters. A. Methodology: ▸ Accounting policy: explain how turnover, CapEx and OpEx were defined and the basis on which they were calculated, including a reference to the related item(s) in the financial statements. If a definition has changed since the previous reporting period, explain the changes and why these changes result in reliable and more relevant information. Explain whether the KPIs disclosed in accordance with Article 8 of the Taxonomy Regulation differ from any Alternative Performance Measures ("APMs") as defined in ESMA's Guidelines on APMs, which are labelled in the same way or that depict items of turnover, capital expenditures and operating expenditures. ▸ Assessment of Taxonomy-alignment: For each KPI, explain how the entity performed the following assessments: i. Whether the substantial contribution criteria, including technical screening criteria, are met; ii. Whether the DNSH criteria, including technical screening criteria, are met; and iii. Whether minimum safeguards are met; Describe the nature of the products / services or assets / processes that are considered Taxonomy-aligned. Explain how turnover / CapEx / OpEx was allocated across economic activities to avoid double counting. B. Context: Interpretation: Explain what each KPI shows and why it increased or decreased in the reporting period. For CapEx, provide reconciliations explaining the drivers of change in CapEx during the reporting period for assets / processes associated with economic activities that qualify as environmentally sustainable. Such reconciliation shall at least refer to (where applicable): disposals and acquisitions of fixed assets, impairments, revaluations, any other valuation adjustments, depreciation and amortization. For Capex, entities shall also disclose the amounts relating to right-of-use assets associated to leased fixed assets (the latter requirement should only apply to entities who account for right-of-use assets based on the applicable accounting standards), accompanied by disclosure of the impact on the calculated CapEx KPI of leased fixed assets. In addition to the above accompanying information entities may provide any disclosure which they consider material to explain the KPIs. This information may include, but is not limited to, information with regard to future objectives in order to explain whether entities have set a future target for the size of the KPI and how they plan to achieve this target. Such disclosure may be provided on a voluntary basis. Across all three KPIs, accompanying information should be placed in the immediate vicinity of the KPIs, as this will make the information most helpful for investors and other users. However, compliance should be permitted by cross-reference in the form of a direct hyperlink to this other part of the non-financial statement. For all three KPIs, non-financial entities should present one year of comparatives, as from the second year of application of the disclosure requirements. Accompanying information should not be misleading or biased and avoid boilerplate language.
	Counting[6]	For all environmental objectives except climate change adaptation, turnover can be counted where the economic activity meets: ▸ The criterion of making a substantial contribution to one or more environmental objectives, including by meeting the standard technical screening criteria ▸ The criterion of not doing significant harm ("DNSH") to any of the other environmental objectives, including by meeting the standard technical screening criteria ▸ The criterion of minimum safeguards			
		For climate change adaptation, turnover can be counted where the activity enables other activities to undergo climate change adaptation			
CapEx	Definition	Change that occurred during the reporting year in the amount of fixed tangible and intangible assets, before any depreciation and amortization charges for the year as accounted for in accordance with IAS 16, IAS 38 and IAS 40 (if applicable)	Change that occurred during the reporting year in the amount of fixed tangible and intangible assets, before any depreciation, amortization and impairment charges for the year as accounted for under the applicable GAAP in the financial statements		
	Counting[7]	Costs incurred are part of plan to meet: ▸ The criterion of making a substantial contribution to one or more environmental objectives, including by meeting the standard technical screening criteria ▸ The criterion of not doing significant harm to any of the other environmental objectives, including by meeting the standard technical screening criteria ▸ The criterion of minimum safeguards The plan should: ▸ Aim to make the economic activity in question Taxonomy-aligned within a maximum period of 5 years ▸ Be approved by the entity's administrative body ▸ Be made available to the public (e.g., on the entity's website) In some exceptional cases, individual improvement measures can be considered to make a substantial contribution without needing to be part of a plan			
OpEx	Counting[8]	A. All expenses that: ▸ Arise from the main business activities, which are generally identified as the principal revenue producing activities of the entity and ▸ Relate neither to the investment nor financing categories and are normally included in the amounts reported within metrics such as operating result B. In identifying the expenses relating to financing and investing activities, entities should consider that: ▸ Financing activities generally result in changes in the size and composition of the contributed equity and borrowings of the entity. Related expenses typically relate to the receipt or use of a financial resource with the expectation that the resource will be returned to the provider of finance as a compensation, generally dependent on the amount and duration of the credit ▸ Investing activities typically relate to the acquisition and disposal of financial and non-financial assets that do not relate to operating assets, such as property, plant and equipment. Expenses from such activities generally relate to assets that generate a return individually and largely independently of other resources held by the entity C. Costs incurred are part of plan to meet: ▸ The criterion of making a substantial contribution to one or more environmental objectives, including by meeting the standard technical screening criteria ▸ The criterion of not doing significant harm to any of the other environmental objectives, including by meeting the standard technical screening criteria ▸ The criterion of minimum safeguards The plan should: ▸ Aim to make the economic activity in question Taxonomy-aligned within a maximum period of 5 years ▸ Be approved by the entity's administrative body ▸ Be made available to the public (e.g. on the entity's website) In some exceptional cases, individual improvement measures can be considered to make a substantial contribution without needing to be part of a plan			

[5] Pursuant to article 19a(1) of the Non-Financial Reporting Directive
[6] Entities should apply their best judgement of how to split the KPI across their activities and to avoid doing so in a way which unduly inflates the KPI related to Taxonomy-aligned economic activities
[7] idem
[8] idem

Practical considerations

The definition of eligible investments to be used by asset managers as the denominator for their KPI calculation is not yet clear and is likely to be further discussed. ESMA acknowledges that it might be difficult to include investments in certain asset classes such as government bonds because their contribution to activities is difficult to estimate. However, the draft advice raises reservations about the possibility to limit eligible investments to the green funds managed since the denominator would be further reduced and could be misleading about the extent the asset managers' investments are Taxonomy-aligned. Should all funds have to be considered, asset managers may wish to screen all their eligible investments to increase the numerator and benefit from a potentially higher KPI.

In the current environment where many investee companies are reviewing their business models and are making plans to become more sustainable, the merits of calculating and disclosing optional CapEx should be considered since this KPI may give more appropriate information in relation to the asset manager's investment objectives and engagement efforts.

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For more information, please visit:

Consultation paper on draft advice to European Commission under article 8 of the Taxonomy regulation

Application of sustainability related disclosures

The European Commission has addressed a letter to the European Supervisory Authorities on 20 October 2020 to confirm the application of the initial requirements of the regulation 2019/2088 on the sustainability-related disclosures in the financial services sector ("SFDR") from 10 March 2021.

The draft regulatory technical standards ("RTS") detailing the website disclosure of principal adverse impacts by investment fund managers, and the website and prospectus disclosures of financial products with either environmental or social characteristics ("light green") or sustainable investment objectives ("dark green"), will not be available by the 30 December 2020 as initially foreseen. However, the Commission considers that the application of the SFDR requirements is not conditional to the entry into force or application of the RTS and that entities in scope should prepare disclosures on the basis of the general principles laid down in SFDR, notably on sustainability risks, the promotion of environmental and social characteristics or sustainable investments, and adverse impacts.

In particular, light green and dark green fund documentation should describe how the level of sustainability is achieved by complying with the disclosure principles set out in articles 8 and 9 of SFDR.

Investment fund managers should use the information reported , where applicable, pursuant to the Directive 2013/34/EU[9] or international standards they adhere to, for the purpose of their disclosure on the principal adverse impacts of their investment decisions.

For more information, please visit: CSSF press release on the sustainability-related disclosures

[9] Non-Financial Reporting Directive

Third-country Developments

Provision of investment services and activities in Luxembourg by third-country firms under MiFID II and MiFIR

Background

Following the European Securities and Markets Authority's ("ESMA") letter of 18 August 2020 to the European Commission ("EC") anticipating the AIFMD review and suggesting, in particular, a review of the AIFM and UCITS directives' delegation rules and substance requirements, ESMA published draft technical standards ("draft TS") on the provision of investment services in the European Union ("EU") by third-country firms ("TCFs") under MiFID II (the "draft ITS") and MiFIR (the "draft RTS") on 28 September 2020.

These technical standards complete the picture drawn by CSSF Circular 19/716, as amended by CSSF Circular 20/743 (the "CSSF Circular") on some of the regimes TCFs can use to service Luxembourg clients.

