Investment Firms

Quarterly Legal and Regulatory Update

Period covered: 1 April 2020 – 30 June 2020

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1. MIFID II – EUROPEAN DEVELOPMENTS

1.1 ESMA publishes MiFID II review report on position limits and position management

On 1 April 2020, the European Securities and Markets Authority (**ESMA**) published its MiFID II Review report on position limits and position management (**Report**).

Article 90 of the MiFID II Directive (2014/65/EU) (**MiFID II Directive**) requires the European Commission (**Commission**), after consulting with ESMA, to present a report to the European Parliament and the Council of the European Union on the impact of the MiFID II provisions relating to position limits and position management. The Report covers the impact of the application of position limits and position management on liquidity, market abuse and orderly pricing and settlement conditions in commodity derivatives markets.

- **Section 3 of the Report** - provides a summary of the position limit regime under MiFID II and an assessment of the impact of the application of position limits on market abuse, orderly pricing and settlement conditions and an assessment of the impact of position limits on the liquidity of commodity derivatives markets and sets out proposals for amendments in order to improve the efficiency of the position limit regime;

- **Section 4 of the Report** - assesses the impact of position management controls on commodity derivatives markets and proposes an amendment to further enhance convergent implementation by trading venues;

- **Section 5 of the Report** - considers the impact of Brexit on the position limit regime and the commodity derivatives framework; and

- **Section 6 of the Report** - provides a summary of the proposals made in the Report.

The Report can be accessed here.

1.2 ESMA publishes latest Double Volume Cap Data

ESMA published the updates of the latest set of data regarding the double volume cap (**DVC**) under the MiFID II Directive in the second quarter of 2020, on 7 April and 8 June.

The MiFID II Directive introduced the DVC to limit the amount of dark trading in equities allowed under the reference price waiver and the negotiated transaction waiver. The DVC mechanism is set out in Article 5 of the Markets in Financial Instruments Regulation (600/2014/EU) (**MiFIR**) with the aim of limiting the trading under the reference price waiver (Article 4(1)(a) of MiFIR) and the negotiated transaction waiver for liquid instruments (Article 4(1)(b)(i) of MiFIR) in an equity instrument.

The data files published by ESMA provide the information needed for the implementation of the DVC mechanism. This includes the identifiers of the instruments and trading venues associated with a suspension of the relevant waivers, and the period in which the DVC will be applicable.

In the updates published on 7 April and 8 June, ESMA amended the suspension files relating to the DVC data which it had originally published on 7 August 2018. The suspension file, which is required under MiFIR, contains a list of International Securities Identification Numbers (**ISINs**) which are suspended from trading. As of 8 June, there was a total of 337 instruments suspended.

The data files and the suspension files can be found here.

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1.3 ESMA's Technical Advice to the Commission on the impact of the inducements and costs and charges disclosure requirements under MiFID II

Following the Commission's request of late May 2019 for technical advice on certain MiFID II investor protection topics, ESMA presented its final report at the end of March. Its report provides technical advice to the Commission on two issues:

(i) the impact of the MiFID II inducements disclosure requirements; and

(ii) the impact of the general costs and charges disclosure requirements under MiFID II, taking into account a variety of stakeholder feedback received in response to ESMA's related call for evidence.

Although its technical advice does not recommend a ban on inducements, its use of terms like "*at this stage*" and its recommendations to consider what the impact of a ban might be on the different distribution models across the EU as well as to look at the actual experience in the Netherlands and the UK (where bans have already been introduced) suggest that a ban on inducements might well be the eventual end result.

This briefing focuses on the technical advice issued by ESMA and what its report outlines as the rationale behind that advice, rather than going back over the MiFID II inducements rules which, in summary, provide:

- that an investment firm will not be regarded as fulfilling its obligations under Article 23 (conflicts of Interest) or Article 24.1 (firms must act honestly, fairly and professionally in accordance with the best interests of their clients) of MiFID II Directive where it pays or is paid any fee or commission, or provides or is provided with any non-monetary benefit in connection with the provision of an investment service or an ancillary service, to or by any party except the client or a person on behalf of a client, except where such inducements:

  (i) are designed to enhance the quality of the relevant service to the client; and

  (ii) does not impair compliance with the investment firm's duty to act honestly, fairly and professionally in accordance with the best interest of its clients.

  This applies to any provision of an investment service or ancillary service. In other words, it is of general application to all investment firms;

- that where an investment firm is providing portfolio management or independent investment advice, it must not accept and retain third party fees, commissions or any monetary or non-monetary benefit paid in relation to the provision of the service to the relevant client; and

- a variety of disclosure obligations with regard to inducements, those disclosures having to be made at different times in the relationship with the client and in particular ways (which can be different in practice to the disclosure obligations imposed under the UCITS or PRIIPs regimes).

(i) Stakeholder Feedback

In developing its advice, ESMA considered whether and how firms were complying with the inducements disclosure obligations and, more generally, the effects of the inducements rules for clients. Some of the stakeholder feedback included:

- that certain stakeholders found the disclosure obligations to be practically challenging, with others seeking a greater level of harmonisation of the presentation of commission payments to distributors under MiFID II and in the UCITS KIID and PRIIPS KID. ESMA felt that, in the context of the provision of a MiFID service, the MiFID approach was the correct one;

- that certain stakeholders noted that there were different interpretations of the "quality enhancement condition" as between different National Competent Authorities (**NCAs**). ESMA felt that more work needed to be carried out, in particular additional market research into the unique market features across jurisdictions, before that issue could be tackled;

- stakeholder concerns as to the differing obligations between instruments subject to the MiFID II rules and comparable investment products, such as insurance products, subject to less burdensome obligations. ESMA felt that comparable projects should be subject to the same rules, unless there was a compelling reason supporting divergent rules (although clearly IDD rules are not within ESMA's responsibility);

