FINNIUS

# Summer's over:
# Developments and action points for asset managers

It's been a summer where many people have taken a real break from the turbulent times over the past year. Now that it's time to get back on track, we'd like to list the recent developments for asset managers.

Remarkably, it was very busy in the field of asset management during the summer. So, once again, there is a lot to know and to do. The focus in our overview is on action points for fund managers, but many of the topics are also directly relevant to investment advisers and individual portfolio managers. We have marked them with an *.

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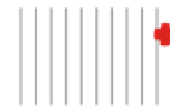
## Sustainability

### SFDR

*Further explanations by the European Commission*

The European Regulation on Sustainability-related Disclosure in the Financial Services Sector 2019/2088, also known as the *Sustainable Finance Disclosure Regulation* (SFDR), has been in force since 10 March 2021. Yet it was only this summer that the European Commission came up with a substantive response to pressing questions regarding 6 topics that the Joint Committee of European



Supervisory Authorities (the ESAs) had already submitted to the EC on the 7th of January regarding the SFDR.

Among other things, the EC has made it clear that exempt managers (light managers) within the meaning of article 2:66a of the Dutch Financial Supervision Act (*Wet op het financieel toezicht*, Wft) and non-EU managers operating under the National Private Placement Regime (NPPR) of article 1:13b Wft must also fully comply with the SFDR. This seems to bring in a number of obligations, such as having a website and drawing up a remuneration policy, through the back door. Dutch managers that make use of the registration regime and non-EU managers that operate under the National Private Placement Regime (NPPR) should therefore now take action to comply with all SFDR obligations as soon as possible. The SFDR contains obligations that apply to the manager as well as to the investment funds under management.

Click here for our full schematic overview of the EC response to the questions raised by the ESAs, including our comments and observations thereon.

*Entry into force of RTS (level 2) not until July 1st 2022*

The European Commission indicated on July 8th that the draft regulatory technical standards (RTS) that provide further detailed requirements in respect of a number of SFDR obligations will not enter into force on January 1st 2022, but on July 1st 2022 all at once. The AFM states on its website that the ESAs will adjust the new timelines in the previously published SFDR supervisory statement. To date, this has not yet happened.

Until the RTS enters into force, market parties must comply with the SFDR, without the further detail and interpretation that the RTS provide in respect of the SFDR obligations. However, the AFM has previously indicated that it does expect market parties to take the RTS into account as much as possible when complying with the SFDR, in preparation of the RTS entering into force. Despite the postponement of the formal application date of the RTS, it is therefore advisable to take note of the RTS already submitted by the ESAs to the European Commission. However, market parties will formally, for the time being, only have to take into account the general level-1 rules of the SFDR.

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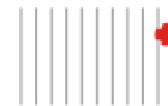
**Consultation on good practices in managing climate and environmental risks**

DNB has drawn up a consultation document (Good Practice) with guidelines for the integration of climate-related and environmental risks into the strategy, governance, risk management and information provision of licensed fund managers and investment companies. The reason for this is that climate-related and environmental risks can have a material financial impact on the solidity and reputation of these financial undertakings. This concerns both the physical consequences of a changing climate and environmental damage (physical risks) and the consequences of a transition to a climate-neutral and more environmentally friendly economy (transition risks).

DNB expects fund managers and investment firms to analyse and describe the impact of these risks on their risk profile. If there is a material risk, DNB expects fund managers and investment firms to manage these risks like any other conventional risk.

After processing the information received and the consultation responses, DNB intends to publish a final version of the Good Practice and Q&A in October 2021. Fund managers and investment firms will therefore be expected to



implement the final Good Practice in their risk management procedures shortly. The focus of DNB's supervision is on the impact of the potential risks on the soundness of the financial undertaking concerned.

# Distribution throughout the EU

**Cross-border pre-marketing opportunities**

*General*

On August 2nd 2021, a package of new rules came into force for the cross-border distribution of UCITS, AIFs, EuVECA, EuSEF and ELTIF funds. The package consists of a Directive amending the AIFM Directive and UCITS Directive and a Regulation amending the EuVECA and EuSEF Regulations, while it also provides for a number of other obligations for all types of fund managers. The aim of the new rules is to simplify and harmonise the cross-border distribution of investment funds.

*Status*

The Regulation has direct effect and came into force on August 2nd 2021. The Directive should also have been implemented in Dutch legislation and regulations on that date. However, this date has not been met. The legislative proposal to implement the Directive is currently pending before the Lower House of Parliament. It is not yet clear when the new rules will take effect in the Netherlands, but the Ministry has expressed the intention to implement the Directive as soon as possible.