Primary change

The draft TS mark a shift in the supervision of TCFs providing investment services and activities in the EU. They are expected to be endorsed by the EC by the end of the year and provide for extensive harmonized reporting requirements in accordance with Article 46 of MiFIR both at the registration stage and on a regular basis. Such reporting requirements will be applicable to TCFs providing investment services (e.g. portfolio management or investment advice) to Luxembourg investment fund managers ("IFMs") or investment companies through a branch (draft ITS), or on a cross-border basis (draft RTS).

While these reporting requirements will bring additional costs for TCFs operating on a cross-border basis or via (an) EU based branch(es) in order to put in place the necessary IT systems, this is compensated by the fact that future registration with ESMA will give access to the EU based on a harmonized regime and harmonized reporting standards for EU-based branches of TCFs.

Key points

1. Current state on play on delegation and investment services provided by third-country entities

Since no third country has been declared equivalent by the EC so far, TCFs can only provide services to IFMs and investment companies established in Luxembourg:

- On a cross-border basis to eligible counterparties and professional clients "*per se*", under the current national regime foreseen in article 32-1(1)§2 of the Law on the financial sector[1] and clarified in the CSSF Circular
- Through a branch established in Luxembourg
- Through a subsidiary established in Luxembourg, with a MiFID licence
- Through a subsidiary based in another EU member state with a MiFID licence based on free provision of services within the EU
- Out of MiFID/MiFIR scope, on a reverse solicitation basis.

On the other hand, IFMs or UCIs delegating portfolio management to a TCF must submit information to the CSSF about such TCF and its authorization to carry on such service in its home-country. A Memorandum of Understanding must also be established between the CSSF and the third-country delegate's national competent authority.

Where a contract is concluded between a TCF and a Luxembourg chapter XV management company or an investment company in respect of investment advice services payable out of the assets of the UCITS, information must be provided to the CSSF about the TCF as well as certain provisions of the contract and other significant activities.

2. Recent and upcoming changes

a. Investment services provided on a cross-border basis

EU Regime

The Investment Firm Regulation[2] introduced some granular reporting requirements into MiFIR art. 46 which are specified in the draft RTS and would apply to TCFs who register with ESMA, in the event of a future EU equivalence decision.

The reports submitted at point of registration should give ESMA a very detailed view of, *inter alia*,:

- The investment services and activities TFCs are authorized to provide in their home country and those they provide in the EU, their EU client base, the types of financial instruments concerned, their annual turnover and aggregated value of assets corresponding to the services provided.
- How the TFC's EU activities contribute to their strategy and why, if relevant, they choose to provide services in the EU on a cross-border basis rather than by establishing branches or subsidiaries
- The composition of the TFC's management body, the persons conducting the EU activities in the EU and the key function holders
- Description of internal governance arrangements
- The EU marketing strategy
- Client complaint procedures and other arrangements for ensuring investor protection
- Different arrangements of the TCF to comply with MiFID/MiFIR rules of conduct and organizational requirements, where applicable

The annual reports must be submitted by 30 April of each year and cover the previous calendar year. Such regular reporting will enable ESMA to update information received at the point of registration and should also include detailed information on the operations (controls, findings, measures and actions) of the internal control functions, (i.e compliance, internal control and risk management) in relation to services provided to EU counterparties.

ESMA has the power to request additional information, to carry out investigations or on-site inspections and to prohibit or restrict a TCF from providing services in the EU.

[1] Law of 5 April 1993 on the financial sector, as amended
[2] Regulation (EU) No 2019/2033 of the European Parliament and of the Council of 27 November 2019

National Regime

The national regime currently available has been clarified by the CSSF Circular. TCFs established in third countries listed in the CSSF Regulation N°20-02[3], authorized in their home country to provide investment services and authorized by the CSSF to provide these services in Luxembourg, can service UCIs and IFMs[4] on a cross-border basis. TCFs are required to submit the application form in Annex II of the CSSF Circular to seek prior approval from the CSSF.

Transitional provisions

Once an equivalence decision is enacted by the EC for a country deemed equivalent in Luxembourg, third-country firms will be able to continue relying on national third-country regimes for a period of three years after the equivalence decision.

b. Investment service provided through a branch

The draft ITS relating to MiFID II article 41 are aligned to a large extent to the draft RTS but some of the reporting fields are adapted to the provisions of investment services and investment activities by a branch established by the TCF. ESMA also introduced some reporting fields related to services provided by a branch of a TCF to *per se* professionals and eligible counterparties located in other member states.

3. Reverse solicitation

Where a TCF makes use of the reverse solicitation regime, Part III of the CSSF Circular clarifies that a TCF is responsible to assess whether the investment service it provides to a Luxembourg client is provided at the client's own exclusive initiative. Such assessment must be conducted on a continuous basis and for every service, taking into account ESMA's Questions and Answers on MiFID II and MiFIR investor protection and intermediaries topics.

Practical considerations

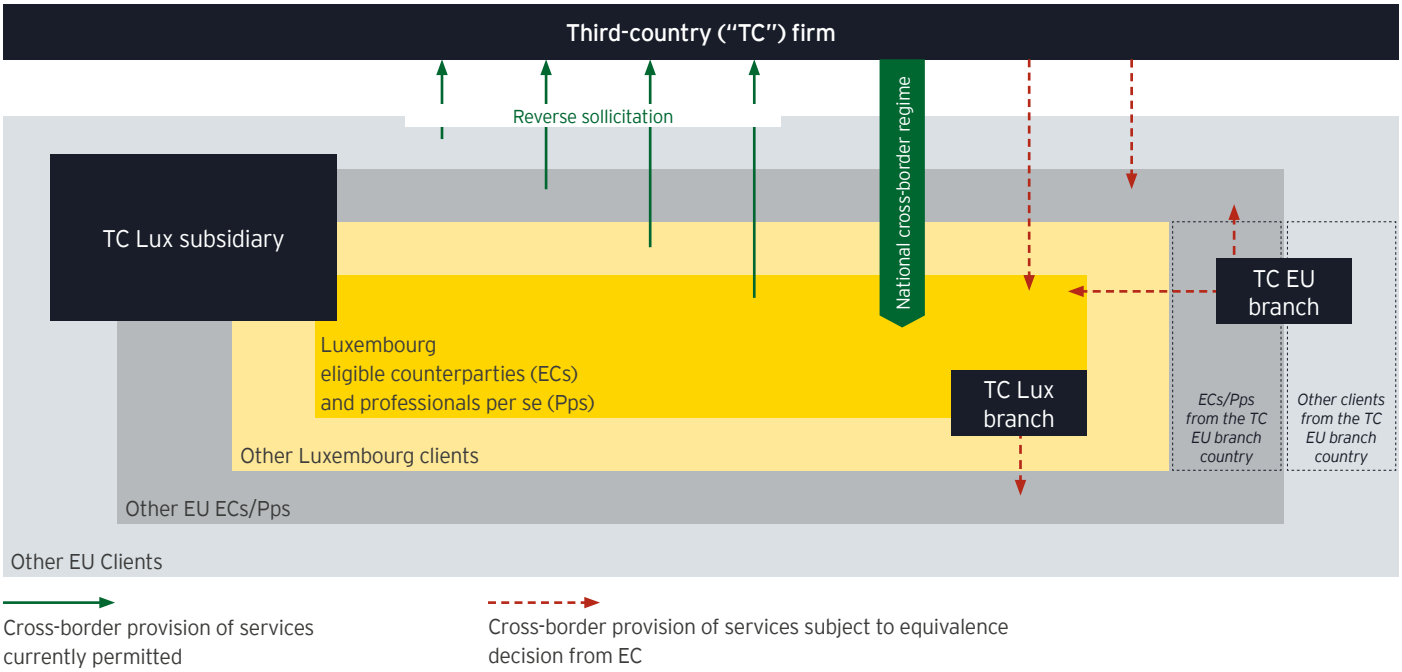
The business model selected by TCFs to access the Luxembourg market is driven by the types, number and geographies of the clients they service or intend to service. The national cross-border regime based on national equivalence is only available to TCFs from a list of countries which is subject to changes and is likely to be extended to the United Kingdom in case no satisfactory trade agreement is reached with the EU.

The EU MiFIR cross-border regime may come as an alternative option in the near future but remains subject to EC equivalence decision, which have to be taken.

