Funds & Investment Management Update – Ireland and Luxembourg

Quarterly Update | April to June 2023

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Table of Contents

1 Legal & Regulatory

1.1 UCITS and AIFMD Costs and Fees

Fees and costs in UCITS and AIFs continues to be, a key priority at a European level - most recently evidenced by the issuance of the ESMA Opinion on undue costs of UCITS and AIFs, published 17 May 2023 (the "ESMA Opinion").

By way of background, ESMA published a Supervisory Briefing back in June 2020 on the supervision of costs in UCITS and AIFs in which it identified the significant impact of costs on the final returns for investors, as well as noting that there was a lack of convergence on the way the notion of "*undue costs*" is interpreted across the EU.

In January 2021, ESMA launched a Common Supervisory Action ("CSA") with national competent authorities ("NCAs") on the supervision of costs and fees of UCITS across the EU / EEA. The CSA's aim was to "*assess, foster and enforce the compliance of supervised entities with key cost-related provisions in the UCITS framework, in particular the obligation of not charging investors with undue costs*".

ESMA has suggested clarifications to the legislative provisions under the UCITS Directive and the AIFMD relating to the notion of undue costs. The proposed clarifications include an obligation on fund management companies to act in such a way to prevent undue costs being charged to a fund and its investors and to develop a pricing process. More significantly, the proposals would obligate managers to *indemnify* investors where undue costs have been charged.

This follows on from the Dear CEO letter from the Central Bank of Ireland (the "Central Bank") of 24 March 2023, which we noted in our Q1 update, which requires fund management companies to conduct a gap analysis of the findings / expectations contained in the letter (e.g. annual review of costs and fees, formal pricing policies and procedures) and, where appropriate, put a plan in place by 30 September 2023 to address any gaps identified.

For further information please see our client update, Central Bank of Ireland Findings Following EU Review of Costs and Fees in UCITS.

1.2 Provisional Agreement for AIFMD 2.0

On 20 July 2023, the European Parliament, Council and Commission, the European Council and European Parliament announced their provisionally agreed position on proposed amendments to AIFMD. The final text will not be available for some time, as such the new requirements are subject to the final text when published (expected to be November), and there may still be some finer details to be worked out. Thereafter allowing for an implementation period for member states, it may be late 2025 or early 2026 before it comes into force. From what we are aware the headline points are set out below.

1. **Delegation**: It has been recognized that delegation can be highly beneficial to investors, by allowing the AIF to access global expertise. However, there will be greater substance / oversight and reporting requirements for AIFMs both on authorisation and thereafter - regular reporting will be required on both the amount and percentage of assets under delegation.

2. **Loan Originating AIFs (LO-AIFs)**

   There will be a new European regime for loan origination by funds. We understand that the legislation should also make clear LO-AIFs can engage in cross border lending in the EU, and albeit by default are closed-ended, they may be opened-ended in certain circumstances. Some of the notable features of the new regime include:

   a) *Risk Retention*: There will be a risk retention requirement (i) until maturity, for (x) loans up to eight years or (y) loans to consumers and (ii) at least eight years for loans of longer maturity. There will be derogations for compliance with product requirements and cases where risk associated with a loan deteriorates.

b) *Definition of a LO-AIF*: a LO-AIF will be in scope of the requirements when the investment strategy of the fund is mainly to originate loans and / or when the notional value of the AIF's originated loans represents at least 50% of NAV.

c) *Leverage Limits*: There will be differing limits for open-ended and closed-ended loans after discussion on what the limits will be and the methodology to calculate same it appears the parties settled on using the commitment approach only, with respectively 175% NAV for open-ended AIFs and 300% closed-ended AIFs. Subscription line financing would not count towards the limits and there will be flexibility to rectify unintentional breaches of the limits beyond the AIFM's control.

d) *Shareholder Loans*: Funding portfolios by debt, i.e. a fund lending to a company it has equity / voting rights by way of loan rather than note, will be permitted and not subject to the LO-AIF requirements up to 150% of the AIF's capital.

3. **White Label Products**, i.e. products using a hosted / third-party ManCo, – there will be a limited amendment in the operative part of the Directive requiring increased conflicts obligations, and regulatory transparency/investor disclosure around same.

4. **Sustainability** - the prevailing view is that this should be addressed 'horizontally', i.e. cross sectoral rather than in individual pieces of legislation, to prevent fragmentation. So it is expected that rather than have material new provisions added to AIFMD, this will be addressed as part of Sustainable Finance Disclosure Regulation ("SFDR") more generally. AIFMs will have to add some detail in their programme of activity to demonstrate compliance with certain specific obligations (e.g. regarding website disclosure, integrating sustainability risks into investment decisions and marketing communications)

For more information, please see our update, A Step Closer to AIFMD 2.0.

