This newsletter outlines Northern Trust's thoughts about recent regulatory changes, and how they might affect your programmes. It summarises recent developments impacting the financial industry and how Northern Trust will support clients through this period. For more information, contact your Northern Trust representative or visit northerntrust.com.
REGULATORY OUTLOOK

UPDATE ON THE REGULATORY LANDSCAPE

While our focus has gradually shifted away from Brexit – recognising that financial services regulatory cooperation discussions are ongoing, with a view to producing a Memorandum of Understanding – we continue to see a focus from regulators on performance fees and cost disclosures, with the European Securities and Markets Authority (ESMA) publishing guidelines in 2020.

Regulators in the region continue to focus on governance, management and oversight frameworks, with an increased focus on culture and accountability. For example, the outcome of the recent review of the implementation of fund management effectiveness framework (known as CP86) by the Central Bank of Ireland has highlighted a number of remediation actions for firms, with board-approved compliance action plans required to be in place by the end of March 2021.

Developments in the anti-money laundering (AML) regulatory space are also gaining pace, with moves towards a centralised European Union (EU) supervisor. Further guidance is also due to be published by regulators on the potential risks applicable to cryptocurrency assets.

We expect these areas to be the focus of most new regulation, as well as financial stability, resilience and measures aimed at encouraging retirement provision for an increasingly aging global population.
WATCHING BRIEF

UPCOMING REGULATORY CHANGES

It remains clear that the volume of regulation impacting Europe’s cross-border funds industry shows little sign of slowing down. We continue to track regulatory developments across this area with key items in the pipeline across the region highlighted below:

• Introduction of the overseas funds regime for recognising EU Undertakings Collective Investment in Transferable Securities (UCITS) funds and money market funds in the United Kingdom (UK).
• Launch of the UK’s Long-Term Asset Fund.
• Further development of the UK regulatory framework in the post-Brexit world and what any potential divergence means for the future relationship with the EU.
• Further developments on climate change and environmental regulation, and global developments in environmental, social and governance (ESG) initiatives.
• Further updates to the Markets in Financial Instruments Directive (MiFID) II legislation, following consultations launched by ESMA in 2020.
• The final two tranches of implementation of margin rules.
• Additional focus on liquidity monitoring following the market volatility caused by the COVID-19 pandemic, likely to focus particularly on money market funds.
• Developments in data privacy legislation following the Schrems II judgement in July 2020.
• Developments in the regulation of crypto assets, including the EU’s Markets in Crypto Assets (MiCA) Regulation, and the recent HM Treasury consultation and call for evidence on the UK regulatory approach to crypto assets and stablecoins.

Whether change is initiated locally or not, the continuing evolution of regulation continues to require vigilant monitoring.

Northern Trust dedicates significant time to tracking and analysing the implication of regulatory change. Should you wish to find out further details please contact your Northern Trust representative.
INVESTMENT FIRM DIRECTIVE AND REGULATION

INTRODUCTION

In December 2019, the Investment Firm Directive and Regulation (IFD/IFR) came into force with implementation of the main provisions applicable from June 26, 2021. This prudential regulatory framework will harmonise the approach to capital requirements for investment firms, which fall below the thresholds for the capital requirements regulation (CRR) applied to credit institutions and significant investment firms today.

The intention of IFR/IFD is to ensure all investment firms authorised in the EU under MiFID are subject to a single harmonised prudential regime.

FIRM CLASSIFICATION AND THRESHOLDS

As part of the implementation, firms are divided into different classes with different treatments applicable dependent on classification. A firm’s classification under the regulation is the key factor in determining impacts going forward; therefore, the most important immediate step is for the firm to carry out an internal assessment against the criteria to determine what category it will fall into.

These categories are:

- **Class I**: systemic/large investment firms with a balance sheet greater than €30bn and carrying out bank-like activities will be classified as credit institutions, and subject to the Capital Requirements Directive & Regulation (CRD/CRR).
- **Class II**: non-systemic investment firms which exceed quantitative thresholds will be in scope for all IFD/IFR rules.
- **Class III**: non-systemic investment firms, defined as small and non-interconnected with a simplified business model and reduced scope of activities, will be subject to limited aspects of IFD/IFR.