[3] Canada, Swiss Confederation, the United States of America, Japan, Hong Kong and Singapore

[4] UCIs and IFMs qualify as professionals *per se* pursuant to Annex III section A of the LSF

Third-country business models and access to EU clients



How can EY help?

EY can help TCFs operating in Luxembourg on a cross-border basis or via a branch with the following:

- Assist with the reassessment of TCFs' strategy within the EU
- Perform a gap analysis of the future ESMA reporting requirements with the existing governance model and IT systems operated by the TCF or its EU branch(es)

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ESMA draft technical standards on the provision of services in the EU by TC Firms

CSSF Circular 19/716, as amended by CSSF Circular 20/743

CSSF Press release 20/26 on the end of the transitional period on 31 December 2020 following the withdrawal of the United Kingdom from the European Union

Executive summary

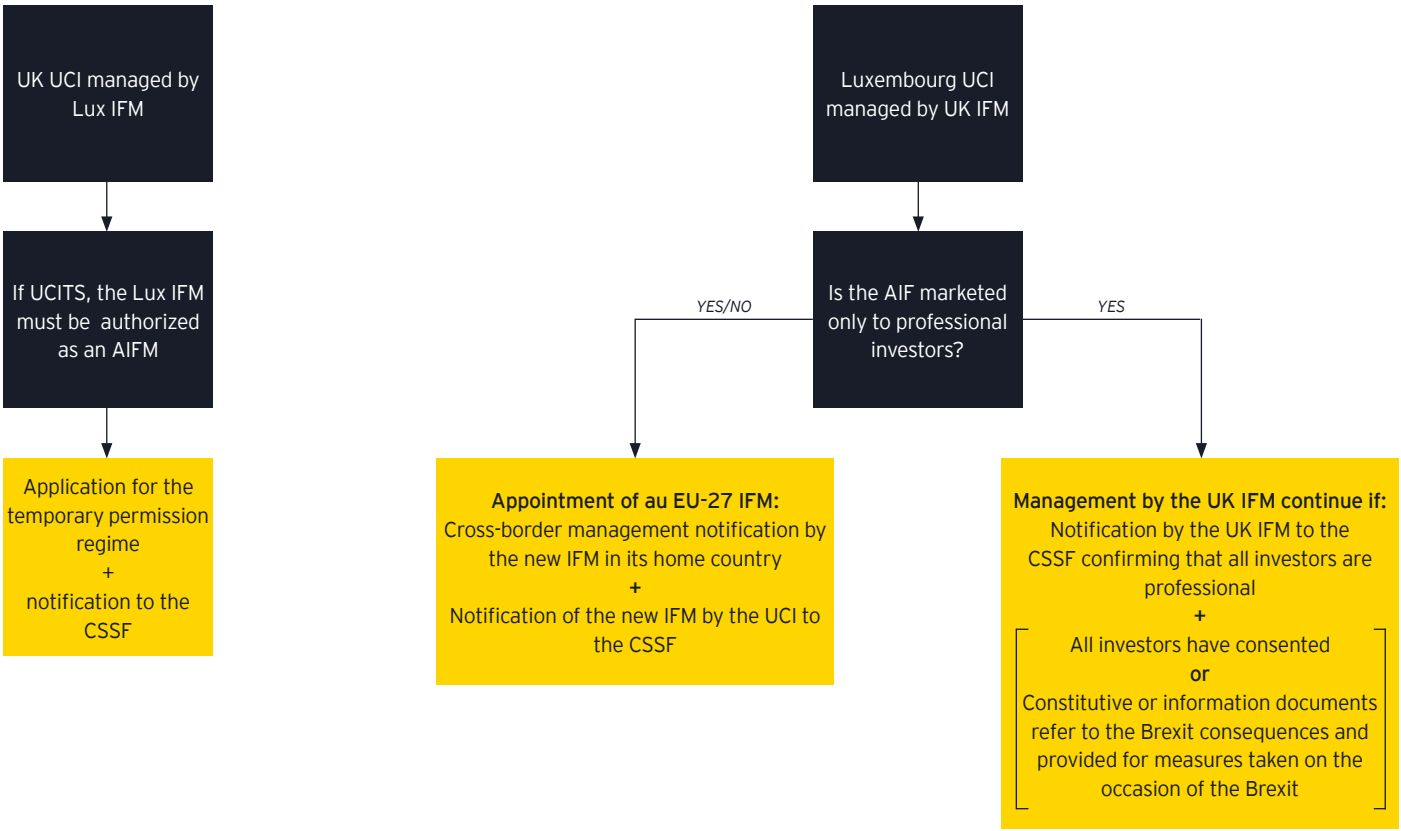
The CSSF[1] issued a press release providing various reminders and clarifications about the actions which need to be taken by 31 December in respect of:

- Luxembourg undertakings for collective investment ("UCIs") managed by a UK investment fund manager ("IFM")
- UK UCIs managed by a Luxembourg IFM
- UK UCIs marketed in Luxembourg

The CSSF also clarifies other Brexit-related issues in relation to UCIs:

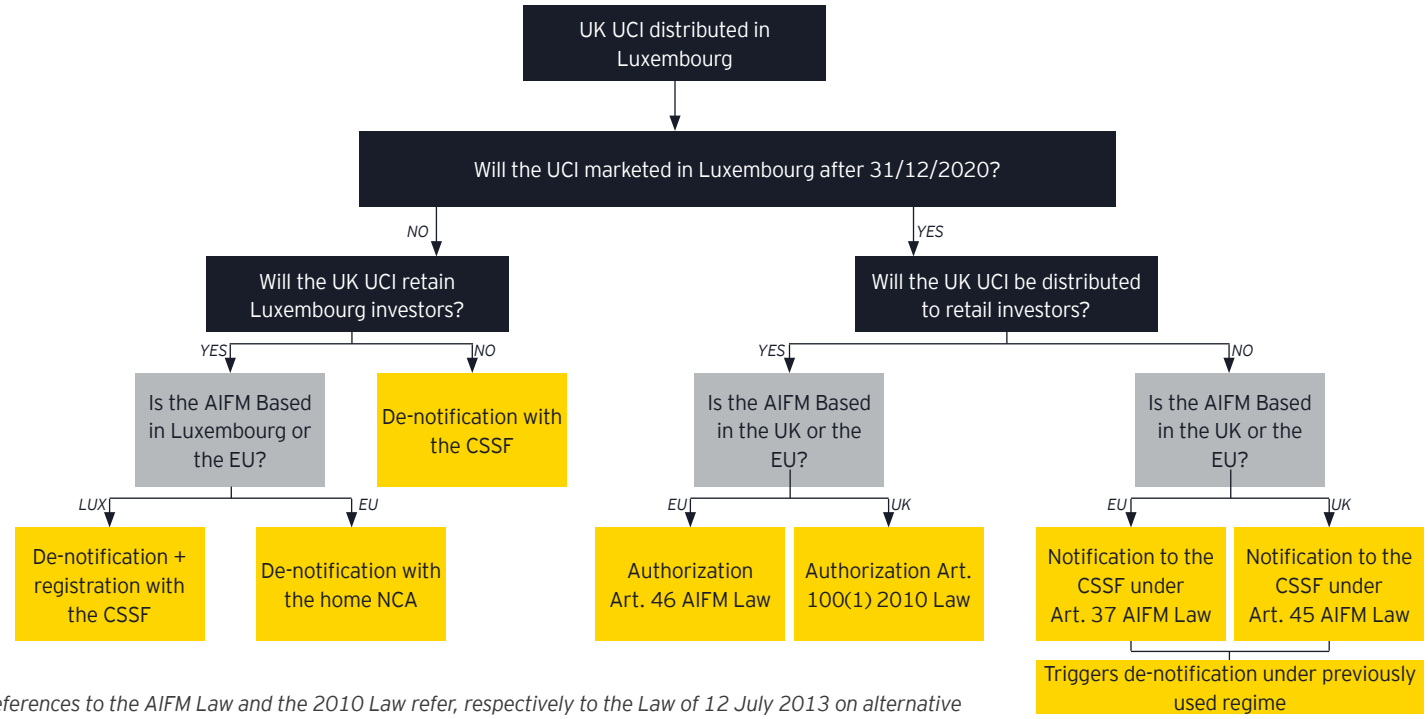
- Delegation of investment management/portfolio management and/or risk management activities to undertakings in the UK
- Compliance with investment policy and eligibility issues
- Its position on secondments.