1.3 Updates to the ESMA Q&As

On 14 June 2023, ESMA updated its Q&A on the application of the AIFMD and its Q&A on the application of the UCITS Directive ("Q&A"). The purpose of the Q&As is to promote common supervisory approaches and practices in the application of the AIFMD and UCITS frameworks and their respective implementing measures.

Cross Border Marketing: In both Q&As, ESMA confirmed as follows:

- It is not possible to passport 'ancillary' services such as administration or marketing services into a host Member State without also passporting the investment management function.

- The de-notification obligations set down in Article 32a(1) of AIFMD and Article 93a(1) of the UCITS Directive must be complied with by an AIFM or UCITS management company in circumstances even where there are no investors in a host Member State. ESMA confirms that the sole exception to this requirement arises in the case of closed-ended ELTIF funds.

The revised Q&A on the application of the AIFMD confirms as follows:

- ESMA confirms that when calculating the leverage of an AIF real estate fund (being one whose core investment policy is to invest in real estate directly or indirectly), the AIFM must include the exposure contained in financial or legal structures involving third parties controlled by the AIF where those structures are specifically set up to directly or indirectly increase the exposure at the level of the AIF.

- Without prejudice to any national rules, registered AIFMs are not subject to / cannot avail of the pre-marketing provisions set down in AIFMD.

- In an earlier Q&A on the application of the AIFMD published by ESMA on 26 May 2023, it also confirmed that non-EU AIFMs cannot carry out pre-marketing activities under AIFMD unless this is permitted under the national laws of an individual Member State.

The Q&A on the application of the UCITS Directive also confirms the following:

- UCITS management companies are permitted to manage AIFs as a 'registered' (or sub-threshold) AIFM, i.e. registered under Article 3 of the AIFMD Directive; and

- UCITS management companies are permitted to manage pension schemes under Directive (EU) 2016/2341 (the "IORP Directive") provided that they are authorised by their national competent authority to manage investment portfolios on a mandate basis in accordance with Article 6(3)(a) of Directive 2009/65/EC (the "UCITS Directive").

Access a copy of the most recent Q&A on the application of AIFMD published by ESMA here.

A copy of the ESMA Q&A on the application of the UCITS Directive is available.

1.4 ESMA CSA on SFDR

On 6 July 2023, ESMA published an update regarding a Common Supervisory Action ("ESMA CSA") with relevant NCAs on sustainability-related disclosures and the integration of sustainability risks. The stated goal of the ESMA CSA is to assess the compliance of supervised asset managers with the relevant provisions SFDR, the Taxonomy Regulation and relevant implementing measures, including the relevant provision in the UCITS and AIFMD implementing acts on the integration of sustainability risks.

This will involve ESMA and national competent authorities (including the Central Bank) undertaking a review of the asset management sector to assess sustainability-related disclosures and the integration of sustainability risks and specifically the risks stemming from incorrect and misleading disclosures on sustainability.

The ESMA statement specifically references adherence to the terms of the UCITS Directive and AIFMD as amended, as highlighted initially in our client update: Sustainable Finance – Changes for UCITS Managers and AIFMs which, in brief, requires UCITS management companies and AIFMs to specifically factor the consideration of sustainability risks into their investment due diligence process, risk management process and conflicts of interest policy (across all the funds managed, not just funds which disclose under Article 8 or Article 9 of SFDR).

Based on initial regulator correspondence issued pursuant to the ESMA CSA, it is notable that the scope of questioning extends beyond just the prescribed requirements under SFDR and the UCITS and AIFMD implementing acts, but also includes questions in respect of manager interpretations and approaches to greenwashing. Regulators have also sought information on how managers practically ensure integration of sustainability risks in terms of resource allocation, in addition to requesting that all written policies and procedures covering all aspects of sustainability-related disclosures and the integration of sustainability risks are submitted.