*Pre-marketing*

The Directive contains a definition of what constitutes 'pre-marketing' in respect of AIFs. A similar definition is included in the Regulation with respect to EuVECA and EuSEF funds. Pre-marketing is the phase prior to 'marketing', in which a fund manager investigates with potential investors whether there is any enthusiasm for a new investment fund that has yet to be established. So far, there were no harmonised rules on this subject in the EU. In a response to Parliamentary questions, the Ministry stated that the new definition of pre-marketing is in line with how pre-marketing is dealt with in practice in the Netherlands.

*Definition of pre-marketing*

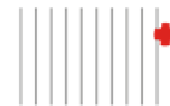
The new definition of pre-marketing allows fund managers to provide information on investment strategies or ideas to potential professional investors, with a view to ascertaining whether those investors are interested in an investment fund (an AIF, EuSEF or EuVECA fund) which has not yet been set up, or which has been set up but is not yet the subject of an application for authorisation or a European passport, and in any case does not amount to an offer to invest in the investment fund.

A fund manager may engage in pre-marketing within the EU unless the information provided:

a) is sufficient to enable investors to commit themselves to acquiring units or shares in a particular investment fund;
b) constitute registration forms or similar documents, either in draft or in final form, or
c) constitutes to founding documents, prospectus or offering documents of an investment fund not yet formed, in final form.

Where a fund manager provides a draft prospectus or draft offering document, the document should not contain sufficient information to enable investors to make an investment decision. In addition, a disclaimer should then clearly state that:

a) the document does not constitute an offer or solicitation to subscribe for units or shares in an investment fund, and



b) the information contained therein should not be relied upon, since it is incomplete and subject to change.

A tricky part of the definition is that the fund manager is not allowed to issue a draft prospectus or offering document if it contains 'sufficient information to enable investors to make an investment decision'. The question is, of course, when this is the case. If a prospectus only bears the disclaimer 'draft', but is already close to final, one should in our opinion conclude that such a draft prospectus contains sufficient information to base an investment decision on.

If a fund manager undertakes pre-marketing in relation to an AIF, EuVECA or EuSEF fund, a notification must be made to the competent authority within two weeks. In this respect, cross-border pre-marketing creates more administrative burdens than before. If an investor joins the fund within 18 months after pre-marketing, this qualifies as an offering/marketing that falls within the rules of the AIFM Directive, EuVECA Regulation or EuSEF Regulation. This means that reverse solicitation can then no longer be invoked.

*Implications for practice*

We welcome the fact that there is a harmonised definition of pre-marketing. This will give legal certainty to fund managers who intend to market their funds cross-border but want to test the appetite for such a fund before doing so. It also makes it clear when there is no marketing, and therefore no need for the fund to be approved. We do have a number of comments to make on this.

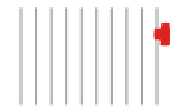
The new definition of pre-marketing is based on testing the interest of professional investors in AIFs, EuVECA and EuSEF funds. For EuVECA and EuSEF funds, this also includes the EUR 100,000 investor, because a EuVECA/EuSEF label also allows an offer to be made to such investors. This clause raises the question of how pre-marketing should be handled in relation to other types of funds (such as UCITS and exempt AIFs) and other types of investors (such as retail and high-net-worth individuals who invest more than EUR 100,000 in an AIF, but are not professional investors).

Attention was also drawn to this in the consultation responses. The legislator has indicated that:

- The new pre-marketing rules also apply to managers using the National Private Placement Regime.
- The new pre-marketing rules <u>do not</u> apply to exempt managers.
- The possibility of pre-marketing is not available to UCITS managers.
- Pre-marketing should be aimed at *professional* investors (and should therefore not be aimed at retail investors).
- Pre-marketing can also be aimed exclusively at professional investors in the Netherlands (domestic pre-marketing). Based on the legislative proposal, it seems that a notification to the AFM is also required in this case.

All in all, therefore, the new definition unfortunately leads to several tricky qualification questions. Can an exempted fund manager (i.e. operating under the AIFMD light regime) not engage in pre-marketing at all? And what about a UCITS manager who only approaches professional investors?

In our opinion, an important distinction must be made between the type of funds to which the new pre-marketing framework will apply and other types of funds, for which, in principle, the 'old' market practice will continue to exist. For example, an exempt fund manager can continue to engage in pre-marketing, as long as there is no offering/marketing, because that would trigger registration with the AFM. The exempted manager only does not need to comply with



the new pre-marketing framework. In our opinion, however, these fund managers must carefully determine what information they can or cannot provide in the pre-marketing phase, which will also depend on the type of investors that are approached. In our opinion, there is little room for pre-marketing in respect of retail investors in view of the legislator's statements.