Cross-border management of UCIs



[1] Commission de surveillance du secteur financier

Cross-border distribution of UCIs in Luxembourg



References to the AIFM Law and the 2010 Law refer, respectively to the Law of 12 July 2013 on alternative investment fund managers, as amended, and the Law of 17 December 2010 on UCIs, as amended

Other Brexit-related issues in relation to UCIs

- The CSSF reminds that delegation of IFM functions to UK regulated asset managers which are subject to prudential supervision is permitted, as the multilateral memorandum of understanding between the Financial Conduct Authority, EU national securities regulators and the European Securities and Markets Authority ("ESMA") signed on 1 February 2019 remains relevant following ESMA's confirmation on 17 July 2020
- The CSSF confirms that any breach of compliance with applicable investment rules or policies triggered by the withdrawal of the UK will be considered as active breaches for the purpose of Circular 02/77. The CSSF draws specific attention to the provisions related to UCITS master-feeder structures where the master fund is a UK-domiciled fund (30% investment limit in "other UCIs") and money market funds deposit rules (deposit with UK credit institutions will no longer be eligible after 31 December 2020)
- Secondments of staff from the UK are acceptable subject to prior notification to the CSSF and provided that they comply with all applicable requirements and that the IFM supervises secondees in an appropriate manner. The Marketing function should be reorganized to ensure compliance with presence requirements applicable to secondees from the UK. Travel for professional purposes is accepted but IFMs should have regard to the COVID situation.

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For more information, please visit: CSSF press release

The future UK overseas fund regime

Background

In case a trade agreement between the UK and the European Union ("EU")[1] is not reached by the end of the transition period on 31 December 2020, passporting of EEA UCITS will be able to continue into the UK for a limited period of time under the temporary marketing permission regime ("TMPR"), provided that the management company or the self-managed UCITS has notified the Financial Conduct Authority ("FCA") by 30 December 2020. In the absence of such notification, passporting firms will automatically enter the Financial Services Contracts Regime ("FSCR") to allow them to wind down their UK business in an orderly fashion.

Primary change

The Financial Services Bill 2020[2] ("the Bill") introduced a new overseas fund regime and will provide for recognition by the FCA of EEA UCITS so that they can continue to be marketed in the UK following the end of the TMPR. As a prerequisite, the UCITS home country must provide at least equivalent investor protection outcomes and HM Treasury[3] must be satisfied that there are adequate supervisory cooperation arrangements between the FCA and the national competent authority in the home country. This retail fund equivalence regime will be introduced through a new section 271A of the Financial Services and Markets Act 2000 ("FSMA") and will provide a more streamlined and simplified process compared to the existing individual fund recognition system under section 272 of the FSMA. However additional requirements specified in separate legal instruments may apply to certain categories of overseas funds.

Key points

TMPR extension

The Bill will extend the TMPR from three to five years to allow sufficient time for the UK government to complete any equivalence assessments and for funds to apply for recognition, either through the OFR or section 272 as appropriate.

Recognition and notification process

The FCA will rely on self-certification from the notifying funds that they are eligible for recognition. Recognition is to be made at both the fund and sub-fund level. The time limit for the FCA to require further information or confirm recognition is two months.
For a money market fund (MMF) marketed to retail clients, an equivalence determination is required under both section 271A FSMA, and the MMF equivalence regime[4]. In case no equivalence is granted under section 271A FSMA, MMF must apply for individual recognition under section 272 FSMA to be able to be marketed to UK retail clients.

Additional requirements for overseas funds

Additional requirements imposed by separate legal instruments may apply for certain categories of funds but are not designed to address fundamental shortcomings in an overseas regime. Proportionality and a level playing field is supposed to be achieved through a provision which requires HM Treasury to have regard to what is required of comparable UK authorized funds when specifying these additional requirements.

Withdrawal of equivalence

HM Treasury may modify or withdraw equivalence in response to material changes in the regulatory regime in either the UK or the overseas countries. In such circumstances, investors should not be forced to divest and the fund should continue to service them. Under a transitional provision, HM Treasury can specify a period during which affected funds can apply for individual recognition under the FSMA section 272 regime or modify or disapply the time limits for the FCA to determine a section 272 application.

Suspension or revocation of individual funds

The FCA has the power suspend or revoke recognition of an individual fund. Fund operators will be required to notify the relevant persons as directed by the FCA. The FCA will also have a power of public censure to inform investors of any wrongdoing by an operator of a recognized overseas fund.

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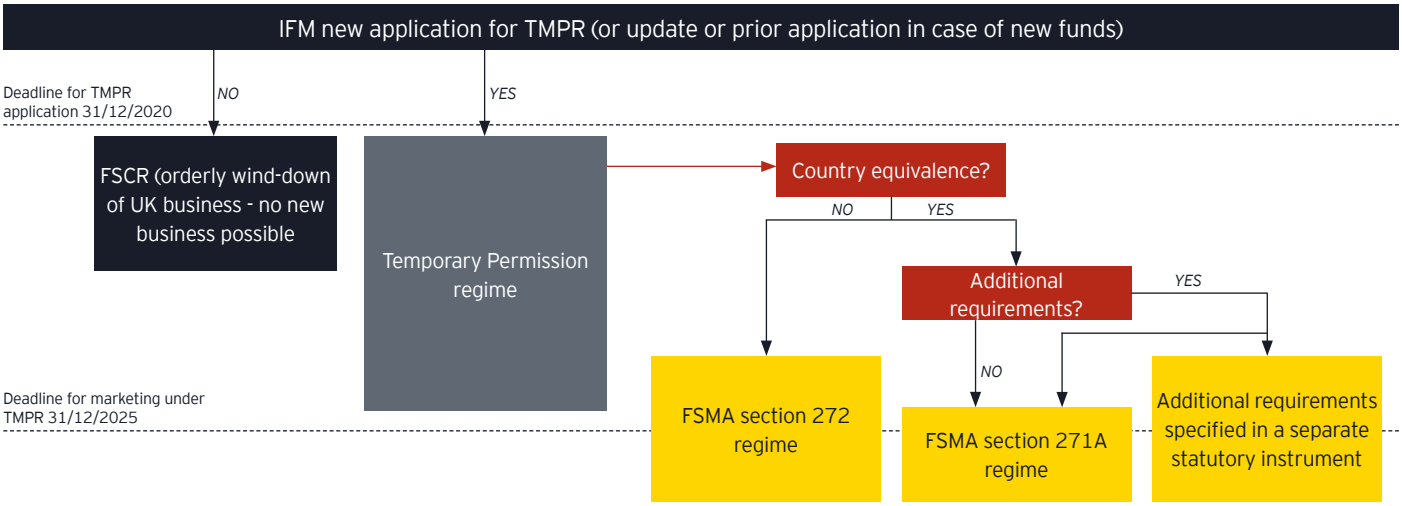
[1] European Economic Area comprising European Union member states plus Iceland, Liechtenstein and Norway
[2] The Financial Services Bill 2019-21 was introduced in the House of Commons on 21 October 2020. The second reading was on 9 November 2020 and the Bill is currently at the report stage.
[3] Her Majesty's Treasury
[4] Article 4A of the MMR



Disapplication of Financial Ombudsman Service ("FOS") and Financial Services Compensation Scheme ("FSCS")

FOS and FSCS are not applicable to overseas funds. Instead, consumers' rights to complain to an overseas alternative dispute resolution facility, where available, will be disclosed when they purchase their investment. Since UK consumers invest in funds through UK authorized intermediaries, they can file their complaints with the FOS and compensation requests with the FSCS in relation to the regulated services provided by UK investment advisors and platforms.

Practical considerations

The extension of the TMPR should avoid disruption in the absence of an immediate equivalence determination. Going forward, the overseas fund regime should provide a relatively straightforward and fair path for EU funds targeting the UK retail market, since additional requirements should not go beyond what is required from a comparable domestic fund.

Unlike the current passport, the FSMA section 271A regime will remain subject to the equivalence determination process which could be affected by the reciprocity of measures taken at a European level. In case of non equivalence or withdrawal of equivalence, overseas funds will have to apply through the individual recognition regime. Despite the simplification of the requirements introduced by the Bill[5], recognition under this regime will remain more onerous and lengthy with a process which can take up to six months.