Monitoring of the classification thresholds together with the newly introduced ‘K-factors’ will be required on an ongoing basis, with reporting expected periodically. Class II firms will be the most impacted by the new prudential regime. They will be subject to the following key areas:

1. Regulatory capital and liquidity requirements, including using K-factors for calculating capital requirements
2. Governance
3. Remuneration
4. Regulatory reporting
5. Public disclosure

Gerry Cross, Director of Policy & Risk and Asset Management and Investment Banks (Interim), Central Bank of Ireland:

“The new prudential requirements for investment firms, a bespoke regime for investment firms rather than one primarily designed for banks, will strengthen the financial resilience of and consumer protections offered by MiFID investment firms. Overall, we expect the increased resilience and risk-readiness of investment firms arising from the introduction of this new regime to bring greater investor confidence.”

From a speech to the KPMG Investment Firms Regulation and Directive Webinar
January 27, 2021
FIRM ACTIVITIES AND OWN FUND REQUIREMENTS

The new regime will also bring changes to capital requirements. Initial capital requirements will continue to serve as the absolute minimum at the point of authorisation and are increased slightly from existing CRR requirements, but there will also be own fund requirements, which an investment firm will need to satisfy at all times.

To calculate the new capital requirements, firms will need to base this on the firm’s activities, known as K-factor methodology. K-factors will apply to investment firms that fall under the new framework and are essentially risk parameters used in the classification of investment firms and the new calculation methodology for capital requirements.

They are quantitative indicators that aim to identify risks that an investment firm may pose to clients, markets or liquidity, as well as to the firm itself. These K-factors mean that, in the future, investment firms will have to calculate their capital requirements on the basis of these new risk metrics.

The K-factors have been divided into three groups:

- Risks to customers (RtC): Items include: Assets under management / Client money held / Assets safeguarded and administered / Client orders handled
- Risks to market access or liquidity (RtM): Items include: Clearing member guarantee or Net position risk
- Risks to the firm itself (RtF): Items include: Concentration risk / Daily trading flow

REPORTING OBLIGATIONS

Firms are required to report the level and composition of their own funds, their own funds’ composition and their own funds’ requirements, and the basis of the calculation, their activity profile and size and liquidity requirements.

UK INVESTMENT FIRM PRUDENTIAL REGIME

The UK’s Financial Conduct Authority (FCA) was a key stakeholder in the development of the IFD/IFR, however, in a statement published in June 2020, the UK indicated it is seeking to tailor the implementation of EU regulations implementation post-transition period. The FCA has begun consultation on the UK-specific prudential regime, to be known as the Investment Firm Prudential Regime (IFPR).

In November 2020, the FCA announced a delay to the implementation of IFPR to January 1, 2022.

Northern Trust Actions

At Northern Trust, we reviewed the regulatory requirements for firms under the Investment Firm Directive and Regulation and understand that the majority of the burden of implementation will fall to investment managers. However, there are a number of data elements which may be required to support the classification determination or K-factor production. If you think you will require our support, or should you wish to discuss this topic in further detail, please contact your Northern Trust representative.
TRANSITION AWAY FROM LONDON INTERBANK OFFERED RATE (LIBOR)

MORE CLARITY HAS EMERGED ON HOW AND WHEN LIBOR WILL CEASE

Further clarity on how and exactly when LIBOR will cease has emerged, with an announcement from the Financial Conduct Authority (FCA) on March 5 of the dates that panel bank submissions for all LIBOR settings will cease, after which representative LIBOR rates will no longer be available:

“The FCA has confirmed that all LIBOR settings will either cease to be provided by any administrator or no longer be representative:

• Immediately after December 31, 2021, in the case of all sterling, euro, Swiss franc and Japanese yen settings, and the 1-week and 2-month US dollar settings; and
• Immediately after June 30, 2023, in the case of the remaining US dollar settings”

In an accompanying press release, Andrew Bailey, Governor of the Bank of England, urged market participants to prepare for the cessation of LIBOR – “With limited time remaining, my message to firms is clear – act now and complete your transition by the end of 2021.” This announcement follows the conclusion of consultations by ICE Benchmark Administration (IBA), LIBOR’s administrator. Its proposals were broadly supported by regulatory authorities.

“Together with the actions taken at the end of last year, these announcements provide a clear end-date for USD LIBOR and a clear path for the change to alternative reference rates.... In the months ahead, supervisors will focus on ensuring that firms are managing the remaining transition risks,” said Randal K. Quarles, Vice Chair for Supervision at the Federal Reserve Board and Chair of the Financial Stability Board.