*Other rules*

The Directive and the Regulation also provide for additional rules, such as those relating to the de-notification of AIFs and UCITS, the provision of local facilities for the benefit of retail investors and rules on marketing (in terms of advertising). On the latter, also see below.

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**Marketing rules**

*General*

The Regulation also contains rules on advertising of investment funds by fund managers (AIFMS, UCITS managers, EuVECA managers and EuSEF managers). The Regulation provides for general standards, such as that marketing material must be identifiable as such and the information contained therein must be fair, clear and not misleading. Because of these new rules that have direct effect in the EU, the currently applicable and comparable standard of 4:19 Wft will no longer apply to managers of AIFs and UCITS.

*Advance notice?*

Please note that the Regulation allows local regulatory authorities to require prior notification of marketing material for retail investors, in order to check compliance with the Regulation. These authorities must publish such requirements and the procedure that applies in such case on their website. This is the case in Belgium, for example.

*Marketing rules on the website of supervisors*

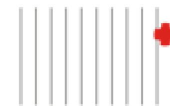
The Regulation also requires that where Member States have certain national rules on marketing, the local authorities must publish this on their website. This should help fund managers when offering their funds across borders. In the Netherlands, for example, we would think of the Unfair Commercial Practices Act (*Wet Oneerlijke handelspraktijken*) and the marketing rules from the Decree on Conduct Supervision of Financial Undertakings (*Besluit Gedragstoezicht financiële ondernemingen*, (BGfo)) and the Further Regulation on Conduct Supervision of Financial Undertakings (*Nadere regeling gedragstoezicht financiële ondernemingen* (Nrgfo)). Remarkably, as far as we can see, the AFM has not yet published information as such on its website. This is already the case in other Member States (for example in Germany and France).

*ESMA guidelines*

In connection with these rules on marketing in the Regulation, ESMA published Guidelines on August 2nd 2021 on marketing (currently only available in English). The Guidelines include (i) the qualification of what qualifies as marketing, (ii) disclaimers that must be included in marketing material, (iii) a balanced description of risks and returns, (iv) other information on risks and returns, costs, historical and projected returns and sustainability aspects.

The Guidelines therefore offer very similar rules for, among others, UCITS and AIFs as also included in the BGfo and the Nrgfo. The rules on marketing in the BGfo and Nrgfo, including for example the obligation to include a risk indicator in marketing material, are national rules. There will be much overlap between the Guidelines and the BGfo/Nrgfo.

As far as we are concerned, these new Guidelines are therefore a good opportunity to abolish the national marketing rules for advertising statements by UCITS and retail



AIFs. With this European framework for marketing by UCITS and AIFs, in addition to the marketing rules that already apply on the basis of MiFID II and the Delegated Regulation, these rules have little added value and lead to unnecessary additional costs for fund managers.

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## Outsourcing

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**Continuing focus of AFM on compliance with outsourcing rules**

On July 26th 2021, the AFM published a news item urging companies in the asset management sector (licensed investment firms, AIFM managers and UCITS managers) to manage and control the risks of outsourcing activities. Asset managers must comply with outsourcing rules from MiFID II, the AIFM Directive or the UCITS Directive. The AFM notes - in short - that many asset managers outsource activities, and that these schemes pose risks. Research by the AFM shows that the measures taken by asset managers in this area sometimes leave much to be desired, or need to be improved. The AFM expects market parties to adjust their policy and practices in this area. In our earlier news item you can read more about the background of this call for improvement by the AFM.

We emphasize that the outsourcing rules also apply to outsourcing within the group (Internal Outsourcing). The AFM also draws explicit attention to this in its aforementioned feedback to the market on the outsourcing survey that it carried out. The AFM notes that institutions by no means apply all of the applicable rules to Internal Outsourcing. The AFM has noticed, for instance, that the actual quality monitoring of Internal Outsourcing is often wrongfully omitted.

In addition, we would like to point out that certain outsourcing activities, including Internal Outsourcing, are subject to a prior reporting obligation to the AFM. Fund managers are generally aware of this, because this duty to report is included in the BGfo and therefore has a clear legal basis. Investment firms sometimes overlook this duty to report, since it has its basis in the EBA Guidelines on Outsourcing and the AFM (apparently) applies these guidelines to all investment firms (thus also to investment firms that do not fall under the CRR and therefore do not fall within the scope of the EBA Guidelines on Outsourcing). The obligation to report only exists for the outsourcing of material activities. Asset managers must therefore carry out a materiality assessment of all their outsourcing activities, record the results and, if necessary, notify the AFM.