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CSSF press release 20/23

Read the Bill

Summary of responses on overseas fund regime

[5] Simplification includes (1) the FCA's assessment will be now limited to matters which are the subject of current rules rather than rules which do not yet exist (2) changes to the fund that the FCA would need to approve will be relaxed

Risk Management

Recommendation of the European Systemic Risk Board (ESRB) on liquidity risk in investment funds

In a report issued on 12 November following an ESRB recommendation, ESMA assessed the preparedness of investment funds that have significant exposures to corporate debt and real estate assets to potential future adverse shocks. ESMA conclusions highlight that overall these funds were able to absorb redemption shocks and proved to be relatively resilient to the COVID-19 related market stress. However, the results also show pockets of vulnerabilities and issues around valuation, availability of liquidity management tools ("LMTs") and loan covenants.

ESMA define five priority areas to enhance the preparedness of funds to future liquidity shocks:

1. Alignment of the funds' investment strategy, liquidity profile and redemption policy

National competent authorities ("NCAs") should continue their engagement with investment fund managers ("IFMs") and misalignment between the liquidity profile of funds' investments and their redemption policies should be corrected in a timely manner. Remediation measures may require a process to obtain investors' consent to introduce LMTs, modify the redemption frequency or adapt the fund's strategy. IFMs should be in a position to demonstrate the liquidity set-up of their funds at the authorization stage and during supervisory actions and pay particular attention to the funds investing in less liquid or illiquid assets.

2. Liquidity risk assessments

Liquidity risk assessments should comply with the obligation to take into consideration all factors which could have an impact on fund liquidity or could trigger unwanted sales, such as margin calls or loan covenants, including all relevant liabilities.

3. Fund liquidity profiles

The AIFMD overhaul should include additional specifications on the establishment and reporting of liquidity profiles, notably:

- How to determine a realistic and conservative estimate of the portion of the fund portfolio which can be liquidated (estimate for each asset class based on reliable methodology and data)
- How to take into account arrangements with respect to gates and notice periods

ESMA calls for an alignment of the UCITS framework in relation to the reporting of liquidity profiles.

4. Liquidity Management Tools ('LMTs')

ESMA reiterates its call for a harmonized framework to govern the availability of additional LMTs in both UCITS and AIFMD frameworks including specifications on the required disclosures for their provision and use.

5. Valuation processes in a context of valuation uncertainty

NCAs should conduct further supervisory activities to make sure management companies' valuation procedures include valuation approaches for stressed market conditions. Where portfolio management is delegated, valuation teams should have sufficient expertise and access to information in order to assess the reliability of valuation sources and establish a fair valuation of the portfolio.

For more information, please visit: ESMA report on ESRB recommendations on liquidity risk in investment funds

CSSF Circular 20/752 : ESMA Guidelines on Liquidity Stress Testing in UCITS and AIFs

Background

CSSF Circular 20/752 (the "Circular") integrates the Guidelines of the European Securities and Market Authority ("ESMA") on Liquidity Stress Testing ("LST") in UCITS and AIFs (the "Guidelines") published on 2 September 2019 in local administrative practice and regulatory approach. By increasing the standard, the consistency and, in some cases, the frequency of LST, the objective of the Guidelines is to mitigate the risks arising from liquidity mismatches and use of leverage in UCIs and their negative impact on investors, fund managers and the broader financial system.

Scope clarification

Pursuant to the Circular, LST should be undertaken for UCITS and AIFs, including exchange-traded funds and leveraged closed-ended AIFs, by the following investment fund managers ("IFMs"):

- Luxembourg management companies subject to chapter 15 of the Law of 17 December 2010 ("the 2010 Law")
- Luxembourg management companies subject to chapter 16 of the 2010 Law and authorized as alternative investment fund managers ("AIFMs")
- Luxembourg branches of IFMs subject to chapter 17 of the 2010 Law and authorized as AIFMs
- Self-managed UCITS investment companies established in Luxembourg
- AIFMs established in Luxembourg
- Internally managed AIFs established in Luxembourg

The Circular also clarifies the scope of the Guidelines which is extended to open-ended and leveraged closed-ended specialized investment funds which are not managed by an AIFM.

Guidelines on the design of models, the understanding of liquidity risk, the governance principles and the LST policy as well as guidelines applicable to depositaries and interaction with the national competent authorities also apply to money market funds. The money market fund regulation[1] and ESMA guidelines on stress test scenarios implemented in Luxembourg by CSSF Circular 18/696 and subsequently updated by Circular 20/735 prevail in the event of any conflict.

[1] Regulation (EU)2017/1131 of 14 June 201 on money market funds

The CSSF also recommends that the following vehicles managed by a registered AIFM consider the provisions of the Circular:

- Open-ended and leveraged closed-ended UCIs subject to part II of the 2010 Law
- Leveraged SICARs that are not AIFs managed by a registered AIFM

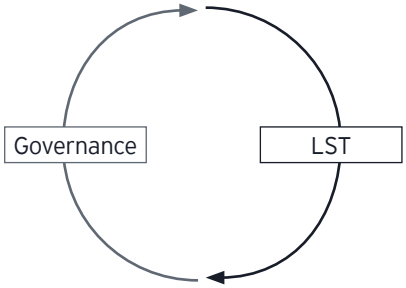
Key considerations

- LST models must be adapted to each fund
- Specific liquidity risk factors should be determined, including difficult-to-model parameters such as second round effect or price uncertainty for less liquid assets
- LST scenarios must be sufficiently severe and should not overly rely on historical data
- Combination of LST results on both sides of the balance sheet must be done after separately testing assets and liabilities
- Managers should aggregate LST across their funds with similar strategies or exposures to better ascertain the liquidation cost or time to liquidity of each security

Key points of the LST regime

Key requirements:

- Integrated and embedded into the UCI's risk management framework
- Documented in an LST policy within the UCITS and AIF risk management process
- Subject to governance and oversight
- Reporting and escalation procedures
- Effective management of conflicts of interest arising from operationalising LST
- Risk management staff should act independently from other functions to perform LST
- Frequency: at least annually but recommended to perform quarterly or more frequently



Key requirements:

- Determination of risk factors
- Type and severity of scenarios
- Sophistication of the LST model – subject to proportionality
- Hypothetical and historical scenario
- Availability of data
- Outputs and indicators to be monitored based on the result of LST

Practical considerations

- IFMs should consider all relevant information in order to design severe but plausible liquidity scenarios for their situation and to calibrate their LST models, including investor behavior inferred from external data;
- IFMs should consider the best approach to cover shocks arising from redemption or other liabilities with liquidity management tools adapted to the UCIs they manage;
- Greater focus on illiquid assets and asset-side liquidity risk factors may be required for AIFs.

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For more information, please visit:

CSSF Circular 20/752

EY alert on ESMA Guidelines on liquidity stress testing in UCITS and AIFs

EY alert on Circular 19/733 – Liquidity risk management of open-ended UCIs

European Supervisory Authorities' draft RTS on bilateral margining

Following clarifications and amendments driven by the Basel Committee on Banking Supervision and the International Organization of Securities Commission, and given the current context, the European Supervisory Authorities propose to:

- Extend the phasing-in of the implementation of the initial margin requirements. Entities with an aggregate average notion amount of non-centrally cleared derivatives ("AANA") greater than EUR50 billion should comply with these requirements as from 1 September 2021. Those entities with an AANA greater than EUR 8 billion should comply from 1 September 2022
- Limit margin requirements for FX Forward and Swap transactions between Global Systematically Important Financial Institutions listed by the Financial Stability Board
- Extend the exemption for equity or index options until 4 January 2024
- Extend the exemption for intragroup transactions until 30 June 2022
- Extend the exemption for bilateral margin requirements potentially applicable to novated legacy contracts to replace UK counterparties with EU counterparties between 1 January 2021 and either, whichever is later, 1 January 2022 or the relevant dates of application set out for specific types of counterparties or contracts

For more information, please visit: draft RTS

CSSF Regulation 20-05
A deeper insight into the key aspects of the Luxembourg Anti-Money Laundering ("AML") provisions

Background

This new Regulation (the "New Regulation"), of 14 August 2020, amends Commission de Surveillance du Secteur Financier ("CSSF") Regulation 12-02 of 14 December 2012 ("12-02") on the fight against money laundering and terrorism financing. This is the first amendment of 12-02. It provides further details on certain provisions of the amended Law of 12 November 2004 (the "AML Law") which implemented European Directive 2018/843 (the "Fifth EU Directive") on 25 March 2020. The changes set out in the New Regulation are effective immediately.