The later June 30, 2023 end-date for USD LIBOR settings is intended to allow for more legacy LIBOR-linked contracts to mature on their existing terms. United States (US) supervisory guidance is clear that firms should not enter into new transactions referencing USD LIBOR after December 31, 2021, given potential “safety and soundness concerns”. 

The Board of Governors of the Federal Reserve System Federal Deposit Insurance Corporation Office of the Comptroller of the Currency:

“The LIBOR transition is a significant event that poses complex challenges for banks and the financial system. The agencies encourage banks to cease entering into new contracts that use USD LIBOR as a reference rate as soon as practicable and in any event by December 31, 2021, in order to facilitate an orderly – and safe and sound – LIBOR transition.”

Statement on LIBOR Transition
November 30, 2020
On the launch of the consultations, the FCA issued a statement pledging to coordinate with US authorities and those in other jurisdictions to consider how to limit new use of USD LIBOR. The International Swaps and Derivatives Association (ISDA) hosted a webinar with the FCA, Federal Reserve Board of Governors and Chairman of the Alternative Reference Rates Committee (ARRC), providing more detail on what this means for the market and next steps.

Also on March 5 ISDA confirmed that the FCA’s announcement “...constitutes an index cessation event under the IBOR Fallbacks Supplement and the ISDA 2020 IBOR Fallbacks Protocol”, thereby fixing the fallback spread adjustment published by Bloomberg. The fallbacks (i.e., to the adjusted risk-free rate plus spread) will automatically occur for outstanding derivatives contracts that incorporate the supplement or are subject to adherence of the protocol in line with the above cessation dates.

While the ARRC expects that many more legacy USD LIBOR contracts will mature by mid-2023 under IBA’s proposals, a number will remain, including those lacking effective means to replace LIBOR (“tough legacy” contracts). The ARRC confirmed in its Guide on the Endgame for USD LIBOR that it will continue to pursue a legislative proposal with New York State, expressing a strong belief that such legislation remains necessary – similar federal legislation is being contemplated.

Seeking to solve a comparable challenge, the European Council has agreed to an amendment to the EU Benchmark Regulation providing for a statutory replacement of a critical benchmark with an alternative risk-free rate in case of that benchmark’s cessation. The mechanism is similar to that proposed by the ARRC, though it remains unclear how approaches in different jurisdictions will interact.

The FCA began consultations and released more details on proposed new powers, including creation of a synthetic LIBOR, under the Financial Services Bill. Use of synthetic LIBOR is for “tough legacy” contracts – use in new contracts will be prohibited. Publication of synthetic LIBOR depends on an announcement that LIBOR has or will become unrepresentative as a benchmark; ISDA fallbacks would still be triggered. New powers will only be applied for the LIBOR settings most commonly used in “tough legacy” contracts (e.g. GBP LIBOR) and where the inputs are available. EUR LIBOR and CHF LIBOR are likely to cease completely. The FCA will publish further details in Statements of Policy after various consultations conclude.

With more to come, there have also been significant accomplishments. Global lending markets were highlighted as an area that has lagged the pace of progress, with the Financial Stability Board (FSB) encouraging market participants to “act quickly to move new business onto alternative rates”. More positively, the ISDA launched updated definitions and a protocol that will embed appropriate contractual language and a ‘fallback’ alternative Risk Free Rate (RFR) – e.g. the Sterling Overnight Index Average (SONIA) and Secured Overnight Financing Rate (SOFR) – plus a spread in new and existing LIBOR linked swap contracts, a significant milestone for the industry supported by global regulators.

Northern Trust Actions

At Northern Trust, an enterprise-wide programme is in place to guide the LIBOR and IBOR transition. This programme has organisational subject matter experts implementing a multi-year plan, driven by client- and product-focused work streams, to manage the transition from the IBORs to alternative RFRs or other benchmark rates.

Northern Trust is monitoring and participating in industry forums to evaluate alternative reference rates, fallback language and best practices to prepare for upcoming changes. Quarterly meetings are ongoing with the Federal Reserve Bank of Chicago and the Prudential Regulatory Authority in the UK. For Northern Trust’s Asset Servicing business, the scope of impacts and high-level requirements have been documented by product.
As of the end of January, more than 13,000 parties had adhered to the protocol (list of adherents). Derivatives clearing houses transitioned to using the ESTR rate in discounting calculations on July 27. A similar transition happened in the US on October 16, from Fed Funds to SOFR, impacting a larger volume of swap contracts and triggering an increase in liquidity in that market. Term SONIA rates have recently gone live in the UK and plans remain for Term RFRs in the US and Japan by mid-year.

