Regulatory Update Q4 2019

1. Luxembourg

1.1 New CSSF AML/CTF investment market entry forms:

On 7 November 2019, the CSSF issued a press release in relation to AML/CTF1 entry forms to be used by funds and investment fund managers (”**IFMs**”) supervised by the CSSF.

The aim of these forms is to collect standardized key information in relation to (i) money laundering and terrorist financing ("**ML/TF**") risks to which the professionals are exposed and (ii) the measures they put in place to mitigate these risks.

In accordance with the CSSF press release, the AML/CTF entry form must be completed and submitted to the CSSF by:

1. UCITS, Part II UCIs, SIFs, SICARs, ELTIFs, EUSEFs, EUVECAs or MMFs2 in the following cases:

- when submitting an application for the set-up of a new fund;

- when requesting approval for an additional sub-fund. In practice, the CSSF seems to take a stricter approach by asking, in certain circumstances, for the form to be completed also for all new and existing sub-funds.

2. IFMs in the following cases:

- when submitting an application for the set-up of an authorised or registered investment fund manager;

- when requesting approval for an additional licence (e.g. for new investment strategies), a license extension (e.g. for MiFID activities) or a change in the shareholder structure, if there has been any change to the information previously submitted.

AML/CTF forms must be accompanied by specific documents, the list of which depends on the ML/TF residual risk of the fund/IFM.

1.2. CSSF FAQ: Persons involved in AML/CTF for investment funds/managers

On 25 November 2019, the CSSF issued an FAQ on persons involved in AML/CTF for a Luxembourg fund or investment fund manager ("**IFM**") supervised by the CSSF for AML/CTF purposes. The aim of the FAQ, which is currently composed of two questions, is to share the CSSF's interpretation of Article 4(1) of the Law of 12 November 2004 on the fight against money laundering and terrorist financing, as amended ("**AML Law**").

While the FAQ is only applicable to entities subject to the CSSF's supervision, unregulated funds may nevertheless wish to take its provisions into account since they are subject to the AML Law as well.

In Question 1 of its FAQ, the CSSF recalls that in its view, every Luxembourg fund and IFM subject to AML/CTF supervision is legally required to appoint:

- a person from among the members of their management bodies, to be responsible for compliance with AML/CTF obligations, in French a "*responsable du respect des obligations*" ("**RR**"); and

- a compliance officer at the appropriate hierarchical level to ensure the control of compliance with AML/CTF obligations, in French a "*responsable du contrôle du respect des obligations*" ("**RC**").

In practice, the CSSF expects that any Luxembourg regulated fund designates:

- one of its governing body's members or the governing body (e.g. board of directors) in its entirety as RR (as a collegial and ultimate management body, it is in any case responsible for AML/CTF matters); and

- a member of the governing body or a third-party appointee (e.g. from the staff of the IFM of the fund) as RC who will be in charge of the day-to-day AML/CTF tasks. In cases where the RC is a third-party appointee, the CSSF provides additional guidance on the formalization of the contractual relationship with the RC. In addition, the CSSF clarifies that the RC can, in exceptional circumstances, be located abroad if the IFM of the fund is not domiciled in Luxembourg.

Similar rules apply to any Luxembourg IFM supervised by the CSSF, which must designate:

- its governing body (e.g. board of directors) in its entirety or one of its members as RR; and

- the compliance officer at the appropriate hierarchical level in charge of AML/CTF aspects as RC. Based on the outcome of the national risk assessment of money laundering and terrorist financing issued in December 2018, the CSSF seems to depart from its previous position (as detailed in point 313 of CSSF Circular 18/698), in accordance with which the need to designate the RC must be assessed in light of the size and nature of activities of the IFM.

The CSSF adds that the above rules are general rules and may need to be adapted on a case-by-case basis since they do not address all possible scenarios.

Source: Regulatory update taken from public websites

Question 2 of the FAQ clarifies the conditions applicable for any person appointed as RR or RC. These conditions are based on those defined under Article 40 of CSSF Regulation 12-02 of 14 December 2012 on AML/CTF.

1.3 PRIIPs assessment: New CSSF press release:

On 11 December 2019, the CSSF published a new press release (19/16) in relation to the PRIIPs assessment document which all **Part II UCIs, SIFs and SICARs** had to complete via the eDesk platform by 31 October 2019.

The CSSF hereby confirms that:

- funds created after 31 October 2019 must also complete the assessment through the eDesk portal; and

- all information fields in the PRIIPs assessment completed through eDesk before 31 October 2019 must be kept up to date via the portal.

2. UK

3.1. FCA extends the TPR application deadline to 30 January 2020:

As published on the FCA website on October 30, 2019, the FCA has extended the temporary permission regime (TPR) application deadline via Connect to 30 January 2020.