Primary Change

While a number of amendments only reflect the update of references to the AML Law (see our article on the AML Laws of 25 March 2020), other changes are more substantial and include, *inter alia*:

- The introduction of Simplified Customer Due Diligence ("SDD");
- Reinforced internal management requirements, based on the frequently asked questions ("FAQ") of 25 November 2019 on Persons involved in Anti Money Laundering and Counter Financing of Terrorism ("AML/CFT") for a Luxembourg Investment Fund or Investment Fund Manager supervised by the CSSF for AML/CFT purposes;
- Guidance on the risk-based approach to be taken in relation to investment business operations;
- Further details on the use of AML systems (internal or via a third party provider);
- Clarifications on the acceptance process;
- The definition of 'customer', encompassing the notion of investor registered in the investment fund register;
- Further guidance on the outsourcing process.

Key points for Investment Fund Managers ("IFMs") and Undertakings for Collective Investment ("UCIs")

1. Customer due diligence measures

Customer acceptance process:

In case of new clients with a low ML/TF risk profile, the acceptance process can be simplified. The CSSF allows professionals to use an automated process which does not require human intervention if it can be demonstrated that this process is a reliable and efficient alternative to manual approval by the professional. The process should be tested and regularly reviewed to ensure its robustness.

SDD:

The New Regulation introduces SDD measures that professionals may apply to the business relationship in case of a justified low risk assessment (the professional should monitor the risk at all times to ensure that the conditions for the application of low risk still apply), for example:

- The exceptional acceptance of other types of ID documents which meet the criteria of reliable and independent sources (e.g. a letter addressed to the customer by a governmental body or other reliable public body). This is only possible where the customer cannot provide the usual identification documents and, insofar as there are no grounds for suspicion
- Due diligence can be updated only upon certain trigger events (e.g. riskier product, relocated to different country, changes in the transaction behaviour or profile or any other trigger event which seems to indicate that the risk is no longer low), instead of being updated on a regular basis
- For persons purporting to act on behalf of a customer, initiator, promoter who launched an investment fund, obtaining information on the country of residence of these persons instead of asking for the full postal address
- For persons purporting to act on behalf of a customer where a customer is a regulated credit or financial institution, instead of requesting the complete identification of these persons, obtaining a letter confirming that the institution applied due diligence measures to these persons and that it carried out regular controls of these persons with respect to the applicable lists of restrictive measures in financial matters
- For customers subject to a compulsory authorisation or registration regime for AML/CFT purposes, the verification that the customer is subject to this regime by performing, for example, a search on the official website of the regulator and documenting the results of the search

2. Risk-based approach

The New Regulation added a paragraph on Know Your Assets ("KYA") in the context of investment businesses. The paragraph obliges professionals to analyze, based on a risk-based approach, the Money Laundering/ Terrorism Financing Risk ("ML/TF") posed by the investment. Further due diligence measures should be taken commensurate with the outcome of the risk-based approach. The regulation stipulates that such risk-based approaches should be formalised and reviewed at least annually or based on a trigger event which would require a re-evaluation of the risk.

The professional also has the obligation to identify the States, persons, entities and groups subject to restrictive measures in financial matters with respect to the assets it manages and to ensure that funds will not be made available to these groups.

3. AML Systems

The professional must ensure that the internal system or system made available by an external service provider, used for the detection of persons, entities or groups involved in a transaction or business relationship subject to restrictive measures in financial matters is adapted without delay to the latest lists.

The identification of politically exposed persons during the business relationship should be carried out at least every six months.

4. Outsourcing arrangements and agency relationships

It is re-iterated that the responsibility with regards to compliance with the provisions of the AML Law, the Grand-Ducal Regulation of 1 February 2010 as amended by Grand-ducal Regulation of 14 August 2020 and the New Regulation remains with the board of directors of the UCI and/or the IFM. Hence, further clarification is provided regarding the minimum content to be included in the contract for outsourcing arrangements to be used by the board of directors of the UCI and/or the IFM. The board of directors of the UCI and the IFM should ensure that the relevant contracts include (i) detailed clauses specifying the roles and responsibilities of each party as well as (ii) the conditions relating to the transmission of information to the professional, notably to make available immediately, regardless of confidentiality or professional secrecy rules or any other obstacle, the information gathered while fulfilling the customer due diligence obligations. In addition, a process should be put in place to transmit, upon request and without delay, of a copy of the original supporting evidence received.

The New Regulation mentions that the policies and internal procedures relating to outsourcing and agency relationships should include detailed provisions (Due Diligence requirements) on the process for the selection and evaluation of third-party delegates and sub-delegates.

The Regulation also specifies the monitoring obligations for third party delegates (most notably transfer agents, portfolio managers to which it outsources the management and investment advisors) which should occur on a regular and ad hoc basis (for example through on-site visits), in accordance with the risk-based approach, where the professional should verify (for example, through sampling) the compliance obligations incumbent upon the third-party delegate.

5. Non face-to-face business relationships

Even though the AML Law does not foresee that non face-to-face relationships automatically result in high risk, some additional measures have to be taken when there are no certain safeguards such as electronic identification means, relevant trust services as defined in Regulation (EU) No 910/2014 or any other secure, remote or electronic, identification process which is regulated, recognised, approved or accepted by the relevant national authorities. If such safeguards are not available, additional measures have to be taken, most notably:

- Measures ensuring that the customer's identity is established by additional identification documents, data or information
- Additional measures ensuring the verification or certification by a public authority of the provided documents
- Confirmatory certification by a credit institution or a financial institution subject to the AML Law or subject to equivalent professional obligations as regards the fight against money laundering and terrorist financing
- Measures ensuring that the first payment of the transactions is carried out via an account opened in the customer's name with a credit institution or a financial institution subject to the AML Law or subject to equivalent professional obligations as regards the fight against money laundering and terrorism financing

6. Internal Management

In its FAQ of 25 November 2019, the CSSF provided an introduction to the functions of 'person responsible for compliance'(the "RR"[1]) and those of the 'compliance officer' (the "RC"[2]).

The RR should be a member of the board of directors or the board of directors as a collective body (or, where applicable, the authorised management responsible for the fight against ML/TF).

The RC is the person who must implement AML/CFT procedures, for example, the compliance officer, where applicable. The RC may delegate the exercise of his function to one or more employees connected to the professional provided that they have sufficient experience and knowledge of the Luxembourg legal and regulatory framework relating to AML/CFT and are of a sufficient level and authority within the entity.

The table below provides information on the RR's and RC's respective responsibilities:

	RR = Person responsible for compliance		RC = Compliance officer	
	UCI	IFM	UCI	IFM
Eligibility criteria	Board member	Board member	Board member	Compliance officer
	Board collectively	Board collectively	Person mandated intuitu personae by the UCI Board (may be chosen among the staff of the designated IFM for externally managed UCIs)	
Additional Requirements	▸ Demonstrable AML/CFT knowledge with regard to applicable Luxembourg legislation ▸ Available (at least one member if the RR is a collegial body) without delay upon contact by Luxembourg competent authorities		▸ Demonstrable AML/CFT knowledge, expertise and experience with regard to applicable Luxembourg legislation ▸ Available without delay upon contact by Luxembourg competent authorities ▸ Has access to all internal documents and systems required for performing its tasks	
	Knowledge about investment and distribution strategies of the UCI	Knowledge about the services offered by the IFM	Knowledge about investment and distribution strategies of the UCI	Knowledge about the services offered by the IFM