1.5 SFDR Pre-Contractual Disclosure: Spot Checks & Enhancing Transparency

When the Central Bank originally announced its SFDR fast track filing process in October 2022, it flagged that it would, in due course, conduct spot checks on the pre-contractual disclosures prepared for Article 8 and 9 funds. Such spot checks have commenced and more formal feedback in the industry may issue in due course. Based on some bilateral engagement with funds selected for spot checks, some initial observations are:

- In the context of Article 8 funds that are heavily reliant on exclusions, requests for additional disclosure on how these feed into the promotion of environmental and social characteristics within the fund strategy;

- Where there is high level reference to internal sustainability models / processes, requests for further disclosure providing detail of what these entail;

- In the context of exclusions being applied to certain issuers based on factors like "material" revenue, requests for quantitative parameters for these exclusions; and

- Sustainability disclosures in the main body of a fund supplement must be also be clearly addressed in the SFDR pre-contractual template.

The above is consistent with the general regulatory obligations of presenting investors with disclosure which affords them sufficient detail to make an informed decision on the investment being put to them, it is nonetheless instructive to see some of the particular points the Central Bank have been looking at in the context of SFDR.

1.6 ESMA Progress Report on Greenwashing

On 31 May ESMA published its Progress report on Greenwashing (the "Report"). This follows the European Commission *'Request for input related to greenwashing risks and the supervision of sustainable finance policies'* issued to the ESAs (ESMA along with the EBA and EIOPA) in May 2022.

In the Report ESMA sets out a common ESA understanding on greenwashing namely that *"greenwashing is a practice where sustainability-related statements, declarations, actions, or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product or financial service."* The Report assesses the concept of greenwashing risk as being the risk that *"misleading sustainability claims occur and mislead investors in their decisions".*

ESMA goes on to identify three main roles that arise in the context of greenwashing, namely trigger, spreader and receiver of a misleading claim. ESMA also notes that sustainability-related misleading claims can occur and spread either intentionally or unintentionally and that greenwashing does not require investors being actually harmed. ESMA further confirms that misleading claims may relate to all key aspects of the sustainability profile of a product or an entity, such as ESG governance and resources; ESG strategy, policies and credentials.

Accordingly the ESMA understanding of greenwashing is a wide ranging concept. This assessment is further supported by the broad range of examples ESMA provides where it notes that *"cherry-picking, omission, ambiguity, empty claims (including exaggeration), misleading use of ESG terminology such as naming and irrelevance,"* are considered to be some of the most widespread misleading qualities.

The Report identifies a number of preliminary remediation actions towards mitigating these greenwashing risks. These include reinforcing the regulatory framework by clarifying certain key concepts, in addition to ensuring that market participant across the sustainable investment value chain are aware of their responsibility to make substantiated claims and communicate sustainability information in a balanced manner.

The final ESMA report is expected at the end of May 2024.

1.7 CSSF Communication on the CSSF's Supervisory Priorities in the Area of Sustainable Finance

On 6 April 2023 the *Commission de Surveillance du Secteur Financier* ("CSSF") issued a press release outlining the CSSF's supervisory priorities in the area of sustainable finance. The focus areas for each type of supervised entity are:

1. Credit institutions:

   a) Transparency and disclosures

   b) The CSSF intends to supervise disclosures through the long form report (as revised by CSSF Circular 22/281) which now includes a dedicated section on sustainability disclosures and agreed upon procedure (AUP) reports on SFDR disclosures.

   c) Risk management and governance

   d) The CSSF plans a self-assessment exercise to review the level of alignment of the banking sector with the CSSF's expectations set out in Circular CSSF 21/773. It also will proceed with on-site inspections and perform a sample-based review of remuneration policies and practices.

   e) MiFID rules related to sustainability

   f) The CSSF expects supervised entities to anticipate the entry into application of the ESMA guidelines on MiFID II Suitability requirements. The CSSF will also perform on-site inspections based on an updated MiFID control plan, ESMA CSA on marketing communications and advertising under MiFID II.

2. Asset managers:

The CSSF will monitor compliance with SFDR, SFDR RTS and Taxonomy Regulation and focus on the below items on a risk-based approach:

   a) organisational arrangements of investment fund managers (IFMs), including the integration of sustainability risks by financial market participants

   b) Verification of the compliance of pre-contractual and periodic disclosures

   c) Verification of the compliance of product website disclosures

   d) Portfolio analysis

3. Investment firms:

   a) Transparency and Disclosures

   b) The CSSF plans to establish a self-assessment questionnaire.

   c) Risk management and governance

   d) The CSSF will prioritise the recognition of ESG risks in the strategies and governance arrangements of investment firms. It is also planned to update CSSF Circular 20/758 in due course

   e) MiFID rules related to sustainability

   f) The CSSF will implement the same actions as for credit institutions.