Firms, UCITS and AIF management companies that wish to temporarily continue their UK business under the TPR after Brexit have until 30 January 2020 to complete their application(s) via Connect. Management companies that have already submitted their TPR application before the deadline extension can ask the FCA to re-open their application until 15 January 2020.

All requests to re-open the TRP application should be sent by email to recognisedcis@fca.org.uk and include the management company´s Firm Reference Number (FRN). You can find the FRN on the FCA register.

3. Europe:

3.1 **ESAs publish joint Consultation Paper on the PRIIPs KID** amendments:

On the 16th of October, 2019, the European Supervisory Authorities ("ESAs") published a joint consultation paper concerning amendments to Commission Delegated Regulation (EU) 2017/653 of

8 March 2017 on key information documents for packaged retail and insurance-based investment products (PRIIPs KID).

In this context, the main aims of the review are to:

- **Allow the appropriate application of the PRIIPs KID by UCITS and relevant non-UCITS funds**, subject to the potential end of the temporary exemption of such funds from the requirements of the PRIIPs Regulation;
- Address the main regulatory issues that have been identified since the implementation of the PRIIPs KID to those products that are currently in scope: **overly optimistic future performance scenarios, misleading presentation of the costs and computation of the transaction costs, lack of clarity of the presentation of the costs and of the use of two different documents for MOPs.**

The Consultation paper includes the following proposed amendments:

Changes to the methodology for future performance scenarios

Possible alternative to present illustrative performance scenarios

Options to change the methodologies to calculate costs and how these are presented in summary tables

Presentation of the costs and summary cost indicator:

Taking into consideration the concerns of stakeholders since the implementation of PRIIPs, the ESAs intend to make substantive amendments to the cost tables **to improve the compatibility with MiFID disclosure requirements and require more specific details or descriptions of the main cost types to be disclosed**.

Although the use of the "**reduction in yield (RiY)**" was challenged for being difficult to understand for investors, the ESAs are of the view that it **remains the most pertinent cost indicator**. In that context they propose to amend the presentation of the cost tables to ensure that the RiY percentages are better understood.

The ESAs consult on several options but highlight their preferred one that consist of splitting the cost information into two different tables as follows:

1. The RiY percentage figure
2. Specific description of the costs and how they are calculated, cost indicators in the form of monetary breakdown of costs at different periods and total monetary cost figure

Changes to the methodology to calculate transaction costs :

Based on the experience gained since the PRIIP introduction, the ESAs note that, **currently**, the **amount of explicit costs** paid by investors **are not comprehensively reflected** due to the application

of the slippage methodology and the current methodology needs to be adapted for different types of assets (OTC, non-financial assets, real assets).

In addition they acknowledge that the methodology needs to be proportionate. As a response, the ESAs propose to introduce a proportionality threshold whereby the PRIIP manufacturer would be able to use a simplified approach where there is a low number of transactions or a low portfolio turnover.

Other criticism of the current methodology relates to the prescriptive arrival price methodology and, in that respect, the ESAs have considered whether it should be replaced by a more principle-based or criteria based approach.

Given the risk of inconsistent application of such an approach, the ESAs preferred approach is to amend but not replace the arrival price methodology, introducing a less prescriptive approach allowing for several derogations.

Ultimately, it is foreseen that whenever the implicit transaction costs are negative, a minimum shall be disclosed.

Possible changes in view of the exemption in Article 32 of the PRIIPs Regulation being due to expire and the possible use of the PRIIPs KID by UCITS from 1 January 2022

Proposals to amend the rules related to PRIIPs offering a range of options for investment ("MOPs) Information gathered since the implementation of PRIIPs indicates that **investors have difficulties understanding the interactions between the generic KID and the specific information and to compare between different MOPs**, especially in relation to the total cost related to a particular investment option.

The ESAs propose to introduce some differentiation between the approaches used for different types of options. More specifically, the PRIIP manufacturer would be required to provide more complete information on a limited number of most relevant options (with a minimum of 4).

The ESAs further consult on the relevant way to narrow the cost ranges presented in the generic KID. One possible option would be to introduce different rows per risk class of the various options in the cost table instead of a single one.

Changes to the presentation of performance information

The consultation paper does not include any concrete proposal in this respect as the presentation is currently undergoing a targeted consumer testing, the results of which are expected in the first quarter of 2020. The presentations that are consulted upon are as follows:

- Including intermediate scenarios (for periods shorter than the recommended holding period)
- Indicating the probability of each scenario
- Including a fourth stress scenario or a row with the minimum investment return
- Adding the past performance to the forward looking performance scenarios

Source: Regulatory update taken from public websites

- Using an illustrative approach to future performance scenarios (not based on probabilities)

Source: Regulatory update taken from public websites

Timing of implementation for existing PRIIPs

The ESAs envisage the possibility to implement the changes that will be proposed to the Commission to existing PRIIPs **already in 2021** and before the deadline of implementation for the UCITS and query the views of stakeholders on the benefits of this approach.