Duties	▸ Validates the supervisory system
	▸ Approves business relationships with PEPs (establishing/continuing)
	▸ Approves business relationships involving high-risk countries
	▸ In case of branches/subsidiaries established in third countries where the law does not permit to implement group-wide AML policies, the RR must:
	  ▸ Approve the AML/CFT risk assessment and the group AML/CFT policies and procedures
	  ▸ Be provided at least with information on the number of suspicious transactions reports filed within a set period and aggregated data providing an overview of the circumstances that gave rise to suspicion
	  ▸ Be provided with at least the number of high-risk customers and aggregated statistical data providing an overview of the reasons why customers have been classified as high risk, such as politically exposed person status
	  ▸ Approve the establishment and maintenance of higher-risk business relationships, or a higher risk occasional transaction
	  ▸ Receives regular and ad hoc reports from the compliance officer on the follow up of the recommendations, problems and shortcomings and irregularities identified during the course of regular controls and verifications of the compliance with the AML/CFT policy. Reports should specify the risks related and their seriousness, propose corrective measures and the position of persons concerned. These reports must allow:
	  ▸ Assessing the scale of the suspicions or reasonable grounds for suspicion of (i) money laundering, (ii)an associated predicate offence or (iii)terrorism financing which were identified and
	  ▸ Expressing a judgement on (i)the adequacy of the AML/CFT policy, procedures and systems and (ii)the collaboration between the professional's departments as regards AML/CFT
	▸ Where a suspicious activity/transaction is identified, the compliance officer should consult the RR where appropriate
	▸ Submits summary report to the CSSF within 6 months of the year end
			▸ Applies the AML/CFT policy and procedure and has the power to propose to the authorized management on his own initiative any measure necessary or useful to this end, including the release of required means
			▸ Reviews the AML/CFT policy on a regular basis
			▸ Performs regular control of the supervisory system
			▸ Ensures the quality of the AML/CFT controls carried out by the first line of defence and, as the second line of defence, must verify compliance by the professional with all the AML/CFT professional obligations
			▸ Must provide written authorization for the acceptance of new customers, where appropriate and for customers with a high-risk profile
			▸ Must be provided with an internal report when it is impossible to verify at the earliest opportunity the identity of a customer and benefical owner (in case where an account is opened before or during the verification of the identity)
			▸ Must be provided with an internal report when it is impossible to verify at the earliest opportunity the identity of the founders, of a company and of the beneficial owner (in case where an account is opened for a company in the process of incorporation)
			▸ Must be involved systematically in the acceptance of customers involving high-risk countries
			▸ Must be provided with reports on suspicious transactions/persons identified and is solely competent to decide on the application and scope of measures required where a suspicious activity or transaction is identified and their termination. The RC is consulted where appropriate
			▸ Must provide the RR, the authorized management and, where appropriate the Board regular and ad hoc reports on the follow up of the recommendations, problems and shortcomings and irregularities identified during the course of regular controls and verifications of the compliance with the AML/CFT policy. Reports should specify the related risks and their severity, propose corrective measures and the position of persons concerned. These reports must allow:
			  ▸ Assessing the scale of the suspicions or reasonable grounds for suspicion of (i)money laundering, (ii)an associated predicate offence or (iii)terrorism financing which were identified and
			  ▸ Expressing a judgement on (i)the adequacy of the AML/CFT policy, procedures and systems and (ii)the collaboration between the professional's departments as regards AML/CFT
			▸ Must prepare at least once a year, a summary report on his activities and his operation and submit it to the person responsible for compliance, the authorized management and the Board and, where appropriate, the specialized committees
			▸ Is the privileged contact person for the Luxembourg authorities as regards AML/CFT issues and for the competent authorities with respect to the application of restrictive measures in financial matters. He is also in charge of the transmission of any information or statement to these authorities	

[1] Responsable du respect des obligations
[2] Responsable du contrôle du respect des obligations

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For more information, please visit:

CSSF Regulation 20-05

CSSF Regulation 12-02, as amended

Flash news

Update of CSSF FAQs on UCITS Directive and AIFMD in relation to data transfer by a central administration of a depositary to another service provider

The FAQs have been updated by the CSSF in November.

Instead of requiring explicit investor consent prior to a data transfer by a central administration or depositary to another service provider, an investment company or a management company/alternative investment fund manager ("IFM") of a common fund should update the fund's application form and prospectus prior to the transfer and inform investors of the documentation update.

The data transferor no longer needs to obtain a commitment from the Board of Directors of the investment company or IFM that the investors have been informed and consented to the transfer.

For more information, please visit: CSSF FAQ on UCITS and CSSF FAQ on AIFMD

ESMA announcement on costs & performance transparency

ESMA announced on 13 November that a common supervisory action will be launched in 2021 to improve supervision and enforcement convergence and ensure proper implementation of its *guidelines on performance fees performance fees in UCITS and certain types of AIFs*[1] and its *supervisory briefing on the supervision of costs*[2].

The translations of the ESMA guidelines on performance fees into all EU official languages were published on 5 November 2020. The guidelines will therefore become applicable as of 6 January 2021 for all new funds or existing funds introducing a performance fee after this date. Funds with a performance fee existing before this date should comply from the beginning of the financial year following 6 July 2021.

While the ESMA supervisory briefing does not bind investment fund managers directly, they are still expected:

- To benchmark fee structures of the funds they manage against funds with similar investment policies,
- To have proper governance in place for the determination and the review of costs charged to the funds
- To implement disclosure to prevent any impression of excessive or duplicate costs being charged to investors, in particular where conflicts of interests have been identified, notably as a result of third-party payments.

ESMA will also possibly continue its coordination of work of the National Competent Authorities in the area of closet indexing.

For more information, please visit: ESMA annual work programme

[1] See EY Luxembourg Market Pulse Regulatory Update, March 2020 edition
[2] See EY Luxembourg Market Pulse Regulatory Update, July 2020 edition

Draft guidelines on marketing communications under the Regulation on cross-border distribution of funds

The final guidelines will apply to UCITS management companies, alternative investment fund managers, European venture capital fund managers and European social entrepreneurship fund managers ("IFMs").

The market communications addressed to investors include:

- Online advertising messages, webpages, video presentations, live presentations, radio messages, factsheets, messages published on social platforms
- Marketing materials, documents or presentations addressed individually or made available by an IFM to the public on its website or in any other location
- Communications advertising a fund addressed to investors or potential investors located in the home member state of the IFM or in a host member state
- Communications describing the characteristics of a fund
- Communications by a third party used by the IFM for marketing purpose
- IFMs should ensure that all their marketing communications addressed to investors are identified as such, including a short disclaimer to:
  - Make clear that the market communication has a marketing objective
  - Draw the attention of investors or potential investors to the fact that an investment decision should not be based solely on this marketing communication
  - Mention the existing fund legal and regulatory documents
  - Describe the risks and rewards of investing in the fund in an equally prominent, clear and easily understandable manner:
    - The font, size and position should be the same for the description of both the risks and rewards
    - Information on the risks should not be disclosed in a footnote or small characters
    - Both risks and rewards should be mentioned either at the same level or one immediately after the other
- Contain information which is fair, clear and not misleading. Information (notably on the fund's investment policy, underlying assets, or costs) included in all marketing communications should be consistent with, and not contrary to, the legal and regulatory documentation

The consultation is open until 8 February 2021 and the final guidelines should be issued by 2 August 2021 at the latest.

For more information, please visit: ESMA consultation paper

ESMA final report on the market abuse regulation[3] ("MAR") review

ESMA submitted its report on the MAR review to the European Commission on 23 September 2020.

With respect to undertakings for collective investment ("UCIs"), ESMA suggested that:

- There are no compelling arguments to exempt UCIs admitted to trading or traded on a trading venue ("listed UCIs") from the scope of MAR.
- Managers of management companies of the listed UCIs without a legal personality and externally managed funds with a legal personality should not be required to meet the MAR obligations applicable to persons discharging managerial responsibilities ("PDMR obligations").
- Self-managed listed UCIs should be specifically excluded from the PDMR obligations.
- Management companies of listed UCIs with legal personality should be held responsible for disclosing inside information when it arises. Asset managers to whom the execution of certain functions have been delegated by management companies, should be responsible for reporting immediately to the management company any information that may be relevant in terms of possible existence of inside information.
- A recital should be included to clarify that management companies of listed UCIs are responsible for drawing up and maintaining lists of those who may have inside information. Third party delegates (asset managers, depositaries, accountants, etc...) should be explicitly in scope of the obligation to draw up and maintain their own lists of those people who may have inside information, where such information exists.

For more information, please visit: ESMA final report

The Digital Operational Resilience Act

The European Commission published on 24 September 2020 a draft Digital Operational Resilience Act ("DORA") which is a key element of the broader digital finance package. DORA's objective is to ensure that regulated firms in the financial sector, including *inter alia* UCITS management companies and alternative investment fund managers ("IFMs"), are resilient enough to ensure continuity of their operations through a severe disruption of their information and communication technology systems ("ICT").