1.8 Extension of the Initial Submission Deadline for the SFDR Data Collection Exercise on Pre-Contractual Disclosures

On 4 May 2023, the CSSF issued a communication about the extension of the initial deadline of 15 June 2023 for the submission of the initial reports on pre-contractual product disclosures in relation to the Sustainable Finance Disclosure Regulation (EU) 2019/2088 ("SFDR") and the Taxonomy Regulation (EU) 2020/852 ("TR") .

The new deadline for the submission of the initial reports of all financial products within the scope of the data collection exercise is, on a best effort basis, by 15 June 2023 and at the latest by 31 October 2023.

The CSSF reiterated that the information provided shall be kept up-to-date and subsequent declarations shall be transmitted to that end.

For more information on these SFDR and Taxonomy Regulation data collection exercises launched by the CSSF, see our Q1 2023 quarterly update.

1.9 CSSF FAQ on Sustainable Finance Disclosure

On 5 May 2023, the CSSF published an updated FAQ on the SFDR modifying Section I 'Key European and CSSF publications' and deleting previous Question 8 on the methodology used to define sustainable investments.

1.10 Central Bank Amendments to QIAIF Post Authorisation Form

In June 2023, the Central Bank amended the Qualifying Investor AIF ("QIAIF") Post Authorisation form. The most significant change relates to the confirmations provided by the AIFM and legal advisers which now requires the AIFM to confirm the changes are not inconsistent with, in addition to the AIF Rulebook, the AIFMD Regulations, the Irish AIFM regulations (where relevant) and the CBI's published guidance, including Q&As on AIFMD. The legal advisers are also required to confirm the documentation is not inconsistent with the Central Bank's published guidance, including Q&As on AIFMD.

1.11 Thematic Review of Conflicts of Interest

The Central Bank, launched a thematic review of conflicts of interest policies and procedures within fund management companies and issued a questionnaire as the first phase of this review which focuses on:

- whether the firm has a written conflicts of interest policy in place and, if so, how often it is reviewed and by whom;
- whether the firm maintains a conflicts of interest register;
- whether conflicts are discussed at board meetings; and
- whether / how often the board and employees receive conflicts of interest training.

To support the responses, the Central Bank also asked to receive copies of the following:

- the conflicts of interest policy;
- the conflicts register;
- board minutes for the last year;
- recent conflicts training materials and attendance records; and
- any internal audit or external audit reports referencing conflicts of interest matters.

1.12 Irish Bribery and Anti-Corruption Law

On 3 May 2023, the European Commission presented proposals to introduce a directive to harmonise and strengthen anti-corruption rules and penalties across the EU, as well as a proposal to establish an anti-corruption agency in each member state.

The proposal extends the list of EU corruption offences to cover misappropriation, trading in influence, abuse of functions, as well as obstruction of justice and illicit enrichment related to corruption offences, beyond the more classic bribery offences. Member States would have to ensure that key preventive tools are in place, including effective rules on access to information, on conflicts of interests in the public sector, on assets of public officials and their interaction with the private sector (including rules on asset declaration, lobbying and revolving doors).

As a reminder on the current obligations, Maples published a client update, Irish Bribery and Anti-Corruption Law in Focus which detailed the entry into force of the Criminal Justice (Corruption Offences) Act 2018 ("2018 Act") on 30 July 2018. The 2018 Act consolidated Irish law on bribery and corruption and introduced a new form of corporate liability where a company is guilty of an offence if anyone acting on its behalf is found guilty of corruption.

1.13 FSB and IOSCO Consultation Report on Anti-Dilution Liquidity Management Tools

The FSB and IOSCO launched their respective consultations on liquidity risk and its management in open ended funds ("OEFs").

The IOSCO Consultation report aims to support greater use of anti-dilution liquidity management tools ("LMTs") by OEFs to mitigate investor dilution and potential first mover advantage arising from structural liquidity mismatch in OEFs.

In early July, the FSB published a consultation paper (the "Paper") intended to address structural vulnerabilities from liquidity mismatch in OEFs and proposes revisions to the FSB's 2017 policy recommendations, setting out key objectives of an effective regulatory and supervisory framework to address the vulnerabilities arising from liquidity mismatch in OEFs.