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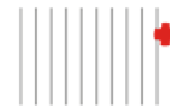
**ESMA Guidelines on Cloud Outsourcing***

The aforementioned ESMA Guidelines were already published in May this year, but will apply to new or amended contracts from July 31st 2021 and to existing contracts from December 31st 2021. The AFM and DNB will apply the Guidelines in their supervision.

The ESMA Guidelines are intended to help asset managers, among others, identify, address and monitor risks when outsourcing tasks to the cloud. Asset managers are likely to find the Guidelines not only helpful, but also a compliance burden. The guidelines contain 37 paragraphs with requirements that must be observed when it concerns 'cloud outsourcing'. That is a preliminary question that needs to be answered, which does not always have a clear cut answer.

A large number of these requirements only apply to outsourcing of critical or important functions (core tasks). This is a criterion that investment firms are already familiar with as a



condition for the applicability of the outsourcing rules under MiFID II. However, this criterion does not apply to the generic outsourcing rules for fund managers. The fact that a materiality test applies to the application of certain guidelines when outsourcing to the cloud is therefore new to this group.

In our opinion, the Guidelines are reason for asset managers to fill in a matrix for themselves: click here.

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## Fund managers with MiFID II top up

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**Application of IFD and IFR by managers - supervisory regulations DNB and Q3 reporting**

The Investment Firm Directive (IFD) and Investment Firm Regulation (IFR) are only applicable to investment firms authorised under MiFID II. IFD/IFR are therefore, in principle, not applicable to fund managers with a MiFID II top-up. However, despite criticism, the Dutch legislator has taken the liberty of broadening the scope of certain capital requirements of the IFD/IFR to include fund managers that are also permitted to provide certain MiFID II services. These fund managers with MiFID II top-up already have to comply with the same requirements as investment firms to a significant extent. This is provided for in the IFD Implementation Act, which provides that parts of the IFD also apply to fund managers with MiFID II top-up. For fund managers with MiFID II top-up, this means, for example, that the ICAAP must become an ICLAAP, because the liquidity component must also be added, and that fund managers are confronted with the so-called k-factor requirement from IFR. However, the calculation of the k-factors requirement only applies to that part of the assets/transactions that are actually performed by the manager in its capacity as investment firm (assets under management within the context of collective fund management are therefore not to be included).

The Implementation Act also authorises DNB to translate the capital requirements arising from the IFR into workable rules for MiFID II top-up fund managers by means of a supervisory regulation. On July 16th, DNB launched a consultation on this supervisory regime. The consultation includes the principle that fund managers are subject to the capital requirement that represents the highest capital requirement: either the capital requirement referred to in UCITS or AIFMD, or the capital requirement referred to in the IFR. The consultation closes on August 30th 2021. We expect the regulatory regime to come into force soon thereafter.

We also note that DNB assumes that the IFD Implementation Act will have come into force before the reporting deadline for the third quarter 2021 reports. DNB has therefore expressed the expectation that the new reporting templates will be used by fund managers for the third quarter reporting. In connection with the mandatory reporting for fund managers with MiFID II top-up under IFD/IFR, DNB also consulted on another supervisory regulation on August 24th 2021. DNB indicates what information must be reported, including frequency and relevant deadlines. Responses to the consultation may be submitted up to and including September 21st 2021.

So a clear action point for fund managers with MiFID II top-up is to make/complete the IFD/IFR impact analysis with urgency, and align their reporting/ICLAAP accordingly.

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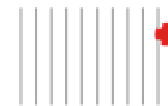
**ESMA Guidelines on the compliance function enter into force*.**



Just before the summer months, the new ESMA guidelines on the compliance function came into force. The guidelines apply to the compliance function at investment firms, banks providing investment services and fund managers with MiFID II top-up. The AFM integrates the guidelines in its supervision of the compliance function of such asset managers. In the past year, the AFM also conducted research at a number of market parties into the operation of the compliance function. Because of the increasing regulatory pressure, the importance of a properly functioning compliance function is also growing. The guidelines specify, among other things, the duties, reporting obligations, professional competence, knowledge, expertise and authority, and the independence of the compliance function.

Compliance officers obviously need to read the guidelines, but so does the director whose responsibilities include the compliance function. A large number of guidelines will not cause any surprises, but there are also guidelines that undoubtedly require attention. We advise compliance officers to record in a checklist whether/how each of the guidelines has been met. This helps to identify gaps. Moreover, such a checklist forms a good basis for any questions the AFM may have at any time with regard to the compliance function, and which in our experience have the same level of detail as the guidelines. A conscious recording per guideline is therefore no unnecessary luxury. Incidentally, such an exercise may also be relevant for fund managers without a MiFID II top-up, despite the fact that the guidelines do not formally apply.