While EURIBOR is expected to continue, two consultations on EURIBOR fallbacks have been released by the European Central Bank’s Euro RFR Working Group with deadlines in January. One is seeking views on ESTR-based fallback rates; the other seeks opinions on a generic set of potential fallback trigger events. The Swiss regulator (FINMA) published a transition roadmap for LIBOR, with recommendations aligning to the timetable for LIBOR transition proposed by the FSB. In the Netherlands, regulators issued a report on benchmark reform, summarising findings from its information request sent to banks and other financial institutions earlier this year.

The key message from regulators globally is to keep up the pace of transition efforts. Key milestones on the ARRC’s paced transition plan still stand, as they remain relevant to the goal of moving away from LIBOR in new business as soon as practical – e.g. the end of Q2 2021 target for no new USD LIBOR business loans, securitisations or derivatives that increase LIBOR risk. A priority on the UK working group’s roadmap is for firms to complete identification of all legacy GBP LIBOR contracts expiring after 2021 that can be actively converted by end-Q1, and progress active conversion where viable through to completion by end-Q3 2021. More intervention from regulators can be expected if they do not see progress against these targets.

Northern Trust Actions (continued)

The programme performed a detailed gap analysis and has developed execution plans. Development to ensure robust and scalable support for alternative RFRs is in progress. Client-specific engagements to discuss LIBOR transition planning are continuing throughout Q1 2021.
CENTRAL SECURITIES DEPOSITORIES REGULATION (CSDR)

INDUSTRY AND REGULATORY DEVELOPMENTS

The Central Securities Depositories Regulation (CSDR) aims to increase safety and improve settlement efficiency, as well as provide a set of common requirements to ensure the safety of EU Central Securities Depositories (CSDs).

To support this, CSDR has been harmonising the authorisation and supervision of CSDs within the EU since 2014. Since 2014, there has been a phased introduction of the requirements, including:

- T+2 settlement cycle
- Authorisation, including strict prudential and conduct rules for CSDs
- Internalised settlement reporting
- Omnibus and segregated accounts, including risk and cost disclosures

As with other EU regulations, Article 75 of CSDR requires the European Commission (EC) to prepare a report on its implementation and submit it to the European Parliament and Council, including any proposed legislative changes if necessary. To support this in December 2020, the EC issued a targeted consultation for stakeholders to provide input on the implementation to date. The feedback is sought on a wide range of specific areas where targeted action may be necessary to make the objectives of the regulation more proportionate, efficient and effective.

The consultation also requests that feedback takes account of recent developments regarding the pressure put on the market by the COVID-19 pandemic. The consultation closed on February 2, 2021, and we anticipate any proposed legislation to be published in Q4 2021.

SETTLEMENT DISCIPLINE REGIME UPDATE

The next key requirement due to be implemented is the Settlement Discipline Regime (SDR), under which any instrument cleared at an EU central clearing house or settled by an EU trading venue or EU central securities depository (CSD) is in scope. The primary objective of the enhanced SDR is to incentivise timely trade settlement, reduce settlement risk and ultimately increase the safety of securities settlement across the European Economic Area (EEA) markets.
This is to be achieved by the introduction of cash penalties and mandatory buy-ins. In our H2 2020 newsletter, we highlighted that the European Securities and Markets Association (ESMA) has proposed a delay in the implementation timeline of settlement discipline to February 2022 due to continued industry challenge and the operational impacts of COVID-19. This delay has been approved by the EC.

Even though the SDR has not yet been implemented, the survey published by the EC has included questions on the framework, which is seen as a positive step in addressing some of the industry concerns being raised. Of challenge is the implementation of buy-ins; considering increased settlement failures experienced during market volatility resulting from the pandemic, these could be seen to have a negative impact on the market at times of stress. Further clarity on the roles of buy-in agents is required.

Northern Trust Actions (continued)

Our core impacted products and services have identified service offering changes for cash penalties to support readiness activities. We have commenced on-boarding an external third-party system for the management of messaging and cash penalties, as well as daily and monthly reporting.