The main amendments proposed include:

- Providing greater clarity on the redemption terms that OEFs can offer to investors, based on the liquidity of their asset holdings, which would be achieved through a proposed bucketing approach where OEFs would be grouped into different categories depending on the liquidity of their assets with the OEFs in each category then being subject to specific expectations in terms of redemption terms and conditions.
- Ensuring availability of a broad set of anti-dilution and quantity-based LMTs for use by OEF managers in normal and stressed market conditions.
- Achieving greater (i) inclusion of LMTs in OEF constitutional docs and (ii) use / consistency in the use of these tools in both normal and stressed market conditions, with the objective of mitigating first mover advantage from structural liquidity mismatch in OEFs by imposing the costs of liquidity associated with their redemptions on redeeming investors.
- Requiring clearer public disclosures from fund managers on the availability and use of LMTs in normal and stressed market conditions with the aim of enhancing investor awareness on the objectives and operation of LMTs.

The revised recommendations, combined with the new IOSCO Guidance on anti-dilution LMTs aim to achieve a significant strengthening of liquidity management by OEF managers compared to other practices and feedback is sought for both in advance of 4 September.

1.14 Data Protection Law

The EU-US Data Privacy Framework (the "DPF") became effective on 10 July. If transferring personal data to entities that have self-certified under the DPF, EU data controllers can rely on such entity's DPF certification i.e. they do not have to put standard contractual clauses ("SCCs") or any other data transfer tool in place with the US recipient. For example, a fund could utilise the DPF if disclosing personal data of investors / directors etc. to a service provider in the USA who is DPF-certified.

Currently, organisations subject to the jurisdiction of either the Federal Trade Commission or the US Department of Transportation are eligible to self-certify that they are compliant with DPF principles, which track the core principles of the GDPR. All DFP-certified companies can be found on the Data

Privacy Framework List. This list must be checked before relying on the EU-US adequacy decision as a mechanism for transferring personal data outside the EEA.

EU data controllers can still rely on the SCCs and other data transfer mechanisms they may already have in place. If doing so, updating their Data Transfer Impact Assessments to reference the additional safeguards and redress mechanisms brought in by the DPF should be considered. These apply regardless of whether an entity is DPF-certified.

1.15 Monitoring the use of Telework

On 26 May 2023, the CSSF issued a press release in relation to CSSF circular 21/769, which entered into force on 1 July 2022, to inform the supervised entities that it is currently undertaking a data collection exercise on teleworking. For more information on CSSF circular 21/769, see our Q1 2022 quarterly update.

1.16 Undertakings for Collective Investment Statistics

Luxembourg

The main points to note in the CSSF's June 2023 update for regulated Luxembourg funds are as follows:

- Total net assets held by Luxembourg UCITS, Part II UCIs, SIFs and SICARs (regulated Luxembourg investment funds) amounted to € 5,197.746 billion as at 31 May 2023.
- The number of CSSF-regulated Luxembourg investment funds active in the markets totals 3,336.
- Of the 3,336 active Luxembourg investment funds, 2,182 entities adopted an umbrella structure and together have a total of 13,069 sub-funds. The remaining 1,154 are structured as stand-alone funds.
- As at June 2023, there were a total of 14,223 fund units.
- During June 2023, there were more redemptions than subscriptions in equity funds and fixed-income funds.

In addition, the number of Luxembourg RAIFs reached 2,365 as of 3 August 2023.

Ireland

In Ireland, the Central Bank released their own statistics on 30 May 2023 regarding investment funds.

- The net asset values ("NAVs") of Irish-resident funds continued to increase reaching €3,738 billion in the first quarter of 2023. Both large inflows (€7 billion) and positive revaluations (€76 billion) were the main drivers of this increase.
- Equity and Bond funds showed the most significant NAV increases of €78 billion and €31 billion respectively. Valuation gains for these two fund types accounted for almost 90% of the overall gains of IFs, due to currency appreciation.
- Money Market Funds (MMFs) showed NAV decreases of €31 billion driven by both investor outflows (€29 billion) and negative revaluations (€2 billion). The valuation losses were due to US dollar depreciation (€5 billion) offset by UK Sterling and Euro appreciation (€3 billion).

1.17 Department of Finance - Funds Sector Review 2030

The Department of Finance is conducting a wide-ranging review of the funds sector under the broad and interlinked themes of *Open Markets, Resilient Markets and Developing Markets* (the "Review"). The Review will seek to ensure that the funds sector in Ireland is resilient and that the regulatory and supervisory frameworks are future-proofed, supportive of macro-prudential stability, investor protection and consistent with international best-practice standards.

Key objectives of the Review include developing a framework within which Ireland can maintain its leading position in fund management and fund servicing and ensuring that the sector continues to support economic activity both at the regional and national level in Ireland.