- perhaps most interestingly, that, notwithstanding the disclosure obligations, clients (mostly retail clients) still find it difficult to understand how commissions affect the independence of advice and they may not know how to adjust their behaviour to the disclosed conflict of interest in any event. ESMA noted that one of the respondents referred to the outcome of a study conducted by the Germany Regulator, BaFIN, "that shows the limited effect of information disclosure related to inducements and costs – no matter their design and comprehensibility – on client's behaviour";

- that some respondents indicated that their product offering had not changed as a result of the MiFID II inducements disclosure rules, although others indicated that the rules had been a driver in the creation of more clean share classes and that MiFID II obligations more generally (such as product governance rules) had had an impact on product range;

- that one of the respondents indicated that in some markets the vast majority of clients are unwilling to pay for advice and that, for that reason, very few advisers providing independent advice exist; and

- that a significant number of respondents felt that the inducements disclosure requirements had had no or very little impact on how clients choose providers or product, with one explaining that "the independence of their advisors is not, in many jurisdictions, a key criterion for investors' choices which are more influenced by personal trust, the perceived quality of the advice or the diversity and range of products offered".

(ii) ESMA's conclusions and technical advice

Based on the feedback, ESMA concluded that the inducements disclosure rules have not had the positive impact expected, and have not facilitated the development of independent investment advice. ESMA's advice to the Commission is to assess:

- the impact the MiFID II inducements regime has had on the distribution of retail investment products across the EU;

- the effects a ban on inducements would have on the different distribution models existing in the EU; and

- the actions that could be taken to mitigate the risk of undesired consequences of an inducements ban.

ESMA recommended that to assess the potential positive or negative effects of a ban, the impact of the bans as introduced in the Netherlands and the UK should be examined.

Pending the outcome of any such assessment, ESMA also set out a number of actions designed to improve clients' understanding of inducements, in particular to improve the comprehensibility and clarity of the existing inducements disclosures (and recommended the use of layman's terms) and also requiring firms to bring to their clients' attention the specific quality enhancing services that they are already benefitting from or that they could benefit from if they requested or used the service.

Although it said that "*at this stage, ESMA does not recommend…to ban inducements completely for all retail products across the Union…*", its recommendation that the impact of a ban be examined and that that examination include a review of those jurisdictions which have already introduced such a ban, suggests to us that the industry should prepare itself for an eventual complete ban.

The second matter that ESMA was asked by the Commission to consider and report on was the cost and charges disclosure requirement under Article 24(4)(c) of the MiFID II Directive. In similar fashion, ESMA detailed the feedback received and its analysis of that feedback. Although noting that the regime generally works well and that it has helped investors make informed investment decisions, ESMA's technical advice, in summary, was that the MiFID II costs and charges disclosure regime should allow for more flexibility when applied to eligible counterparties and professional clients:

- Eligible counterparties - should be allowed to opt-out of the entire costs and charges disclosure regime and the obligation to provide the illustration of the impact of costs on return should not apply at all.

- Professional clients - more flexibility should be provided, depending on the type of service provided rather than on whether the client is a per se professional client or an opt-up professional client. Professional clients, both per se and opt-up should be allowed to opt-out of the entire costs and charges disclosure regime except where investment advice or portfolio management is being provided.

ESMA recommended that firms keep records of the documented requests to opt-out and should contractually agree with clients what type of costs information the client will receive instead.

The report also recommended amending Article 3 of the MiFID II Delegated Regulation so that when information is required be provided in a durable medium, the provision of that information by means of electronic communications should become the default option. Firms should also be required to provide clear information to their clients as to the consequences attached to the provision of a valid email address, and that in such a case no information will be provided in a paper form, unless explicitly requested by the client.

Finally, the technical advice recommended that the MiFID II Delegated Regulation be amended so that firms are no longer required to personally address their best execution and conflicts of interest policies to their clients, once those policies are freely accessible on the firm's website.

A copy of the Final Report can be accessed here.

1.4 Public consultation on the exercise of national discretions in the Investment Firms Directive

On 6 May 2020, the Department of Finance published a public consultation paper on the exercise of national discretions contained in the Investment Firms Directive (EU) 2019/2034 (**Consultation Paper**).

The new framework comprises the Investment Firms Directive (EU) 2019/2034 (**IFD**) and the Investment Firm Regulation (EU) 2019/2033 (**IFR**). In time, the IFD and IFR will be supplemented by way of delegated acts, regulatory technical standards (**RTS**) and implementing technical standards (**ITS**). The IFR and the IFD will, for most existing investment firms, replace the existing prudential requirements for investment firms set out in the Capital Requirements Regulation (575/2013) (**CRR**) and Directive 2013/36/EU (**CRD IV**), and will also amend the MiFID Directive and MiFIR.

Under the new proposed regulatory regime, certain systemically relevant investment firms which engage in "bank-like" activities and services will be reclassified as "credit institutions" (Class 1) and will be fully subject to the prudential requirements laid down in CRR and CRD IV. Other similar investment firms, but with smaller assets sheets (Class 1 minus) may be subject to the same prudential requirements as Class 1 firms. All other investment firms which are not considered systemic (Classes 2 and 3) will be subject to a new tailored regime with bespoke and lighter prudential requirements.

The objective of the new proposed framework is to provide for capital, liquidity and other prudential requirements for investment firms in the EU which reflect the business models of those firms and proportionately capture the risks posed and faced by these firms. Although most of the IFD will be transposed in Ireland on a fully harmonised basis (and the IFR applies directly without requiring any local transposition), there are a small number of provisions within the IFD which allow Member States exercise a national discretion. The Consultation Paper seeks the public's input on whether and in what manner those national discretions might be exercised.

The national discretions being consulted on are listed on pages 10 – 12 of the Consultation Paper and relate to the designation of Ireland's NCA for IFD and aspects of the remuneration regime for Class 2 investment firms (Class 3 firms will be subject solely to the current MiFID II remuneration framework).

The first discretion being consulted on relates to Article 4(1) of the IFD which provides that a Member State must designate one or more competent authorities to carry out the functions and duties provided for in the IFD and in IFR. The Consultation Paper asks if stakeholders agree with the designation being allocated to the Central Bank of Ireland.

