



Regulatory insights

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European updates

ESG & Sustainable Finance

ESMA publishes 3 explanatory notes on the Sustainable finance framework.

On 22 November 2023 ESMA published three explanatory notes to stakeholders covering key topics of the EU sustainable finance framework:

- 1 sustainable investments and environmentally sustainable activities;
- 2 Do No Significant Harm (“DNSH”) regime; and
- 3 use of estimates

The notes aim at setting out factual information regarding these concepts and providing helpful aide to stakeholders to navigate and better understand the Sustainable Finance legislative framework.

These documents are purely descriptive. They are not intended to replace relevant legal texts nor to provide guidance on the application of relevant provisions.

The three documents are useful reminders and consolidated sources of information on the three areas covered.



Asset Management

The text of the political agreement on the review of the AIFMD has been published.

The Council of the EU published the final text of that political agreement (Political Agreement) on the review of the Alternative Investment Fund Managers Directive (AIFMD 2). Whilst the Political Agreement focuses on the AIFMD, it also touches on the UCITS Directive by aligning requirements between the AIFMD and the UCITS.

The following are the key elements of the targeted amendments to the AIFMD and the UCITS Directive:

Authorisation. Going forward, alternative investment fund managers (AIFMs) and UCITS management companies (Mancos) must provide more information when applying for authorisation, including with regard to substance. The rules applicable to conducting officers will also become stricter by requiring that these are natural persons domiciled in the EU and either full-time employees or executive member(s) of the governing body with a full-time commitment to conducting that business.

Delegation/Reporting. AIFMs and Mancos must provide more information on delegation/sub-delegation arrangements to their NCAs, both at the time they apply for an authorisation and in their regulatory reports to their NCA. Going forward, these reports must contain among others (i) information on the delegates and sub-delegates, (ii) quantitative information, such as reporting on the assets of AIFs, respectively UCITS, that are subject to delegation and, (iii) with respect to Mancos, justification of their delegation structure based on objective reasons.

The amended rules aim to provide the supervisory authorities with a clear idea on the substance and operations of the AIFM / Manco.

Loan originating funds. The Political Agreement recognises that the management of AIFs may comprise loan origination activities. In an effort to harmonise the different national regimes on loan originating funds, AIFMD 2, introduces rules relating to AIFs performing loan origination activities.

A loan-originating AIF has been defined as an AIF: (i) whose investment strategy is mainly to originate loans, or (ii) where the notional value of the AIF's originated loans represents at least 50% of its net asset value.

Once AIFMD 2 has been implemented by EU Member States, new rules will apply to these types of AIFs, such as:

Loan-originating AIFs must be closed-ended, except where the AIFM can demonstrate that the AIF's liquidity risk management system is compatible with its investment strategy and redemption policy. ESMA will develop draft RTS to determine the requirements with which such an AIF has to comply in order to remain open-ended.

Loan-originating AIFs have a leverage limit of 300% for closed-ended AIFs and 175% for open-ended AIFs. The leverage percentage is expressed as the ratio between the exposure of the AIF (calculated using the commitment method) and its net asset value.

A loan concentration limit to a single borrower of 20% of the AIF's capital must be respected if the borrower is a financial undertaking, an AIF or a UCITS.

AIFMs must ensure that the managed AIF retains 5% of the loans originated and subsequently transferred to third parties (i) until maturity, for originated loans with a maturity of up to eight years or for loans granted to consumers regardless of their maturity, and (ii) for other loans, for at least eight years.

AIFMD 2 prohibits AIFMs from managing AIFs that originate loans with an “originate-to-distribute-strategy”.

Transitional rules have been introduced to make a distinction between (i) existing AIFs originating loans (up to five years from the date of entry into force of AIFMD 2) with a possibility for AIFMs to opt in, and (ii) existing loans (for which the implementation of some rules is not required).

Liquidity management tools

AIFMs and Mancos must implement procedures for activating and deactivating any selected liquidity management tools (LMTs) and the operational and administrative arrangements for using such tools.

AIFMs managing open-ended AIFs and Mancos must select at least two LMTs from a list of LMTs (except side pockets) set out in the relevant Annex. Redemptions in kind and side pockets may also be activated, provided that certain conditions are met. The list contains the usual LMTs and Cyprus AIFMs and ManCos are already familiar with their use.