Respondents to the online consultation are invited to address all or only a selection of the questions in the consultation paper. There is also the possibility to share any additional opinions, information or feedback that you may have on matters within the Terms of Reference that are not addressed directly in the specific questions within the consultation paper. The Maples Group will be participating in the consultation at industry level and is happy to discuss including client comments as part of our submission.

The deadline for this public consultation is 15 September 2023.

1.18 IOSCO Publishes Good Practices for Implementing its ETF Principles

Following on from their recent consultation paper on good practices for consideration, the International Organisation of Securities Commissions ("IOSCO") published its report on Good Practices Relating to the Implementation of the IOSCO Principles for Exchange Traded Funds (the "Report") in May 2023.

The Report builds on the Principles for the Regulation of Exchange Traded Funds published in 2013 (the "ETF Principles").

The Report notes that the global ETF market has evolved and grown since the publication of the ETF Principles. However, in good news, IOSCO has concluded that *"the ETF Principles remain relevant and appropriate. No major gaps have been identified, and no major regulatory issues were reported by IOSCO members or industry participants"*.

IOSCO further notes that the ETF structure has generally remained resilient during historical stress events, and that as at the date of the Report, no structural issues related to ETFs have been identified that have had a bearing on financial stability.

IOSCO propose 11 'good practices' (the "Good Practices") that regulators, responsible entities and / or trading venues are encouraged to consider and adopt for the implementation of the ETF Principles, spread across four different categories: (i) Effective Product Structuring, (ii) Disclosure (iii) Liquidity Provision, and (iv) Volatility Control Mechanisms.

The focus of the Good Practices is on the structural aspects or ecosystem within which ETFs operate, rather than the products themselves.

1.19 Central Bank Sanctions Screening

The Central Bank has issued a questionnaire to selected firms regarding sanctions compliance. This is a reminder of the importance of having a framework in place to ensure compliance with financial sanctions obligations such as:

- Development of a dedicated policy outlining processes in place to ensure compliance with financial sanctions obligations / updates to AML policies to capture in greater detail how processes in place to comply with financial sanctions obligations;
- Review of administration agreement terms (regarding delegation of the financial sanctions screening function);
- Updated prospectus disclosures;
- Enhancements to investor application forms; and

- Training on new and enhanced obligations for compliance with financial sanctions obligations (dedicated or as part of a wider training module on AML).

1.20 ESMA Guidelines on Certain Aspects of the MiFID II Requirements

On 31 March 2022, ESMA published a Final Report on Guidelines on certain aspects of the MiFID II remuneration requirements (ESMA35-36-2537) (the "MiFID Remuneration Guidelines"). The MiFID Remuneration Guidelines will replace the previous ESMA guidelines issued in October 2013.

The final MiFID Remuneration Guidelines were then published on ESMA's website on 3 April 2023 and will apply from 3 October 2023.

The MiFID Remuneration Guidelines provide clarifications regarding:

- Design of remuneration policies and practices;
- Governance; and
- Controlling risks related to remuneration policies and practices.

1.21 MiFID Suitability Guidelines

On 3 April 2023, ESMA also published guidelines on certain aspects of MiFID II Suitability Requirements ("MiFID Suitability Guidelines") and these will apply from 3 October 2023.

The MiFID Suitability Guidelines apply in relation to Article 25(2) of MiFID II and Articles 54 and 55 of Delegated Regulation 2017/565 ("MiFID II Delegated Regulation") and apply to the provision of investment advice and portfolio management.

Under the MiFID Suitability Guidelines firms will, inter alia, need to ask clients about their sustainability preferences as part of the suitability assessment and ensure that investment advice and investment decisions match those preferences.

1.22 Central Bank's New Enhanced Flexibility for QIAIF Digital Asset Exposure

On 4 April 2023, the Central Bank published a new AIFMD Q&A ("New Guidance") that increases the limits for a QIAIF seeking indirect exposure to digital assets and removes the need for a Central Bank pre-submission under the limits depending on the QIAIF's liquidity.

The New Guidance provides for the ability of a QIAIF to seek indirect exposure to digital assets and increases the limits, under which there is no pre-submission requirement to the Central Bank. Where a QIAIF is structured as open-ended, it can gain indirect exposure to digital assets of up to 20% of its NAV and where structured as closed-ended or open-ended with limited liquidity, it can it can gain indirect exposure to digital assets of up to 50% of its NAV.