The second and third discretions being consulted on relate to the variable remuneration requirements set out in Article 32 of the IFD, in particular those relating to elements of the pay-out process, namely the payment of variable remuneration in instruments and the deferral of payment of variable remuneration.

Balance Sheet Threshold for Exemption

Under Article 32(4) of IFD, the requirements for pay out of variable remuneration in instruments and the deferral of payment of variable remuneration will not apply to:

(a) an investment firm that has on and off-balance sheet assets equal to or less than €100 million;

(b) an individual who receives less than €50,000 annual variable remuneration and this does not represent more than one fourth of the individual's total annual remuneration.

A Member State is given the discretion to increase the figure in para (a), below which the requirements would not apply, to a maximum of €300 million provided certain criteria set out in Article 32(5) are fulfilled. A Member State is also given the discretion to lower the threshold.

The Consultation Paper asks whether Ireland should use these discretions in order to raise the threshold up to a maximum of €300 million or to reduce it, and asks what the threshold should be raised to or reduced to.

€50,000 Threshold for Exemption

A Member State can decide that staff members who are entitled to annual variable remuneration of less than the €50,000 threshold will not be entitled to the exemption because of:

(a) national specificities in terms of remuneration practices; or,

(b) the nature of the responsibilities and job profile of those staff members.

The Consultation Paper asks whether Ireland should exercise the discretion to prevent staff relying on the exemption set out in Article 32(4)(b) and if so, should the basis be clearly set out including the relevant national specificities and staff job profiles.

Types and designs of instruments in which variable remuneration may be paid

Article 32(3) allows a Member State or the Competent Authority, the discretion to place restrictions on the types and designs of instruments or prohibit the use of certain instruments for the purposes of variable remuneration.

The Consultation Paper asks whether Ireland should restrict or prohibit the use of certain types or designs of instruments for the purpose of variable remuneration. It also asks whether the restriction or prohibition of certain types or designs of instruments for the purposes of variable remuneration should be addressed by way of transposing regulations or whether the power should be provided to the proposed designated body set out, the Central Bank.

Interested stakeholders had until the close of business on 6 July 2020 to submit any feedback in relation to the Consultation Paper. The Department of Finance has indicated that the comments received will be taken into consideration when transposing into Irish law the IFD national discretions.

The IFD and IFR were adopted as legislative proposals on 05 December 2019 and entered into force on 25 December 2019. They are scheduled to be transposed into Irish law by 26 June 2021.

The Consultation Paper can be accessed here.

1.5 ESMA updates Q&As on Investor Protection and Intermediaries Topics

On 28 May 2020, ESMA published an updated version of its questions and answers publication "on MiFID II and MiFIR investor protection and intermediaries topics" (**Q&As on Investor Protection and Intermediaries Topics**). The update made to the Q&As on Investor Protection and Intermediaries Topics is set out below:

- **Question ID: Part 12 Inducements – Question 7** (updated on 28 May 2020) this new question clarifies the application of the definition of "acceptable minor non-monetary benefits" as is set in the MiFID II Delegated Directive.

A copy of the Q&As on Investor Protection and Intermediaries Topics can be accessed here.

1.6 ESMA updates Q&As on Market Structures Topics

On 29 May 2020, ESMA published an updated version of its questions and answers publication "On MiFID II and MiFIR market structures topics" (**Q&As on Market Structures Topics**). The update made to the Q&As on Market Structures Topics is listed below:

- **Question ID: Part 5 Multilateral and bilateral systems – Question 9b** (updated on 29 May 2020) the new question clarifies the authorisation requirements of multilateral systems facilitating the execution of repurchase agreement transactions under Article 5 of the MiFID II Directive.

A copy of the Q&As on Market Structures Topics can be accessed here.

1.7 ESMA updates Q&As on Transparency Topics

On 29 May 2020, ESMA published an updated version of its questions and answers publication "on MiFID II and MiFIR transparency topics" (**Q&As on Transparency Topics**). The updates made to the Q&As on Transparency Topics are listed below:

- **Question ID: Part 4 Non-equity transparency - Question 19** (updated on 29 May 2020) amended an existing answer on the conversion of large in scale (**LIS**) and size specific to the instrument (**SSTI**) thresholds in lots;

- **Question ID: Part 4 Non-equity transparency – Question 20** (updated on 29 May 2020) clarifies the default liquidity status, SSTI and LIS thresholds of non-equity instruments; and

- **Question ID: Part 4 Non-equity transparency – Question 21** (updated on 29 May 2020) clarifies the publication of transactions in an aggregated form.

A copy of the Q&As on Transparency Topics can be accessed here.

1.8 European Banking Authority launches consultations on draft RTS on prudential, reporting, disclosures and remuneration requirements under IFR and IFD

On 4 June 2020, the European Banking Authority (**EBA**) launched public consultation papers on its first set of draft RTS on prudential, reporting, disclosures and remuneration requirements for investment firms under the IFR and the IFD.

The first consultation paper on prudential requirements for investment firms under the IFR and the IFD includes three draft RTS on the reclassification of certain investment firms to credit institutions, five draft RTS on capital requirements for investment firms at solo level, and one draft RTS on the scope and methods of prudential consolidation for investment firms at group level.

The deadline for responses to the consultation is 4 September 2020. The EBA has provided that they intend to finalise these RTSs by December 2020 and for the RTSs to apply from June 2021. The first consultation paper can be accessed here.

The second consultation paper on reporting requirements and disclosures, includes draft ITS on the levels of capital, concentration risk, liquidity, the level of activities as well as disclosure of own funds and draft RTSs specifying the information that investment firms have to provide in order to enable the monitoring of the thresholds that determine whether an investment firm has to apply for authorisation as a credit institution.

The consultation closes on 4 September 2020 and the EBA will deliver the final draft ITSs and RTSs to the Commission in December 2020. The second consultation paper can be accessed here.

