

A year of change

Nick Blake-Knox, of Walkers, outlines the recent events, trends and regulatory occurrences which fund managers are dealing with in 2018 and beyond

Q What market trends have you seen recently?

A In terms of trends we are seeing an increasing role for Esma. This is particularly the case with supervisory convergence, which has been identified by Esma as an area of strategic importance and has been included in its 2019 Work Programme which sets out its priorities and areas of focus for 2019. Esma views supervisory convergence as a necessary step in achieving its overall mission to enhance investor protection and promote stable and orderly markets.

One of the key objectives of the supervisory convergence programme is to remove regulatory arbitrage and this is particularly relevant in the context of firms seeking to relocate as a result of Brexit. A Supervisory Coordination Network (SCN) has been established by Esma at which EU national competent authorities are afforded the opportunity to share and discuss details of Brexit related relocation applications that they have received in order to allow for the adoption of a common supervisory approach across member states. The SCN process has resulted in the expectations of certain NCAs, particularly those in relation to local substance, evolving over the course of the authorisation process, which in some cases can take more than 12 months to complete.

My sense is that the historical position where asset managers have established funds in certain jurisdictions and were potentially advantaged/disadvantaged by different applications of European rules will significantly reduce; we have



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seen this, for example, in relation to share class hedging where Esma has intervened and issued an opinion recently.

Q Are some market participants now paying more attention to the EU and jurisdictions they know they're still going to be able to conduct business within post-Brexit?

A As things currently stand, there is still significant uncertainty around the status of any withdrawal agreement and the post-Brexit landscape for the distribution and management of funds. We have seen a bifurcated approach with a large number of firms seeking to put in place contingency arrangements irrespective of the Brexit outcome by proactively setting up structures in the EU27 in advance of Brexit, with a large group of managers still waiting to pull the trigger and implement their Brexit plans. This second group, which includes many smaller managers, is waiting for a clearer understanding of whether there is likely to be a transitional period or not. The latter approach is clearly a higher risk strategy given that the authorisation processes take time and these managers are unlikely to obtain new authorisations in advance of Brexit if they have still had no engagement with the regulators up to this point. We have been assisting clients to map out alternative options which can

be implemented more quickly, such as the use of third-party management company solutions as an interim measure.

In terms of Ireland as a domicile, the Central Bank of Ireland has continued to receive a steady flow of authorisation applications from asset managers throughout 2018 seeking to establish Ucits management companies, AIFMs and Mifid firms which demonstrates the continued attraction of the jurisdiction. We have also seen firms seeking to establish fund management companies with Mifid top-up permissions which afford firms more flexibility to provide investment services to their non-fund clients.

There is still hope that a withdrawal agreement will be put in place whereby a transitional period will apply, potentially one which is further extended. Recent initiatives by the UK, whereby they've introduced a temporary permissions regime (TPR), which will allow for the continued sale of EU funds in the UK post-Brexit for a limited time period, have provided some further encouragement although the application of the TPR to funds which are registered post-Brexit remains unclear.

Q What other key developments have occurred in 2018 and will occur in the near future?

A On the regulatory front, there are a number of EU regulations which have either come into effect already during the course of 2018 (e.g. GDPR) or are due to come into effect shortly that will impact fund managers.

One of these is the Securitisation

Regulation, which will introduce a harmonised framework for securitisations across the EU, thus moving away from the current position whereby sector specific requirements are set out in the relevant sectoral legislation. "Securitisations" capture any transaction or scheme whereby the credit risk associated with an exposure or pool of exposures is tranching and can apply to a broad range of instruments including asset-backed securities and collateralised loan obligations.

The principal impact of the existing requirements under AIFMD, which are broadly similar to those under the Securitisation Regulation, has been that the AIFM is required to ensure that any securitisations which are acquired by the AIFs under its management comply with the 5% risk retention requirements.

Under the Securitisation Regulation, similar requirements will soon apply to Ucits in respect of securitisations issued on or after 1 January 2019. This is a significant development for many Ucits managers that invest in securitisations, particularly those who invest in US issued paper, which will not typically be structured in a manner to comply with these requirements.

For managers who invest in these products within their Ucits ranges, there are large compliance projects underway to ensure that they are ready for the introduction of these new requirements including identifying any legacy positions which may be brought into the scope of the Securitisation Regulation on or after 1 January 2019. Ucits managers are also assessing any potential impact on their ability to continue meeting their investment objectives and/or any adverse impacts to investment performance due to the narrowing of the investment universe in which they may invest.

It should be noted that the requirements introduced under the Securitisation Regulation also extend to non-EU AIFMs who manage or market AIFs within the EU. This is particularly notable because many AIFs which have been marketed under the Article 42 regime under AIFMD have fallen outside the scope of these requirements until now and so AIFMs of non-EU AIFs which are



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managed or marketed within the EU are now assessing the potential impact to their portfolios.

Q Will US issuers who are not subject to these requirements do anything to change their issuance approach to enable EU purchases?

A Although there are similar risk retention requirements in the US under Dodd-Frank, these are not identical to the EU requirements and therefore cannot be relied upon to satisfy the EU risk retention requirements without certain gold plating. Indeed, more recently we have seen the US market move away from the application of risk retention requirements in relation to CLOs. At this time, we are taking a 'wait and see' approach. Given that the EU market for certain issuers is relatively small, it is unlikely that they will seek to gold plate their requirements to ensure European

compliance although we have seen some securitisations being structured in a dual compliant manner.

Q What further market trends have you recently seen?

A In terms of other trends, we're continuing to see a focus on costs and charges, both by the regulators and in relation to the fee models that are being employed. Indeed, Mifid II significantly enhanced the requirements for fee transparency and also introduced new rules regarding inducements which are likely to continue to be disruptive in relation to traditional fee models and further incentivise the growth of ETFs.

We have also seen scrutiny by the Central Bank of Ireland in relation to Ucits performance fees and it recently carried out a thematic review of practices relating to the calculation and verification of performance fees. In addition, the Central Bank issued a "Dear CEO" letter on 4 September 2018 highlighting supervisory issues which were identified during this thematic review and requiring Ucits that charge performance fees to review their existing methodologies and confirm to the Central Bank of Ireland in writing by 30 November 2018 that such a review has been carried out.

We expect the focus on fees to continue to be front and centre of the regulatory agenda going forward. **HFM**