Northern Trust representatives are actively engaged in industry associations the Association for Financial Markets in Europe (AFME), Association of Global Custodians (AGC) and the Investment Association (IA) to ensure we continue to monitor regulatory developments and support ongoing industry lobbying and development of market practice guides where open questions remain. We continue to monitor any developments resulting from the EC survey and will provide any updates to you on these as they arise.
SUSTAINABLE FINANCE DISCLOSURES REGULATION (SFDR)

INTRODUCTION

In our previous newsletter, we highlighted the introduction of the new EU regulation on sustainability-related disclosures in the financial services sector (SFDR). SFDR introduces disclosures for financial market participants at both the firm and the product level and was scheduled to be implemented on March 10, 2021.

Financial market participants are required to disclose how they have integrated an assessment of sustainability risks into policies, processes and due diligence. In late 2020, the EC acknowledged there were delays in the production of the implementing technical standards, and that these would now be required at a later date.

SDFR: REGULATORY TIMELINE OVERVIEW

RECENT DEVELOPMENTS

The EC confirmed however that the level 1 measures of the legislation would continue to apply from March 10, 2021. Subsequently, a revised level 2 regulatory technical standard (RTS) was published on February 4, 2021.

This revised technical standard seems to have taken onboard some of the feedback that industry bodies and firms provided on the previous April 2020 draft consultation. This final draft is pending ratification from the EC within the next three months, and it is anticipated (pending confirmation) that the level 2 measures in the RTS will now come into force on January 1, 2022.
Compliance with the requirements of the level 1 text was required to be in place by March 10. To meet these level 1 requirements, firms must undertake fund classification to identify which article the fund falls into, being either Article 8 – a fund which promotes environmental or social characteristics, or Article 9 – a fund that has sustainable investment as its objective in terms of sustainability factors.

Prospectus updates are required for sustainable products, including steps taken to determine classification. Firms must also disclose a policy on the integration of sustainability risk in investment decision-making, review and update management policies including disclosures related to sustainability risks and remuneration.

A due diligence policy relating to the “principal adverse impacts” (PAI) of ESG investment decisions is also required. Policy updates are to be included as part of website disclosures (even if in summary form). It is important to note that even if sustainability factors are not taken into account, firms must include a statement as to why they do not consider principle adverse impacts to apply. Further periodic disclosures to allow investors to understand how funds are achieving their Article 8 or Article 9 objectives are being implemented from January 1, 2022.

Following widespread criticism of the principle adverse impact disclosures in the original consultation from April 2020, which included 50 items of which 32 were mandatory, the revised RTS has significantly reduced the volume of mandatory indicators to 14 for investment companies, albeit the volume of indicators has increased. The PAI return is annualised, meaning firms will be required to collate the data on a quarterly basis from January 1, 2022 to December 31, 2022, with the first return required in June 2023.

For UK firms, the SFDR legislation was not on-shored as part of the Brexit withdrawal agreement legislation process, therefore the management level disclosures may not apply. However, there may be circumstances where product level rules apply, e.g. for a fund marketing into an EU country under the national private placement regime of the Alternative Investment Fund Managers Directive (AIFMD); the fund level disclosures would continue to apply in this instance. Firms should prioritise identifying funds falling within the scope of the legislation to ensure any extra territorial obligations are met.

**Northern Trust Actions**

At Northern Trust, our Investment Risk and Analytical Services (IRAS) product team has a suite of environmental risk reporting in place called ‘ESG Insights’. If you would like to discuss this topic in further detail, please contact your Northern Trust representative.
In our newsletter in H2 2020, we highlighted that the European Supervisory Authorities (ESAs – the European Banking Authority [EBA], the European Securities and Markets Authority [ESMA] and the European Insurance and Occupational Pension Authority [EIOPA]) had notified the EC that it was unable to submit a revised technical standard for ratification, updating the Key Information Document (KID) disclosures. Although both the European Banking Authority and ESMA were supportive, the board of members of EIOPA failed to approve the draft.