The third and fourth consultation papers on remuneration requirements include one draft RTS on the criteria to identify all categories of staff whose professional activities have a material impact on the firm's risk profile or assets it manages and one draft RTS specifying the classes of instruments that adequately reflect the credit quality of the investment firm as a going concern and possible alternative arrangements that are appropriate to be used for the purposes of variable remuneration of risk takers.

The deadline for responses to the consultations is 4 September 2020 and the EBA intends to finalise the RTS on pay-outs in instruments for variable remuneration by November 2020. The third and fourth consultation papers can be accessed here and here.

Action	The deadline for responses to the consultations is 4 September 2020.

1.9 ESMA provides guidance on the compliance function under MiFID II

On 5 June 2020, ESMA published guidelines on the MiFID II compliance function. These guidelines replace the ESMA guidelines on the same topic issued in 2012 and include updates that enhance clarity and foster greater convergence in the implementation and supervision of the new MiFID II compliance function requirements.

The guidelines will enhance the existing standards by providing additional clarifications on certain specific topics, such as new responsibilities in relation to MiFID II's product governance requirements and further details on the reporting obligations of the compliance function.

The guidelines are addressed to investment firms and credit institutions providing investment services and activities and credit institutions selling or advising clients in relation to structured deposits and undertakings for the collective investment in transferable securities (**UCITS**) management companies and external alternative investment fund managers (**AIFMs**) when providing investment services and activities in accordance with the UCITS Directive (2009/65/EC) (**UCITS Directive**) and the Alternative Investment Fund Managers Directive (2011/61/EU) (**AIFMD**).

These guidelines apply from two months of the date of publication of the guidelines on ESMA's website.

A copy of the guidelines can be accessed here.

Action	Firms to review the contents of the guidelines and update their procedures/documentation concerning their compliance function as is needed.

2. EUROPEAN MARKETS INFRASTRUCTURE REGULATION (EMIR)

2.1 EMIR RTS on amendments to bilateral margin requirements

On 4 May, 2020, the European Supervisory Authorities (**ESAs**) published a revised version of the draft RTS amending the Delegated Regulation on risk mitigation techniques for non-centrally cleared OTC derivatives (bilateral margining) under the European Market Infrastructures Regulation (Regulation (EU) 648/2012) (**EMIR**).

In response to the Covid-19 outbreak, the ESAs have updated the RTS to take into account the related decision from the Basel Committee on Banking Supervision (**BCBS**) and the International Organisation of Securities Commissions (**IOSCO**) to defer by one year the implementation of the remaining phases of the initial margin requirement. In addition, the draft RTS also provides that:

- the derogation from the requirement to exchange variation margin for single equity and index options is deferred until 4 January 2021.

- the derogation from the requirement to exchange initial margin for intragroup transactions within groups with third-country entities is deferred until 20 December 2020.

- the exemption from the mandatory exchange of variation margin in respect of physically-settled FX forwards and swaps between institutions and end-users where at least one of the counterparties is not a credit institution or a MiFID investment firm (or any third country equivalent).

The Final Report can be accessed here.

Please see the Dillon Eustace briefing entitled "Changes to the EMIR margining requirements" which can be accessed here.

Action	As is applicable Firms to review the draft RTS and consider the derogations.

2.2 ESMA publishes updated EMIR Questions and Answers

On 28 May 2020, ESMA published an update to its EMIR Q&As.

A new Q&A 54 has been inserted into the "TR" Section concerning the reporting of OTC derivative contracts by a financial counterparty on behalf of the NFC pursuant to the Article 9(1a) of EMIR as amended by EMIR Refit (Regulation (EU) 2019/834).

In addition, Q&A 1 appearing in the "General Questions" Section has been revised with effect from 18 June 2020. This Q&A clarifies that generally a fund should be considered as the counterparty to a derivative transaction and not the fund manager. It also clarifies that in the context of an umbrella fund, generally the sub-fund of the umbrella should be considered as the counterparty.

The updated Q&A can be accessed here.

3. BENCHMARK REGULATION

3.1 Commission consults on Delegated Regulations under BMR on sustainable finance issues

On 8 April 2020, the Commission launched three separate consultations on delegated regulations setting out sustainability criteria for benchmarks provided in accordance with the Regulation (EU) 2016/1011 (**Benchmark Regulation**) or (**BMR**). The consultation period closed on 6 May 2020.

One regulation sets out the minimum standards that benchmarks must satisfy in order to be termed “EU climate transition” and “EU Paris-aligned” benchmarks.

A second regulation sets out the explanation that should be included in the benchmark statement about how environmental, social and governance factors (**ESG**) factors are reflected in each benchmark / family of benchmarks.

The final regulation which sets out the minimum content which benchmark administrators must provide concerning how ESG factors are built into the benchmark methodology.

4. CENTRAL BANK OF IRELAND

4.1 MiFID Firms required to review compliance with appropriateness requirements

On 29 June 2020, the Central Bank of Ireland (**Central Bank**) published a press release along with an industry letter (**Letter**) setting out its findings from its recently undertaken thematic inspection of MiFID firms’ compliance with their requirement to assess whether a product is appropriate for a client and to issue a warning to the client where it is not.

The Central Bank’s inspection was undertaken as part of ESMA’s common supervisory action designed to enhance the protection of consumers and promote consistent supervision of investment firms throughout the EU.

The Letter emphasises the importance of the correct application of the appropriate assessment by firms in order to ensure the protection of investors who are making investment decisions on complex products without taking investment advice. In the adjoining press release, Gráinne McEvoy, the Director of Consumer Protection stated that: “*The appropriateness test is a key component of consumer protection for people who are using the services of an investment firm …*”.

The Central Bank found a number of shortcomings in the inspected firms application and consideration of the appropriateness requirements, including:

1. failure to provide evidence that the firm is paying sufficient attention to the application of the appropriateness requirements and/or placing undue reliance upon standardised questionnaires and 'box-ticking' to demonstrate compliance;

2. weak processes, systems, and controls, resulting in errors and assessments undertaken with incomplete information;

3. employing a blanket approach to gathering client information that fails to consider the significant differences in risk and complexity that occurs between investment products; and

4. inadequate and weak warnings issued where products are found to be inappropriate for clients, including the use of vague, ambiguous language.