The New Guidance outlines that a QIAIF seeking exposure to digital assets must comply with the following requirements:

- The AIFM must have an effective risk management policy addressing all risks relevant to an investment in digital assets, which must, at a minimum, address liquidity risk; credit risk; market risk; custody risk; operational risk; exchange risk; money laundering / terrorist financing risk; legal, reputational and cyber risk;
- The AIFM must carry out appropriate stress testing on the proposed digital asset investments. The New Guidance outlines the stress testing should be extreme yet plausible, reflecting asset price volatility of digital assets including the potential entire loss of value in the investment;
- The AIFM must have an effective liquidity management policy which includes a suite of tools that is sufficient to enable the AIFM to manage liquidity events arising in the QIAIF;
- The prospectus / supplement of the QIAIF must contain clear disclosure on the nature of the proposed digital asset investment and a clear articulation of the relevant risks associated.

1.23 Individual Accountability Framework

On 9 March 2023, the Central Bank (Individual Accountability Framework) Act 2023 ("IAF Act") was signed into law and will significantly change the regulation and governance of regulated financial service providers in Ireland ("RFSPs").

The IAF Act amends and updates three pieces of core legislation and gives the Central Bank power to make regulations to strengthen and enhance individual accountability in the Irish financial services industry.

The IAF Act is in the process of being supplemented by statutory instruments (regulations) issued by the Central Bank and regulatory guidance, some of which is currently under consultation (in the form of the Central Bank's Consultation Papers 153 and 154 ("CP153" and "CP154"). The main requirements of the IAF Act will not come into force until after the consultation processes have concluded.

The IAF Act comprises the following core elements:

- The introduction (initially on a limited-scope basis) of a new Senior Executive Accountability Regime ("SEAR");
- The introduction (for all Irish RFSPs) of new "Common Conduct Standards" and "Additional Conduct Standards", applicable to certain individuals in RFSPs, and new "Business Standards" applicable to the firms themselves;
- Enhancements to the Central Bank's Fitness and Probity regime; and
- Changes to the Central Bank's investigation and enforcement process, and the administrative sanctions procedure.

For further information please see our update, CP153: CBI Consults on Individual Accountability Framework as Act Becomes Law.

The Maples Group is working with a number of managers on assessing the impact of the IAF Act on their business and putting in place frameworks to comply with the relevant requirements.

1.24 Update of CSSF's FAQ Regarding the AML / CFT Market Entry form (FUNDS and IFMS)

On 29 June 2023, the CSSF published an updated version of its FAQ on the AML Market Entry Form for funds and IFMs. It clarifies the circumstances in which a market entry form should be completed.

1.25 FATF AML Report on Luxembourg

On 23 June 2023, the FATF announced its adoption of the mutual evaluation report of Luxembourg following its recent inspection of the country's AML regime. The FATF concluded that Luxembourg has reached a high level of technical compliance with the FATF's requirements and that its AML / CFT regime is delivering good results. The report found that Luxembourg needs to focus on strengthening its measures in certain areas, including improving the detection, investigation and prosecution of more complex money laundering cases. The FATF will publish the report by September after the FATF's quality and consistency report is published.

1.26 Virtual Assets Investments in Luxembourg

On 6 April 2023, the CSSF published an updated FAQ on virtual assets amending Question 2 and introducing a new Question 3A. It clarifies that a Luxembourg investment fund manager ("IFM") does not require a specific license in order to manage an AIF investing in virtual assets through one or several target funds. However, to the extent the AIF invests more than 20% of its NAV in one or more target funds, the IFM must obtain a license for the 'fund of funds' strategy. In addition, it outlines that it is the IFM's responsibility to determine whether the target fund's main exposure is to virtual assets and in such circumstances to undertake an assessment of the ability of the target fund's manager to identify and manage the risks pertaining to investments in virtual assets.

1.27 Central Bank Discussion Paper on Macroprudential Policy for Investment Funds

The Central Bank has published a Discussion Paper on *An approach to macroprudential policy for investment funds*. The Discussion Paper ("DP11") presents an overview of key considerations for developing and operationalising a macroprudential framework for the funds sector given its growing importance for the functioning of the financial system and real economy. It is designed to engage stakeholders, domestically and internationally, in order to further advance discussion and progress in this area. DP11 seeks views on a number of issues, including the nature of the systemic risk in this context; the current regulatory framework for the funds sector; the objectives and principles of macroprudential policy; the design of macroprudential tools; and considerations for operationalising the macroprudential framework for the funds sector. The Central Bank invites relevant stakeholders to provide written responses to the questions contained throughout DP11 until 15 November 2023. Stakeholders are also invited to provide any general observations on the matters discussed or issues raised.