## AML/CFT

### AML/CFT legislative package of the EC

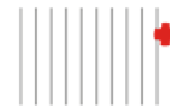
The EC presented four legislative proposals on July 20th 2021:

- A proposal for a Regulation establishing a new European AML/CFT Authority (AMLA);
- a proposal for an AML/CFT regulation;
- a proposal for a Sixth Anti-Money Laundering Directive, which will replace the existing Fourth Anti-Money Laundering Directive (as amended by the Fifth Anti-Money Laundering Directive); and
- a proposal for a revision of the Regulation on information accompanying transfers of funds.

This package of legislative proposals, if adopted by the Council and the European Parliament, will lead to significant changes in the European AML/CFT landscape. In our earlier press release of this summer, we provide further insight into the key elements of these proposals.

### State of affairs regarding the UBO register of FGRs

On 9 August, the consultation period for the Implementation Decree on registration of beneficial owners of trusts and similar legal constructs closed. In the draft Implementation Decree the legislator has made use of the possibility to limit the categories of persons who must be considered to be the UBO of a collective investment scheme (CIS) in the form of a fund for joint account (*fonds voor gemene rekening*, FGR). This is a common fund vehicle in the Netherlands which essentially is formed by an agreement between de fund manager, a



legal entity holding legal title to the fund assets and each participant.

In order to ensure the practicability of the registration requirement, the draft Implementation Decree makes a distinction between unit-holders. The Decree changes the concept of the UBO in such a way that only participants with an interest of at least 3% are deemed to be UBOs. This means that participants with an economic interest below the 3% limit will not be registered in the Trust Register. With this 3% limit, the legislator follows the obligations to report control in an issuer. In cases where none of the participants has an interest of at least 3% in an FGR, a description of the group in whose interest the FGR is primarily established or operates will suffice. This could for example be 'unit-holders in an AIF'. See our earlier news item for a more extensive discussion on the Implementation Decree consultation.

In the consultation responses to the Implementation Decision, interest groups criticise the (low) threshold of 3%. We are curious to see whether the legislator will meet the many objections in the final decision.

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**EBA Consultation on AML/CFT Compliance Officers*.**

In early August, EBA launched a consultation for new guidance on the role, duties and responsibilities of persons appointed as AML/CFT compliance officers. However, the guidelines also contain provisions on other subjects, such as training and education and AML/CFT governance in general. This concerns, for example, the director who is appointed as AML responsible direct. Up until now, it has been a matter of guessing what the precise responsibilities and duties of the director responsible for AML compliance are, so we think it is a good thing that more clarity is provided in this respect. The guidelines will ultimately apply to the entire financial sector. The consultation period runs until November 1st 2021, so the guidelines will probably apply sometime in early 2022.

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# Enforcement

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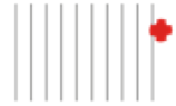
**ESMA provides insight into enforcement under AIFMD/UCITS**

As in previous years, ESMA has published overviews of the enforcement measures imposed by the regulators of the various Member States on fund managers under the AIFM Directive and UCITS Directive. This is the fourth annual overview for UCITS and the second for AIFs. These summaries provide an interesting insight into the enforcement practices in the various Member States.

Under the AIFM Directive, a total of 131 enforcement measures were imposed in 2020 (compared to 87 measures in 2019), while the total amount of fines for 2020 was EUR 3.3m (compared to EUR 9m in 2019) ESMA notes that a small number of regulators are responsible for the majority of the measures and that, overall, the figures at national level are low. It is also notable that the AFM did not take any formal enforcement action under the AIFM Directive in 2020, even though it is a fairly active regulator and, moreover, there is a relatively high amount of assets under management in AIFs in the Netherlands. Much of its enforcement activity appears to have been directed towards AML-compliance and informal measures (such as warnings).

Under the UCITS Directive, a total of 100 enforcement measures were imposed in 2020. Fines for a total of EUR 1.1 million were imposed. ESMA notes that the enforcement powers are not used proportionally across the different Member States and that, in general, the total of measures taken at national level is low. Also under the UCITS Directive, the AFM



did not impose any enforcement measures in 2020. On the other hand, the UCITS market is relatively small in the Netherlands compared to other Member States.

We expect the enforcement activities of national supervisors to increase rather than decrease in the coming years.

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