Ancillary activities. Some non-core services are added to the list of ancillary activities for AIFMs and Mancos, including:

- Reception and transmission of orders in relation to financial instruments for Mancos.
- AIFMs may also provide (i) administration of benchmarks and (ii) credit servicing functions, whereas Mancos may only administer benchmarks, except where these are used in the UCITS that they manage.

Going forward, non-core services, such as investment advice, may also be provided in the absence of discretionary portfolio management activities by the AIFM, respectively the Manco.

Fees and costs. The fees, charges and expenses borne by the AIFM in connection with the operation of the AIF and ultimately allocated to the AIF need to be disclosed. In addition, the AIFM shall, on an annual basis, disclose the charges and expenses directly or indirectly borne by investors.

Additional periodic disclosures for AIFs. Additional information must be disclosed to investors, such as the composition of the originated loan portfolio and, on an annual basis only, the entities utilised in relation to the AIF’s investments by or on behalf of the AIFM.

EU Parliament is expected to vote on the text in early February 2024. Following that vote, the Council of the EU will formally approve the text voted. The publication and entry into force of AIFMD 2 is expected by the end of Q1 2024. The Political Agreement provides that Member States must apply the measures from two years after the entry into force, with the exception of the measures implementing the reporting requirements, which they must apply from three years after the entry into force of AIFMD 2.

Digital Finance

EBA publishes its technical advice on the classification of asset-reference tokens and e-money tokens and related fees under MiCA

On 8 November 2023, the EU Commission published four draft delegated acts under the Regulation on markets in crypto-assets ((EU) 2023/1114) (MiCA) and the EBA published its third and final consultation package on technical standards and guidelines under MiCA.

The EU Commission's delegated acts are intended to supplement MiCA by:

Specifying criteria for an asset-referenced token (ART) or e-money token (EMT) to be classified as significant (Article 43(11) MiCA).



Introducing criteria and factors to be taken into account by ESMA, the EBA, and competent authorities in relation to product intervention powers (e.g. the ability of a body/authority to restrict or ban the sale of crypto-assets or related activities) (Articles 103(8), 104(8) and 105(7) MiCA).

Laying down procedural rules for the EBA to impose fines/penalties on issuers of significant ARTs and EMTs (Article 134(10) MiCA).

Introducing rules on the supervisory fees charged by the EBA to issuers of significant ARTs and EMTs (Article 137(3) MiCA).

In September 2023, the EBA published its technical advice to the EU Commission on the criteria for classifying ARTs and EMTs as significant and the fees to be charged by the EBA to issuers of significant ARTs and EMTs.

The EU Commission plans to adopt the delegated acts in Q2 2024 before the relevant MiCA provisions begin to apply from 30 June 2024.

The draft delegated acts are open for feedback, via the EU Commission's portal, until 6 December 2023.

The EBA's third and final consultation package on MiCA technical standards and guidelines was published on 8 November 2023. This package includes seven draft Regulatory Technical Standards (RTS), one draft Implementing Technical Standards (ITS) and two sets of draft guidelines covering the following matters:

Liquidity

- [RTS to specify the highly liquid financial instruments with minimal market risk, credit risk and concentration risk](#) (Article 38(5) MiCA).
- [RTS to further specify the liquidity requirements of the reserve of assets](#) (Article 36(4) MiCA).
- [RTS to specify the minimum contents of the liquidity management policy and procedures](#) (Article 45(7)(b) MiCA).
- [Guidelines on liquidity stress testing](#) (Article 45(4) MiCA).

Own funds requirements and stress testing of issuers

- [RTS to specify the adjustment of own funds requirements and stress testing of issuers of ARTs and EMTs](#) (Article 35 MiCA).
- RTS to specify the procedure and timeframe to adjust its own funds requirements for issuers of significant ARTs or EMTs (Article 45(5) MiCA).

Recovery plans

- [Guidelines on recovery plans to be drafted by issuers of ARTs and EMTs](#) (Article 46(6) MiCA).

Reporting transactions

- [RTS on the use of ARTs and EMTs denominated in a non-EU currency as a means of exchange](#) (Article 22(6) MiCA).
- [ITS on the reporting on ARTs and EMTs denominated in a non-EU currency](#) (Article 22(7) MiCA).