2 Tax

2.1 Increase in Revenue Level 1 Interventions in Relation to VAT Recovery

In general, the activities carried on by regulated funds in Ireland are VAT exempt activities involving the issuing, transferring or otherwise dealing in stocks, shares, debentures and other securities. However, Irish regulated funds can still suffer VAT on services provided to them and, where they receive non-exempt services from outside Ireland, the Irish fund is required to register and account for Irish VAT in relation to that supply of services.

Where an entity is carrying on VAT exempt activities in the nature of issuing, transferring or otherwise dealing in stocks, shares, debentures and other securities, the entity can recover VAT charged to it where those services are supplied outside the EU, i.e. where they are provided to a non-EU recipient. Published guidance of the Irish Revenue Commissioners ("Revenue") on VAT deductibility for the funds industry acknowledges this basis of VAT recovery for regulated funds, stating that when considering the entitlement to deduct VAT, it is the qualifying activities related to the share dealing activity that needs to be taken into account.

In their guidance, Revenue reference two specific approaches that can be taken in relation to VAT deductibility for Irish funds. The first method is based on the level of non-EU investments that are included in the fund's NAV (effectively the amount of non-EU shares owned or amount of shares traded with non-EU persons). The second method is based on the quantum of non-EU investors in the fund (effectively the amount of the fund's own shares owned or traded by non-EU investors). Revenue's view is that the asset basis is the most reliable or correct in terms of reflecting the use to which costs incurred are put. They also note that the investor basis may be used only where it can be demonstrated that it more accurately reflects the use to which the costs incurred are put.

We have seen an increase in Level 1 Intervention queries from Revenue in relation to the VAT recovery basis adopted by regulated funds, particularly where the investor basis has been relied on. Fund boards and managers should ensure that full and appropriate records have been kept in relation to the VAT recovery position adopted and the reasoning applied. Where any queries are received from Revenue, it is important to take appropriate advice and ensure a full and appropriate response is prepared. Our Tax Team have assisted in a number of cases and would be happy to advise where any interventions arise.

2.2 Ecofin Report: Proposed ATAD3

(Unshell Directive) Still Not Finalised after 11 Rounds of Negotiations among EU Member States.

On June 16, 2023, the Ecofin Council submitted a report to the European Council on the status of various tax projects including the proposed European Commission Directive on the Misuse of Shell Entities for Tax Purposes ("Proposed Unshell Directive" or "Proposed ATAD3"). The report highlighted that since the Proposed Unshell Directive's initial draft release on 22 December 2021, there are still several controversial matters for the EU Member States to resolve. So far, there have been 11 rounds of negotiations between the EU Member States spanning over 18 months.

If and when the Proposed Unshell Directive is adopted, it is expected to have a substantial impact on European holding and financing structures.

Due to the delays in negotiation, the Proposed Unshell Directive is expected to be effective in EU Member States as of 1 January 2025 and with only a one year look back.

For our summary of the Proposed Unshell Directive's initial draft version, please see our update, Proposed EU Directive on Shell Entities – The Impact on International Business.

2.3 Taxation of Luxembourg Reverse Hybrid Entities: New Circular and Compliance Guidelines Issued

On June 9 2023, the Luxembourg tax authorities released an initial administrative Circular regarding the taxation of Luxembourg reverse hybrid entities, which includes tax transparent entities and arrangements that meet the conditions specified in Article 168quater of the Luxembourg Income Tax Law ("LITL"), along with a Q&A document concerning the corresponding annual return (Form 205) that was published earlier this year. Additional administrative guidelines are anticipated, particularly regarding the collective investment vehicle exemption and the hybrid mismatch rules.

In the Circular, the Luxembourg tax authorities have confirmed that a Luxembourg reverse hybrid entity will be subject to Luxembourg corporate income tax as a resident taxpayer, rather than as a resident corporation, and thus subject generally to a rate of 18.19%. The Circular also confirmed that distributions of income by a reverse hybrid entity to its partners are not subject to Luxembourg withholding tax, and that several domestic rules would not be applicable to reverse hybrid entities including Luxembourg's CFC rules, the participation exemption regime, and the interest limitation rules.

With respect to tax compliance, the new Form 205 will replace Form 200 for transparent entities that primarily generate income from movable capital and will requires the reporting of the net income subject to the reverse hybrid rules as well as a list of all direct and indirect investors of the reverse hybrid entity.

For further information please see our update, Taxation of Luxembourg Reverse Hybrid Entities: Initial Administrative Circular and Compliance Guideline (Form 205).

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