In December 2020, the EC invited the ESAs to jointly submit draft regulatory technical standards amending the KID within six weeks, but also clarifying how it foresees a broader review of the PRIIPs regulation as a priority for the EC. This upcoming assessment will be part of the new Capital Markets Union action plan, and will thoroughly examine the application of the PRIIPs framework, including:

- How to achieve better alignment between PRIIPs Insurance Distribution Directive (IDD) and Markets in Financial Instruments Directive II (MiFID II) regarding provisions on costs disclosure
- The scope of products as foreseen by the PRIIPs Regulation
- How to ensure that the KID contains the key information necessary for retail investors, while avoiding too much or too complex information for these investors
- How to allow the creation of a digitalised KID, allowing layered information and reviewing the default paper basis of the KID, taking into account the specific challenges for different types of products (e.g. multi-option products [MOPs])
- The need for a more tailored approach, such as for MOPs, in order to maximise understanding and use of the information, while continuing to allow for comparability of similar products

A Retail Investment Strategy, due in the first half of 2022, will aim to identify the shortcomings and propose remediation measures to allow retail investors to take full advantage of capital markets.

Following these further details and approach to a wider review being provided by the EC, EIOPA Board of Supervisors further analysed the draft RTS, which was adopted by a qualified majority on February 3, 2021.

Northern Trust Actions

At Northern Trust, we continue to monitor regulatory developments to ensure our existing PRIIPs KID and transaction cost product remains compliant with the regulatory requirements. As before, should you wish to discuss this topic in further detail, please contact your Northern Trust representative.
PAN-EUROPEAN PERSONAL PENSION PRODUCT (PEPP)

Regulation on the pan-European Personal Pension Product (PEPP) was published in July 2019 and came into force 12 months after publication in the official journal. The PEPP will be an individual long-term savings product designed to harmonise the EU pensions market.

With less than a third of Europeans saving for a private retirement, and diversity of regulation hindering the development of a competitive market for pensions, the PEPP is being introduced to complement the existing pensions market, with an aim of being portable, simple and cost-efficient.

On August 14, the European Insurance and Occupational Pensions Authority (EIOPA) published draft regulatory and implementing technical standards on the framework to implement the PEPP. In December 2020, two mandatory consumer information documents have also been adopted by the PEPP Key Information Document (PEPP KID) and the PEPP benefit statement. PEPP consumer information documents introduce a holistic approach for assessment of PEPPs’ risk-reward profiles, with summary risk indicators in PEPP KID.

EIOPA notes that the success of the PEPP will depend on strong supervision and close cooperation between national competent authorities (NCAs) in all EU member states; regular supervisory reporting will be required.

EIOPA has issued advice on supervisory reporting and criteria for intervention powers, to ensure efficient supervision for the monitoring of the PEPP market at national and EU level. It is estimated the first PEPP products will appear at the end of 2021.

EUROPEAN LONG-TERM INVESTMENT FUNDS (ELTIF) REVIEW

Following a request for input from the EC in October 2020, the European Securities and Markets Authority (ESMA) wrote to the EC on February 3, 2021, highlighting some areas of the ELTIF Regulation where improvements could be made, and that it sees the need to consider amendments to the framework as part of its review.

In its letter, ESMA highlighted the low number of ELTIF registrations across the region, and noted the balance required between marketing these funds to make them an attractive investment vehicle for professional investors and a savings placement alternative for retail investors.

The original objective of the framework was to improve access to funding for small and medium enterprises (SMEs), and enable the ELTIF to support the recovery for the European economy and deepen the capital markets union (CMU). ESMA considers that the review of ELTIF framework should focus on the following areas where amendments could be put forward:

Currently 25 European Long-Term Investment Funds are registered across the region with 17 active from 4 countries.
ELIGIBLE ASSETS AND INVESTMENTS

Further extension and clarification of ELTIF’s eligible assets and investments could help accelerate the creation and further development of ELTIFs, with suggested measures including:

1. Clarifying the definition of real asset
2. Allowing ELTIFs to invest in other funds
3. Reducing the amount of €10mn in relation to the investment in direct or indirect holdings
4. Softening the requirements of “majority owned subsidiary”

AUTHORISATION PROCESS

The requirement for the competent authority of the ELTIF to provide approval to the EU Alternative Investment Fund Manager (AIFM) intending to manage the ELTIF supplementary to existing authorisation under AIFMD. The requirements for this additional authorisation may create confusion as to responsibilities of the two competent authorities, and therefore this requirement should be considered for removal.

CONFLICTS OF INTEREST

Article 12 of the regulation implies that an ELTIF and an AIF managed by the same EU AIFM cannot co-invest with similar terms and conditions in the same assets. This could result in the investment in the same assets aimed at aligning interest between fund and manager being prohibited. Clarification is sought as to the situations to which Article 12 of the regulation applies.