Supervisory colleges

- [RTS on the criteria for determining the composition of supervisory colleges for each issuer of a significant ART or EMT](#). The draft RTS also specify the general conditions for the functioning of supervisory colleges under MiCA (Article 119(8) MiCA).

The deadline for comments on the EBA consultation package is 8 February 2024.

IOSCO policy recommendations for crypto and digital assets (CDA) markets

IOSCO published on 16 November 2023 its Final Report with Policy recommendations for Crypto and Digital CDA Markets.

The report outlines 18 policy recommendations for the regulation of CDAs which aim to support greater consistency with respect to regulatory frameworks and oversight in IOSCO member jurisdictions, and to address concerns related to market integrity and investor protection arising from crypto-asset activities.

In line with IOSCO's established approach for financial market regulation, the recommendations are addressed to relevant authorities. They look to support jurisdictions seeking to establish compliant markets for the trading of crypto-assets in the most effective way possible.

IOSCO's detailed and targeted recommendations elaborate the regulatory expectations, either through application of existing rules or development of new rules, depending on the jurisdiction, to address the key areas of harm observed in these market.

The Recommendations cover six key areas, consistent with the IOSCO Objectives and Principles for Securities Regulation and relevant supporting IOSCO standards, recommendations, and good practices:

1. Conflicts of interest arising from vertical integration of activities and functions,
2. Market manipulation, insider trading and fraud,
3. Custody and client asset protection,
4. Cross-border risks and regulatory cooperation,
5. Operational and technological risk, and
6. Retail distribution

IOSCO separately consulted on proposed policy recommendations for 'decentralised finance' or 'DeFi' on 7 September 2023, which will be finalised by the end of this year. At that time, IOSCO will also publish an umbrella note explaining in more detail the interoperability between the two sets of recommendations.



Anti-Money Laundering

The EBA consults on new Guidelines on preventing the abuse of funds and certain crypto-assets transfers for money laundering and terrorist financing purposes.

On 24 November 2023 the EBA launched a [public consultation](#) on new Guidelines on preventing the abuse of funds and certain crypto-assets transfers for money laundering and terrorist financing purposes. These ‘travel rule’ Guidelines specify the steps that Payment Service Providers (PSPs), Intermediary PSPs (IPSPs), crypto-asset service providers (CASPs) and Intermediary CASPs (ICASPs) should take to detect missing or incomplete information that accompanies a transfer of funds or crypto-assets. They also detail the procedures all these providers should put in place to manage a transfer of funds or a transfer of crypto-assets that lacks the required information. These Guidelines aim at forging a common understanding to ensure the consistent application of EU law as well as a stronger anti-money laundering and countering the financing of terrorism (AML/CFT) regime.

The consultation runs until 26 February 2024.



Glossary

AIF Alternative Investment Fund (EU)

AIFMD Directive 2011/61/EU on Alternative Investment Fund Managers

AIFMs Alternative Investment Fund Managers

AML Anti-Money Laundering

CSRD Corporate Sustainability Reporting Directive

CySEC Cyprus Securities and Exchange Commission

CP Consultation Paper

EBA European Banking Authority

EC European Commission

ESG environmental, social, and governance

EMIR European Market Infrastructure Regulation

ESAs European Supervisory Authorities (EBA, EIOPA and ESMA)

ESMA European Securities and Markets Authority

EIOPA European Insurance & Occupational Pensions Authority

EU European Union

MiFID Markets in Financial Instruments Directive

NCA National Competent Authority

RTS Regulatory Technical Standards

SFDR Sustainable Finance Disclosure Directive

OECD Organisation for Economic Co-operation and Development

UCITS Directive directive 2009/65/EC on Undertakings for Collective investments in Transferable Securities

UCITS Undertakings for Collective investments in Transferable Securities (EU)

Main Contacts

Eleni Neocleous

Board Member

Risk and Regulatory, Risk Consulting

T: + 357 22 209 023

E: eneocleous@kpmg.com

Marie-Hélène Angelides

Senior Associate, Asset Management expert

Regulatory Compliance, Risk Consulting

T: + 357 22 209 227

E: mangelides@kpmg.com

Eleni Poyiadji

Principal, MiFID and AML expert

Risk and Regulatory, Risk Consulting

T: + 357 22 209 248

E: epoyaji@kpmg.com



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