

Webinar for DPs for Regulatory Compliance - advice on Covid-19 related issues.

20/04/20 4pm

Moderator:

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Panellists:

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This was the fifth in a series of webinars to be held over the coming weeks providing updates and a forum to exchange information within the DP peer group. The discussion covered various issues including the following:

1. Advertent & Inadvertent Breaches

- The main investment restrictions that the DP for Regulatory Compliance (DPRC) should be conscious of during this time of high volatility were considered.
- One of the key areas of focus has been on the 5/10/40 rule. In a time of significant volatility, certain assets lose money over a very short period of time which may increase the position sizes of those better performing assets in a portfolio. As a result, managers need to be conscious of managing that risk. If a change happens as a result of market movement the breach is inadvertent and the manager should rectify that breach in the best interests of unitholders with a notification made to the regulator. Compensation would not be payable as a result of an inadvertent breach.
- Managers also need to be very conscious in this period of significant volatility that they don't advertently breach any of the restrictions. An advertent breach would result in the payment of compensation and given the volatility we are currently experiencing that compensation could be significant.
- Sometimes there is a discussion as to whether or not the breach is advertent or inadvertent and ultimately it is the depository who decides whether a breach is advertent or inadvertent.
- If the breach is advertent it needs to be remediated as soon as possible and it will be necessary to determine what the impact of the breach has been. Depending on the significance of the monetary compensation a breach may need to be notified to the regulator. Usually the depository will notify the regulator should it be a reportable breach.

2. Value At Risk (VaR) breaches

- A number of VaR breaches have been seen over the last couple of weeks given the extreme volatility in the market. The approach taken has been to look at these VaR breaches as inadvertent with managers monitoring the level of exposure on an ongoing basis. These breaches are not triggering any compensation payments or changes in the investment portfolio.
- A number of managers who have traditionally run high leverage have looked to take risk off at the moment.
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3. Why is internal co-ordination a particular challenge for the DPRC compared with the DPs for other managerial functions?

- The DPRC role is different than the other DP roles in the sense that in other roles you can tend to be more insular, you can tend to carry out your role without referring to the other DPs as much.
- DPRC is responsible for ensuring all other DPs are looking after their regulatory compliance obligations as well as tending to their own regulatory compliance responsibilities.
- Internal coordination is particularly important as a result of the current working situation. Important that the DPRC maintain communication with all other DPs notwithstanding that you're now not located within the same building.

4. How are ManCos and SMICs with a low PRISM rating dealing with the current challenges?

- ManCos and SMICs whose PRISM rating moves from low to medium/low experience a significant change in circumstances and engagement with the Central Bank.
- Central Bank engagement is now starting to get pushed down to the low impact firms where there is much more asked of them from the regulator as a result of Covid-19.
- Low impact firms are now starting to have much more engagement with the Central Bank and that filters through the DPRC and the DPRC in much firms is expected to be the point of contact back to the Central Bank.
- This increased engagement can be quite challenging. Important that the DPRC keeps control of the communications received from the Central Bank whether they come through the dedicated email address or through some other individual within the firm.
- Important also that the DPRC is responsible for all correspondence to and from the Central Bank.

5. From a European perspective, has the pace of regulatory developments by regulators slowed as a result of the Covid-19 pandemic?

- No, the pace of regulatory developments has not slowed as a result of the Covid-19 pandemic.
- Broadly, the agenda is still pushing on. There was no scope from the regulator to allow any delay in the completion and submission of the ESMA Liquidity Questionnaire.
- ESMA is continuing to produce consultation papers and guidelines. For example, the recent performance fees consultation paper and guidelines. Nothing has really slowed at European level.
- Constant stream of updates coming through represents another challenge for the DPRC.

6. A snapshot of the subsequent Q&A:

- **Given volatile markets, there are likely to be inadvertent breaches. Given the valuations are poor e.g. lots of fire sales selling down positions which can be significantly detrimental to investors, is 28 days still valid even if not in the interests of investors?**

- The 28 days requirement is a requirement to notify the regulator if an inadvertent breach is still open after 28 days. There is some latitude in the rules about rectifying an inadvertent breach. The rules say that the inadvertent breach must be rectified as a priority objective but taking due account of the interests of unitholders.
 - If it is felt that a period extends beyond 28 days, the Central Bank would be notified, and the Central Bank might come back and query as to why the breach has not been rectified as of yet. At that stage the manager can explain the rationale behind not rectifying the inadvertent breach and if the rationale stands up, they are operating in compliance with the requirements.
 - Governance around the manager's approach is going to be very important. The decision-making process, looking at what the alternative positions were, what the manager could have done but decided not to, why holding the position was the best thing to do in the interests of the investors and what the manager's plan B is to get out of the position.
- **In terms of the level of engagement by the DPRC with the Board of the ManCo or the SMIC, what are you currently seeing in terms of the written decision making currently being made as a result of the COVID-19 pandemic? What constitutes best practice?**
- Need to demonstrate that governance within an organisation is alive to the different market situation and actively considering the issues which may arise.
 - Regulator relies very heavily on minutes, certainly as an initial port of call when they're understanding how a business is run so its important to have minutes and documented correspondence illustrating how you have responded to the current market volatility.
 - DPRCs are seeing a lot more correspondence with the Board. All of the frequency of reviews are being ramped up at this time because of the levels of volatility and anxiousness in the markets.
- **What reporting requirements are the Central Bank particularly focused on at the moment?**
- Liquidity is one of the key areas of focus by the Central Bank. The Central Bank want to know if you're going to be using one of the extreme liquidity tools i.e. if you're going to be using the gate or if you're going to be suspending the calculation of the net asset value. These are discussions which should be entered into with the regulator before a definite decision is made.
 - Redemptions over 5%. Central Bank want to know if there were any issues in meeting such redemption requests.
 - Questions about cybersecurity. Spike in phishing as a result of everyone working from home.
 - Business Continuity Planning issues and any significant breaches.