PORTFOLIO COMPOSITION AND DIVERSIFICATION

The limits of risk spreading imply making a minimum 10 investments. For infrastructure projects, the need to make 10 investments per ELTIF may be costly and difficult to achieve. If it is considered relevant to distinguish between ELTIFs marketed to retail investors and those marketed to professional investors; in the case of ELTIFs only subscribed by professional investors, it could be considered to lower? these limits so that an ELTIF may be allowed to invest in less than 10 investments.

REDEMPTIONS

As closed-ended funds, ELTIFs currently only allow redemptions at the end of life of the fund (except for limited circumstances). This is due to the illiquid nature of the assets invested in, and that valuation is only assessed at the time of disinvestment.

To address concerns of retail investors who may perceive their investment as locked in, a possible option would be to develop a regime for an ELTIF of indefinite duration, e.g. admitted to trading on regulated markets and provided minimum liquidity conditions are met. Disinvestment would only be allowed on secondary market.
DISPOSAL OF ELTIF ASSETS
The requirement to disclose to the competent authority the schedule for the orderly disposal of assets, in order to redeem investors units or shares after the end of the life of the ELTIF, appears burdensome and may not be required. Understanding of the nature of the relevant schedule is required in advance of withdrawal of the requirement.

PROSPECTUS AND COST DISCLOSURE
The information that must be provided in the prospectus may veil the key messages to the investor; consideration to the order of presentation of the messages, or reduction in the amount of mandatory information, may be required.

LOCAL PHYSICAL PRESENCE
The requirement for ELTIF managers to set up local facilities in each member state they intend to market ELTIFs creates additional costs, and the obligation was removed in June 2019 for cross-border distribution of collective investment undertakings (UCITS and AIFs distributed to retail investors). Removal of this obligation for all ELTIF investors could make them more attractive.

OTHER RESIDUAL AREAS:
• Professional investors – making some of the requirements more flexible for professional investors could make the investment in ELTIFs more attractive.
• Investment incentives – ESMA is of the view that a favorable tax treatment across the EU would encourage retail participation and could be decisive in making ELTIFs more attractive across the EU.
• Eligibility criteria for investors and consistency with the European Venture Capital Fund (EuVECA) and European social entrepreneurship funds (EuSEF) Regulations – Different approaches are used in the regulations as regards to eligibility criteria for investors; this could be standardised.

ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE (AIFMD) REVIEW
In our most recent newsletters, we highlighted progress on the long-awaited outcome of the review of the scope and application of the AIFMD required under Article 69 of the regulation. Further to the ESMA letter to the EC published in August, the EC introduced a public consultation survey in November 2020 with the deadline for responses by January 29, 2021.
The questions in the survey span several key themes, including:

- The functioning of the AIFMD regulatory framework, scope and authorisation requirements, including the functioning of the AIFM passport.
- Investor protection, including questions on investor categorisation, investor access, valuation rules, adequacy of disclosure requirements, and views of the AIFMD rules on depositaries and the introduction of a depositary passport.
- International relations covering the competitiveness of EU AIFs, national private placement regimes for third country AIFs and delegation rules.
- Financial stability – covering supervisory reporting, leverage and harmonisation of liquidity risk management tools, supervisory setup and cooperation measures among the competent authorities.
- Whether rules surrounding investing in private companies are achieving their aim of increased transparency and accountability related to holding controlling stakes in non-listed companies.
- Sustainability / ESG looks at how the AIFMD should interact with the Sustainable Finance Disclosure Regulation and the EU taxonomy.
- Miscellaneous section including sanctioning regime, and merger of UCITS and AIFM regulatory frameworks, which discusses whether level 2 rules on delegation should be applicable to UCITS, and the possibility of a single licence for AIF and UCITS managers.

If the EC decides, following consultation, to propose changes to the existing legislation, this will likely be published in H2 2021.

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Northern Trust Actions

At Northern Trust, we continue to monitor regulatory developments. As mentioned previously, should you wish to discuss this topic in further detail, please contact your Northern Trust representative.
All source documents referenced within this newsletter can be directly accessed using the hyperlinks contained within the electronic edition of the newsletter. To access the electronic edition please go to:

www.northerntrust.com/insights-research/regulatory-developments

*Information contained herein is current as of the date appearing in this material only and is subject to change without notice.