3.2 AMLD V Implementation

In the context of the implementation process of **AMLD V**1, on 8 August 2019, the Luxembourg government introduced a draft Bill of Law2 ("**Bill of Law**"), which notably amends the Law of 12 November 2004 on the fight against money laundering and terrorist financing, as amended ("**AML Law** ").

Under the current version of the Bill of Law, major amendments to the AML Law will include, amongst others:

- extension of the scope of the AML Law to additional professionals, such as virtual assets service providers and, where the value of the transaction or a series of linked transactions amounts to EUR 10,000 or more, persons involved in the trading, intermediation and storing of works of art;

- extension of the category of "financial institutions" to all persons subject to CSSF supervision for anti-money laundering and counter terrorist financing ("**AML/CTF**") purposes, thus harmonising the sanction regime, and in particular the administrative fines applicable to professionals supervised by the CSSF;

- specific enhanced due diligence measures for business relationships and transactions involving high risk countries3 ;

- addition of new factors potentially evidencing a higher risk in Annex IV of the AML Law4 ;

- harmonisation of powers, including the sanction regime, of supervisory authorities and self-regulatory bodies;

- enhanced national and international cooperation between Luxembourg and foreign competent authorities;

- enhanced protection of whistleblowers.

As well as implementing certain provisions of AMLD V, the Bill of Law also embeds in the AML Law certain provisions of (i) the Grand Ducal Regulation of 1 February 2010 providing details on certain provisions of the AML Law, as amended, and (ii), the CSSF Regulation 12-02 on AML/CTF (e.g. KYC documentation, internal controls and training of personnel).

Furthermore, the Bill of Law enforces certain recommendations of the FATF (relating notably to due diligence obligations).

Finally, no transition period is currently provided under the Bill of Law which, once adopted, would therefore be applicable four days after publication.

3.3 Benchmarks Regulation

Regulation (EU) 2019/2089 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks was published in the Official Journal of the European Union on 9 December 2019.

It amends the Benchmarks Regulation (EU) 2016/1011 ("**BMR**") by adding provisions with respect to EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks.

Article 51 of the BMR has been amended in order to extend the transitional provisions applicable to third country benchmarks until 31 December 2021. ESMA has updated Q 9.3 of its Q&A on BMR accordingly.

Additional transitional provisions have been added to Article 51 to allow the provision and the use of existing benchmarks that have been recognised as critical benchmarks for existing and new financial instruments, financial contracts, or for measuring the performance of investment funds until 31 December 2021 (instead of 1 January 2020), or where the index provider submits an application for authorisation, unless and until such authorisation is refused.

The transitional provisions for EU-based index providers of existing benchmarks, which have not been recognised as critical benchmarks, remain unchanged.

These benchmarks may be used by supervised entities until 1 January 2020 or, where the index provider submits an application for authorisation or registration, unless and until such authorisation or registration is refused. In order to enable EU supervised entities using benchmarks to be aware of which applications for authorisation/registration of EU-based index providers are pending, a list with those EU-based index providers is available on ESMA's website. ESMA will update this information until the first week of January 2020.

4. ESMA:

4.1 ESMA updates Q and A on EMIR implementation:

On the 2nd of October, 2019, ESMA published an updated version of the Q&A regarding the application of EMIR. The update contains, among others, the following clarifications:

ESMA clarifies the timing of the first time calculation and notification by counterparties that start taking position in OTC derivatives only after the entry into force of the EMIR refit.

In that respect, new counterparties or counterparties that start taking position in derivatives and which choose to calculate their aggregate month-end average position for the previous 12 months, need to perform the calculation 12 months after they start taking positions in derivatives and must notify ESMA and their regulator immediately should they exceed the clearing thresholds.

ESMA also specifies the requirement for counterparty representation as follows:

When counterparties which trade derivatives would normally need to obtain representations from their counterparties of their EMIR status, this is not applicable to counterparties that are not subject to the clearing obligations as they are not subject to that clearing requirement regardless of the status of their counterparties.

4.2. AIFM: Update of ESMA Q&A

On 4 December 2019, ESMA added a new question in its Q&A on AIFMD .

The question relates to the reporting obligation for AIFMs, and to the reporting of the results of liquidity stress tests for closed-ended unleveraged AIFs in particular.

In its answer, ESMA refers to the exemption provided for those funds in Article 16 (1) of the AIFM Directive and recommends that AIFMs which manage closed-ended unleveraged AIFs (i) indicate in the AIFM consolidated reporting template published by ESMA that the question is not applicable, and (ii) report in this field the fact that the relevant fund is a closed-ended unleveraged AIF.

However, in the event where an AIFM does decide to conduct liquidity stress tests for the unleveraged closed-ended AIFs that it manages, ESMA states that it should report the results of the liquidity stress tests in the same field.

Source: Regulatory update taken from public websites