The Central Bank has also provided a list of strong and weak practices in place in the firms inspected in the Appendix to the Letter.

The Letter states that the Central Bank expects that firms will review the findings set out and appraise whether their own practices need to be revised. Importantly the Letter provides that the findings and issues set out may form part of any Central Bank supervisory engagement in future.

A link to the press release can be found here and a link to the Letter here.

Action	The Letter issued on 29 June 2020 requires that all firms selling complex products on an execution-only basis to consumers to consider the contents of the Letter and take all remedial action necessary to ensure they are acting in the best interests of consumers.

5. OUTSOURCING

5.1 ESMA consults on cloud outsourcing guidelines

On June 3, 2020, ESMA published a consultation paper on Outsourcing to Cloud Service Providers (**draft Guidelines**). These apply to financial institutions under the direct or indirect jurisdiction of ESMA, which includes investment firms.

ESMA proposes that the draft Guidelines, once finalised, will apply from 30 June 2021 to "all cloud outsourcing arrangements entered into, renewed or amended on or after this date".

The draft Guidelines are partially inspired by the 2019 EBA guidelines on outsourcing. The Guidelines must be endorsed by EU NCAs and will not override more stringent rules applicable to certain categories of institutions.

The consultation on the draft Guidelines is due to close on September 1, 2020. Legacy arrangements will have to conform to the draft Guidelines no later than December 31, 2022.

ESMA's consultation paper can be accessed here.

Action	The deadline for responses to the consultation is 1 September 2020

6. ANTI-MONEY LAUNDERING (AML) AND COUNTERING THE FINANCING OF TERRORISM (CFT)

6.1 Commission adopts new Delegated Regulation amending list of high-risk third countries under MLD4

On 7 May 2020, the Commission adopted a Delegated Regulation (EU) 2020/855 (**Regulation**), amending the list of high-risk third countries that are deemed to have strategic deficiencies in their AML/CFT regimes.

This Regulation adds the following countries to the list of high-risk countries - Bahamas, Barbados, Botswana, Cambodia, Ghana, Jamaica, Mauritius, Mongolia, Myanmar/Burma, Nicaragua, Panama and Zimbabwe. It also removes the following nations from that list in light of improvements – Bosnia-Herzegovina, Ethiopia, Guyana, Lao People's Democratic Republic, Sri Lanka and Tunisia.

Notable omissions from the list include Saudi Arabia, Puerto Rico and the US Virgin Islands. (All were included on the draft list issued by the Commission in February 2019, which was rejected by the Council).

The Delegated Regulation was submitted to the Council of the EU and the Parliament to consider for approval. It shall apply from 1 October 2020. The Commission has provided a later application date for this Regulation because of the COVID-19 pandemic. This Regulation was published in the Official Journal of the European Union on 19 June.

The Commission explains, in a related press release, that this update is necessary as its list of high-risk third countries has not reflected the latest FATF lists since October 2018.

The text of the Regulation can be accessed here.

6.2 Commission staff working document on new methodology for identifying high-risk third countries under MLD4

On 7 May 2020, the Commission published a staff working document setting out a new methodology for identifying high-risk third countries under the Fourth Money Laundering Directive ((EU) 2015/849) (**MLD4**).

The new methodology updates and replaces the Commission's June 2018 staff working document.

The new staff working document can be accessed here.

6.3 Commission publishes an action plan designed to strengthen the EU's framework for preventing money laundering and terrorist financing

On 7 May 2020, the Commission published an action plan designed to strengthen the EU's framework for preventing money laundering and terrorist financing. This note provides an overview of the main features of the plan.

Please see the Dillon Eustace briefing paper entitled "Towards a common AML framework for the EU" which can be accessed here.

7. SUSTAINABLE FINANCE

7.1 ESAs consult on draft RTS on ESG disclosures under SDFR

On 23 April 2020, the Joint Committee of the ESAs published a consultation paper (**Consultation Paper**) on proposed RTS under Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 (**SDFR**).

In this Consultation Paper, the ESAs set down how they propose "financial market participants" inform investors about the consideration of sustainability factors in the investment decision-making and advisory processes. The proposals, which are set out in Section 4 of the Consultation Paper address the "principal adverse impact reporting" obligation set down under Article 4 of the SDFR which applies from 10 March 2021 and which must be complied with in full by large "financial market participants"[1] and otherwise applies to other financial market participants on a "comply or explain basis".

The ESA proposals include an obligation to use a template principal adverse impacts statement in order to ensure comparability of information published by financial market participants as well as setting down common indicators which the ESA suggest are used by all in-scope financial market participants to report on the principal adverse sustainability impacts of investments during the reference period. A link to the Dillon Eustace client briefing entitled "The New ESG Framework: Principal Adverse Impact Reporting" can be accessed here.

[1] Defined as those financial market participants which on their balance sheet date exceed an average number of 500 employees during the financial year or financial market participants which are parent undertakings of a "large group" as defined under Article 3(7) of Directive 2013/34/EU which, on their balance sheet date, exceed an average number of 500 employees during the financial year on a consolidated basis.

The ESAs have included a series of questions for stakeholders in the Consultation Paper on certain elements of the draft RTS and as a result the finalised RTS may vary from the draft RTS. However, the draft RTS do provide some indicators as to the proposed direction of travel on the type of information which will need to be disclosed to investors in ESG products under the new framework.

The deadline for comments on the proposals is 1 September 2020. The draft RTS will be submitted to the Commission as a final report for endorsement before being published in the Official Journal of the EU. Six of the RTS must be delivered to the Commission by 30 December 2020 and one must be delivered by 30 December 2021.

Action	Firms should monitor the progress of the draft RTS and initiate an action plan to assess the scope of the obligations imposed under the SDFR which will begin to apply from 10 March 2021.