The DORA will introduce, *inter alia*:

- Regulatory and supervisory powers to one of the European Supervisory Authorities in respect of critical ICT third party providers
- Harmonized rules for digital operational resilience testing
- Harmonized ICT incident classification reporting
- Harmonized ICT risk management rule

Future standards to be developed should ease mutual recognition of tests across member states and enable cross border firms to optimize costs.

ICT risk management rules emphasize that the role of the board includes determining risk tolerance and impact tolerance for ICT disruptions and review business continuity and disaster recovery plans. These rules also require, *inter alia*, firms to develop response and recovery strategies and plans, including communications to customers and stakeholders.

However, firms qualifying as microenterprises will not be required to implement complex governance arrangements, dedicated management functions, in depth assessments after major changes in the network and information infrastructures, regular analyses on legacy ICT systems and expanded testing of business continuity, or response and recovery plans to capture switchover scenarios between their primary ICT and redundant facility.

For more information, please visit: the draft regulation

[3] Regulation (EU) 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse

Update from the fund registration and distribution practice

Switzerland : Financial Services Act (FinSA) and Financial Institution Act (FinIA) – Impact on foreign funds

The Swiss Federal Council published a document on the impact of the Financial Services Act (FinSA) and Financial Institutions Act (FinIA) on foreign funds, providing an update on the approved Ombudsman Offices and Register of Advisers on 21 July 2020.

The FinSA and FinIA related ordinances and circulars entered into force from 1 January 2020.

The Swiss Authorities allow the financial service providers and client advisers to comply with the new legal provisions within a two-year transitional period.

The purpose of FinSA is to oversee all financial services as well as to regulate the offer of the products in the Swiss market rather like MiFID II in the EU. FinIA introduces coordinated supervision on various categories of financial institutions such as portfolio managers, managers of collective assets, fund management companies and securities firms.

FinSA categorizes clients into segments and has significant consequences on the distribution of funds:

- *Client/Investor segmentation:* The financial service provider shall assign the persons to whom they provide financial services to a specific segment such as retail, professional or institutional clients. The segmentation of clients provided for in article 4 §3-5 and article 5 §1,4 impacts the notion of qualified investors (professional investors).
- New notions around fund marketing in Switzerland: The Swiss Authorities will examine the newly introduced notions revolving around marketing in Switzerland such as distribution, offers, advertising and roadshows
- *Language of the fund documents:* The fund documents for Switzerland can be published in English or in one of the three Swiss national languages being French, German or Italian as from 1 January 2020. Funds wishing to change their official language for Switzerland must express their intention in both the FINMA filing and a publication on the Swiss publication platform.
- *Ombudsman and Register of Advisers:* Any person (individual or company) that provides financial services on a commercial basis in Switzerland or for clients in Switzerland (financial service provider) should be affiliated to a Swiss ombudsman office at the latest when commencing activity (article 77 FinSA) and subscribe to an adequate insurance policy. Four ombudsman offices in the sense of FinSA have been recognized by the Federal Department of Finance (FDF) with effect from 24 June 2020. The Federal Department of Finance may authorize others in the future.
- *The licensing requirement for distributors* (Distributor Authorizations) of collective investment schemes ("CIS") is abolished. Under the Collective Investment Schemes Act, as amended by the FinSA and the FinIA, distributors of CIS no longer need a FINMA authorization or, for foreign distributors, an authorization to distribute CIS in their home jurisdiction to carry out their activity in Switzerland. This authorization has been replaced by the requirement for employees of certain financial service providers to enter into a register of advisers in Switzerland. A first register and the specific requirements in respect of the registration conditions have been approved by FINMA and are applicable from 20 July 2020. Additional registers may be approved by FINMA later.
- *Transitional Periods:* The transitional period applies to both financial service providers which are already active on the Swiss financial market and to newcomers. Client advisers actively offering financial products must affiliate themselves to an ombudsman's office by 23 December 2020 and must submit an application to be recorded in the register by 19 January 2021. The client advisors will thereafter have until 31 December 2021 to obtain a formal entry in a register as per Article 95 §2-3 FinSA.

The only exception to the two-year transitional period applies to independent wealth managers/financial advisers that become subject to FinIA: they must notify FINMA within 6 months of their intention to obtain an authorization as a financial institution and will thereafter have until 31 December 2022 to complete their request for authorization as per Article 93 §4 FinIO.

Germany: BaFin published the updated guidance notice (2013) on marketing of EU UCITS in Germany

The *Bundesanstalt für Finanzdienstleistungsaufsicht* ("BaFin") has published the updated guidance notice (2013) on marketing of units of EU UCITS in the Federal Republic of Germany pursuant to section 310 of the Investment Code on 2 November 2020.

These guidelines provide a non-exhaustive list of specific provisions to the investments to be complied with while marketing units of EU UCITS as specified in Article 91(3) of the Directive 2009/65/EC.

The amendment made in the updated guidance notice is mentioned below:

Under the Section "IV. Requirements for marketing" in point "3. Publication of information to investors" part "d" has been amended as "in the following cases, the information must be provided to investors in Germany by means of a durable medium in accordance with section 167 of the investment code in German language (section 298(2) of the investment code)".

According to the section mentioned above, the publication by means of a durable medium may only be done in German language from now on. The previous version of the Guidance Notice allowed the publication in another language customary in the sphere of international finance.

France: AMF updates the information to be provided by undertakings for collective investment incorporating non-financial approaches

The *Authorité Des Marchés Financiers* ("AMF") has amended the Doc-2020-03 on the information to be provided by UCIs incorporating non-financial approaches on 27 July 2020.

The following policy applies with the following timeline:

1. Creation of UCIs, product modifications and notification of cross-border marketing of a foreign-based UCITS: immediate application.
2. Existing products as of 11 March 2020: application at the latest on 10 March 2021. During this transitional phase, modifications of the products to delete any non-financial reference (e.g. change of denomination) only require informing investors by all means.

The purpose of this policy is to ensure the quality of the information provided for investors and its consistency with non-financial investment management approaches adopted by fund managers. The policy defines a number of criteria enabling the assessment of the effective nature of the approaches used. The criteria to be allowed to make non-financial characteristics a key aspect of communication are based notably on the threshold defined by the French socially responsible investment public label. These criteria are addressed to funds wanting to make consideration of non-financial characteristics a key aspect of their product communication.

This policy applies to the following asset management and distributors of collective investment products authorized for marketing in France to retail investors, that comprise:

- Asset management companies of French UCITS and French AIFs that can be marketed to retail investors
- The entities marketing such collective investment products in France, but also incorporated under foreign law

This policy is not applicable to French-domiciled collective investment products which are only marketed abroad and whose subscriptions and acquisitions of units or shares are reserved for non-French-resident investors.

Chile: CCR updated the application form for the approval of foreign funds in Chile

The *Comision Clasificadora de Riesgo* ("CCR") has published the updated application forms for the approval procedure of foreign capital instruments which are regulated by Agreement N°32 of the investment regime of pension funds in Chile on October 2020.

The updated application form published by the CCR for the approval of shares of foreign open and closed-ended mutual funds shall be completed and uploaded to the CCR's webpage to start the approval process.

The major changes made to this application form and the required documents are the following:

- A letter signed with the electronic signature by the "*Gerente General*" (CEO) of one of the Chilean AFPs (Pension Fund Managing Companies) or the AFC (Unemployment Fund Managing Company), showing interest in approving the requested fund as an investment option
- The page 3, 4 and 5 that includes the preliminary information, statement and the updating commitment in this application form, should be signed with electronic signature by the appropriate signatory
- In Appendix N°2, N°3-A, N°3-B and N°3-C, the assets under management of the holding company, management company, investment manager and sub-investment manager should be disclosed in US dollars
- In Appendix N°3-B and N°3-C, the exclusions of the assets related to services such as custody, bookkeeping or safekeeping are removed for the disclosure of the assets under management of the investment manager and sub-investment manager
- In Appendix N°4, under the depository/custodian the assets under custody should be disclosed in US dollars and the part requesting information on applicable legislation has been removed
- In Appendix N°11-A and N°11-B, the section about the liquidity of the instruments has been restructured and modified by removing a few parts of the requested information
- The Appendix N°13, the property participation of the fund is applicable to only open-ended mutual funds

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