7.2 Commission consults on delegated legislation integrating sustainability into MiFID II

On 8 June 2020, the Commission published consultation draft texts of six Commission Delegated Regulations and Directives integrating sustainability into the UCITS Directive, AIFMD, the MiFID II Directive, the Solvency II Directive (2009/138/EC) (**Solvency II Directive**) and the Insurance Distribution Directive (2016/97/EU) (**IDD**) as part of the EU's action plan on sustainable finance. The draft Commission Delegated Regulation and Directive brings the following MiFID related amendments:

- the Delegated Directive (EU) 2017/593 which supplements the MiFID II Directive and contains product governance obligations will be amended. The amendment provides that investment firms manufacturing and distributing financial instruments should consider sustainability factors in the product approval process of each financial instrument and in the other product governance and oversight arrangements for each financial instrument that is intended to be distributed to clients seeking financial instruments with a sustainability-related profile. A general statement that a financial instrument has a sustainability-related profile will not be sufficient. The draft Commission Delegated Directive amending Delegated Directive (EU) 2017/593 can be accessed here; and

- the Commission Delegated Regulation amends Delegated Regulation (EU) 2017/565 on the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms. The Delegated Regulation (EU) 2017/565 supplements the MiFID II Directive and contains organisational requirements and operating conditions for investment firms.

  The amendment concerns investment firms providing financial advice and portfolio management and these firms will need to carry out a mandatory assessment of sustainability preferences of clients. Investment firms should take these sustainability preferences into account in the selection process of financial products. Investment firms will also be required to prepare client reports that explain how the recommendation meets a client's investment objectives, risk profile, capacity for loss bearing and sustainability preferences. The amendments also require investment firms to take into account sustainability risks when complying with the organisational requirements and to integrate sustainability risk into risk management policies. The draft Commission Delegated Regulation amending Delegated Regulation (EU) 2017/565 can be accessed here.

Feedback on the draft Delegated Regulation and Directive must be provided to the Commission by 6 July 2020. The Delegated Regulations and Directives will apply 12 months after they enter into force.

7.3 Update: Publication of the Taxonomy Regulation in the Official Journal of the EU

In December 2019, the European Council and the European Parliament reached political agreement on the text of a proposed Regulation on the Establishment of a Framework to Facilitate Sustainable Investment (2018/0178(COD)) (**Taxonomy Regulation**).

The Taxonomy Regulation forms part of the Commission's sustainable finance strategy. Its purpose is to provide clarity to businesses to what degree, economic activities are considered to be environmentally sustainable.

On 18 June 2020, the European Parliament officially adopted the Taxonomy Regulation. This was subsequently published in the Official Journal of the EU on 22 June 2020.

Under the Taxonomy Regulation, portfolio managers of ESG products which: (i) promote environmental characteristics, or (ii) invest in an economic activity which contributes to an environmental objective, will be required to disclose information on the relevant environmental objective being contributed to and how and to what extent investments of the portfolio are in economic activities that qualify as environmentally sustainable in the relevant client disclosures.

The Taxonomy Regulation will come into force on 12 July 2020 however the client disclosure obligations do not apply until 1 January 2022 (in the case of ESG products which contribute to climate change mitigation or climate change adaptation) or 1 January 2023 (in the case of ESG products which contribute to one of the four other environmental objectives set down in the Taxonomy Regulation).

Action	Firms should assess whether or not they will be subject to disclosure obligations under the Taxonomy Regulation depending on the type of portfolio under management.

7.4 Commission launches consultation on Renewed Sustainable Finance Strategy

The Commission launched a consultation relating to a renewed sustainable finance strategy on 8 April 2020. The aim of this strategy is to set out a roadmap to increase private investment in sustainable projects. It seeks to further support the European Green Deal and to manage and integrate environmental risks into the financial system.

Interested parties have until 15 July to submit responses which will be used to inform the Commission's strategy on sustainable finance. The consultation paper specifically asks whether the existing rules on fiduciary duties, best interests of investors/the prudent person rule, risk management and internal structures and processes in sectoral rules applicable to managers should be adapted to require them to consider and integrate adverse impacts of investment decisions on sustainability.

The Commission consultation can be accessed here.

7.5 Commission consults on delegated legislation integrating sustainability into UCITS Directive, AIFMD, MiFID II, Solvency II and IDD

On 8 June 2020, the Commission published for consultation draft texts of six Commission Delegated Regulations and Directives as part of the EU's action plan on sustainable finance. This consultation process closes on 6 July 2020.

The draft legislation incorporates sustainability issues and considerations into frameworks for the UCITS Directive, the AIFMD, the MiFID II Directive, the Solvency II Directive, and the IDD.

The ESMA report can be accessed here.

7.6 Commission FAQs on Taxonomy Regulation and technical expert group on sustainable finance

On 10 June 2020, the Commission published a set of FAQs about its work regarding EU Taxonomy and the EU Green Bond Standard. This included an update on the work of the technical expert group (**TEG**) on sustainable finance, established to assist in implementing the Action Plan on Financing Sustainable Growth. The FAQs cover topics such as:

- the legal process and how the taxonomy will be developed;
- details about whether the Commission will extend the taxonomy to cover social objectives and a "brown" taxonomy, covering activities that are environmentally harmful;

- how the platform on sustainable finance will be set up, and that it is likely to be operational by September 2020; and
- how the taxonomy should be used, including its interaction with the Non-Financial Reporting Directive (2014/95/EU).

The Commission's published FAQ's can be accessed here.

8. COVID–19

8.1 Regulatory flexibility in the face of COVID-19

Regulators are known for flexing their muscles; not for showing flexibility or exercising forbearance. However in these extraordinary times, some national and European regulatory bodies have taken exceptional measures. Some have altered their business as usual requirements, extending reporting and filing deadlines. Others have implied or recommended that enforcement action will or should not be taken for certain technical breaches which may occur due to operational difficulties faced by firms from COVID-19. Examples of some of these measures are set out below:

- **Central Bank**

  The countercyclical capital buffer which banks are required to hold was reduced from 1% to 0% on 1st April 2020 and the Central Bank said that it does not intend to announce an increase in this capital buffer before the first quarter of 2021. The Central Bank expects this to free up about one billion in capital in the banking system to absorb losses and allow banks to support additional credit supply to households and firms. A link to the announcement can be accessed here.

  The Central Bank has also launched a COVID-19 hub on its website where relevant information and policy decisions by the Central Bank and other European authorities will be uploaded as new information becomes available can be accessed here.

- **Revenue Commissioners**

  The Revenue Commissioners have extended several reporting deadlines and made some concessions as regards claiming payroll tax reliefs and exemptions, due to the pandemic. These include disregarding the presence in the State of an individual for corporation tax purposes, for a company of which the individual is an employee, director, service provider or agent, where the individual's presence in the State is shown to result from COVID-19 travel restrictions. The same concession will also be applied in the converse situation, where an individual is in another jurisdiction but would otherwise have been in the State, were it not for the COVID-19 travel restrictions.

  Revenue has also extended the filing deadlines for all 2019 share scheme returns from 31 March 2020 to 30 June 2020. Further detail of the various measures introduced by Revenue can be accessed here.

- **Companies Registration Office**

  The Registrar of Companies has announced that all annual returns due to be filed by any company from 20 March 2020 up to 30 June 2020 will be deemed to have been filed on time, if all elements of the annual return are completed and filed by that date. The 30 June 2020 date will be kept under review and may be extended depending on how the situation develops. Further information can be accessed here.

- **Commission**

  The Commission has extended the deadlines for some consultations. These include an extension of the deadline for the MiFID II consultation to 18 May 2020, and for the Non-Financial Reporting Directive (2014/95/EU) consultation to 11 June 2020. Further details of the extensions to various consultation deadlines can be accessed here.

- **Data Protection Commission**

  The Data Protection Commission (**DPC**) has acknowledged that the COVID-19 crisis may affect organisations' ability to action GDPR requests from individuals, such as subject access requests. It said that although the timelines for responding to individuals' requests are set down in law and cannot be changed, it was aware of the need for a proportionate regulatory approach due to current circumstances. The DPC said that if a complaint is made to it concerning an organisation's failure to respond to a request within the statutory timelines, the facts of each case - including any organisation specific extenuating circumstances - will be taken into account. The DPC's website sets out steps which organisations should take if they are encountering difficulties in responding to GDPR requests as a result of the current pandemic and can be accessed here.

- **ESMA**

  ESMA has recommended that NCAs show flexibility as regards some regulatory requirements in light of COVID-19. A non-exhaustive list of some of ESMA's recent statements and recommendations is referred to below:

  (i) **Best Execution Reports**: ESMA has recognised the difficulties encountered by execution venues in preparing general best execution reports required under RTS 27 and RTS 28 of MiFID II, due to the pandemic and has recommended that NCAs take these circumstances into account by considering the possibility that execution venues unable to publish RTS 27 reports due by 31st March 2020 may only be able to publish them as soon as practicable after that date and no later than by the following reporting deadline (i.e. 30th June 2020), and that firms may only be able to publish RTS 28 reports due by 30th April 2020 on or before 30th June 2020.

  (ii) ESMA has also encouraged NCAs not to prioritise supervisory action against execution venues and firms in respect of the deadlines of the general best execution reports for the above periods, and recommended that they apply a risk-based supervisory approach in their day-to-day enforcement of RTS27 and RTS 28 concerning these deadlines. A link to the ESMA statement can be accessed here.

  (iii) **Securities Financing Transaction Regulation (SFTR) Reporting Requirements**: ESMA has confirmed that the first phase of SFTR reporting requirements - which applies to credit institutions, investment firms, and relevant third-country entities - will be postponed by three months to 13th June 2020. It has also said that it does not require any trade repositories to register with it ahead of 13th April 2020. A link to the relevant statement can be accessed here.

  (iv) **Call Taping**: ESMA has acknowledged that due to the exceptional circumstances created by the COVID-19 outbreak, that in some situations, notwithstanding steps taken by a firm, it may not be practicable to record telephone conversations as required by MiFID II. However ESMA said if such a scenario occurs, it would expect firms to consider what alternative steps they could take to mitigate the risks related to the lack of recording. A link to the statement can be accessed here.

- **European Banking Authority**

  The EBA has recommended that competent and resolution authorities should assess the extent to which the delayed submission of data included in the EBA reporting framework would be justified, as a result of the difficulties facing institutions due to COVID-19.

The EBA has recommended that in general, institutions should be allowed up to one additional month to submit the required data, with certain specific data sets being excluded from this measure. It has also suggested that competent and resolution authorities do not prioritise their supervisory actions towards ad-hoc data collections that are not specifically required to monitor institutions, in the context of the COVID-19 outbreak. It has also encouraged competent authorities to be flexible when assessing institutions' compliance with the deadlines for the publication of their Pillar 3 reports. Further information is available here.

It is good that regulators are recognising the pressures and challenges which businesses are facing as a result of COVID-19. Some of these measures will give organisations a bit of breathing space to focus on the key operational matters which they are prioritising at this this time.

8.2 ESMA statement postponing publication dates for annual non-equity transparency calculations and quarterly SI data

On 9 April 2020, ESMA published a statement, announcing that it is postponing publication dates in the light of COVID-19 for:

- annual non-equity transparency calculations, including the liquidity assessment and the determination of the pre-trade and post-trade large in scale and size specific to the instrument thresholds for derivatives, exchange traded commodities (**ETCs**), exchange traded notes (**ETNs**), emission allowances and structured finance products, which will be postponed from 30 April 2020 to 15 July 2020. Their application will be postponed from 1 June 2020 to 15 September 2020;

- quarterly systematic internaliser (**SI**) data for the performance of the SI test for derivatives, ETCs, ETNs, emission allowances and structured finance products by 1 August 2020 and will apply from 15 September 2020; and

- annual transparency calculations for bonds remain unchanged. The new pre-trade and post-trade large in scale and size specific to the instrument thresholds will apply from 1 June 2020.

The statement provided that ESMA and NCAs, will continue to closely monitor the situation and will take or recommend any measures necessary to mitigate the impact of COVID-19 on market transparency.

A copy of the statement can be accessed here.

8.3 ESMA extends MiFID II/MiFIR transparency review report consultation

On 9 April 2020, ESMA issued a press release that it has decided to further extend the response date for the consultation on the MiFID II/MiFIR review report on the transparency regime for non-equity instruments and the trading obligation for derivatives from 17 May to 14 June 2020.

The decision has been taken in view of the effects of the ongoing COVID-19 pandemic on stakeholders and market participants' current focus on crisis work and their operational constraints, as well as taking into account the technical complexity of the consultation.

The consultation paper can be accessed here.

8.4 Central Bank Actions to mitigate the impact of COVID-19

On 16 April 2020, the Central Bank introduced a new section of its website entitled "COVID-19 – Prudential Regulatory Flexibility Measures". The section sets out the regulatory flexibility that will be applied by the Central Bank in certain areas for credit institutions, securities markets, investment management, investment firms and fund service providers and insurers/reinsurers.

In particular investment firms should visit the new webpage therein entitled "Securities Markets, Investment Management, Investment Firms and Fund Service Providers". On that webpage, the Central Bank indicates that it is:

- allowing flexibility in respect of the remittance dates of a number of regulatory returns due from investment firms, fund service providers and investment funds over the COVID-19 period;
- clarifying its expectations as regards the deadlines for the submission of assurance reports in respect of investment firms and fund service providers' arrangements for the safeguarding of client assets or investor money;
- clarifying its expectations as regards risk mitigation programme (**RMP**) implementation dates;
- postponing its regular assessments of the domestic regulatory policy framework in respect of securities markets, investment management activities and investment firms; and
- clarifying the application of relevant announcements made by the ESAs to date.

The website page can be accessed here.

8.5 Central Bank Letter - PCF vacancies due to COVID-19

In the Central Bank's industry letter of 30 April 2020, a number of issues are addressed in light of the coronavirus pandemic. One of these relates to the role of Pre-Approved Controlled Functions (**PCFs**) and the Central Bank acknowledged the possibility that a PCF may become incapacitated due to COVID-19.

To avoid any detriment to firms in such an instance, the Central Bank has permitted that once authorisation is sought, companies may appoint a suitable individual to a PCF role for a limited period of time where a vacancy arises due to illness. The Central Bank details the steps that should be taken when opting for this course of action in its COVID-19 Regulated Firms – FAQ.

On 6 May, Dillon Eustace prepared an overview of the Central Bank requirements and the approach that firms should take in relation to temporary PCF appointments. This overview can be accessed here.

8.6 ESMA reminds firms of MiFID II conduct of business obligations when dealing with retail investors

On 6 May 2020, ESMA published a statement reminding firms about their conduct of business obligations under the MiFID II Directive in the context of increasing retail investor activity during the COVID-19 pandemic.

ESMA received reports from several NCAs that they have noticed a significant increase in the number of investment accounts opened by retail clients and a surge in trading by retail clients. It is bringing to firms' and clients' attention the risks of trading in these uncertain market conditions and to remind investment firms of their conduct of business obligations.

ESMA believes that firms have even greater duties when providing investment services to investors who decide to invest during these times of intensified market volatility and reminds firms of their obligation to act honestly, fairly and professionally in accordance with the best interests of their clients and to comply with all relevant MiFID II conduct of business and related organisational requirements. In particular, ESMA highlights firms' obligations in respect of product governance, information disclosure, suitability and appropriateness.

NCAs will continue to monitor retail clients' involvement in the financial markets and firms' compliance with their conduct of business obligations and related organisational requirements under MiFID II.

The statement can be accessed here.

8.7 Update on short selling bans by Austrian FMA, Belgian FSMA, French AMF, Greek HCMC and Spanish CNMV

On 18 May 2020, ESMA announced the non-renewal of the emergency restrictions on short selling and similar transactions by the Austrian FMA, Belgian FSMA, French AMF, Greek HCMC and Spanish CNMV.

ESMA's announcement is available here.

In a further update on 11 June 2020, ESMA renewed its decision to require holders of net short positions in shares traded on EU regulated markets to notify their relevant NCAs if the position exceeds 0.1% of the issued share capital. This measure applies for 3 months from 17 June 2020 but does not apply to shares traded on the regulated market but where the principle venue for trading is in located in a third country.

The ESMA decision can be accessed here.

8.8 ESMA publishes statement on MiFIR open access and COVID-19

On 11 June 2020, ESMA issued a statement to clarify the application of the MiFIR open access provisions for trading venues and central counterparties (**CCPs**) in light of the recent adverse developments related to COVID-19.

ESMA aims to coordinate the supervisory actions of NCAs by setting out the issues they should consider when assessing open access provisions requests and to consider the uncertainty and volatility driven by the COVID-19 pandemic may negatively impact CCPs and trading venue operations and increase their operational risk combined with the limited capacity for assessing access requests and managing the financial stability of migrating flows of transactions.

The current exemptions under MiFIR, which allows NCAs to temporarily exempt trading venues and CCPs from the open access provisions for exchange traded derivatives, expired on 3 July 2020 and from 4 July 2020 the open access provisions for exchange traded derivatives will apply.

A copy of the statement can be accessed here.

8.9 COVID-19: ESMA revised work programme for 2020

On 15 June 2020, ESMA published its revised work programme for 2020. ESMA had originally published its 2020 work programme in October 2019, however, it has now revised its work programme as a response to the COVID -19 crisis.

Annex I to the work programme sets out delays to ESMA's planned consultations due to COVID-19. Among other things, these relate to work on sustainable finance, investment management, credit rating agencies, securitisation and market integrity

ESMA's revised 2020 Work Programme is available here.

If you have any questions in relation to the content of this update, to request copies of our most recent newsletters, briefings or articles, or if you wish to be included on our mailing list going forward, please contact any of the team members below.

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