Regulatory Insights

February 2024

Anti-Money Laundering

AML Regulation and MLD6 - Final compromise texts published by the EU Council

The EU Council (Council) has published on 14 February 2024 the final compromise texts for the proposals for:

- A Regulation on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (AML Regulation); and
- A Directive on the mechanisms to be put in place by the member states for the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and repealing Directive (EU) 2015/849 (MLD6).

The final compromise texts reflect the political agreement that was reached between the Council and the Parliament in January 2024.

The texts will be finalised and presented to member states' representatives in the Committee of Permanent Representatives and the Parliament for approval. If approved, the Council and the Parliament will have to formally adopt the texts before they are published in the EU's Official Journal and enter into force.

The key points of the AML Regulation and the MLD6 are summarised below:

Anti-Money Laundering regulation

Obliged entities

The provisional agreement expands the list of obliged entities to new bodies. The new rules will cover most of the crypto sector, forcing all crypto-asset service providers (CASPs) to conduct due diligence on their customers. This means that they will have to verify facts and information about their customers, as well as report suspicious activity.

According to the agreement, CASPs will need to apply customer due diligence measures when carrying out transactions amounting to €1000 or more. It adds measures to mitigate risks in relation to transactions with self-hosted wallets.

Other sectors concerned by customer due diligence and reporting obligations will be traders of luxury goods such as precious metals, precious stones, jewellers, horologists and goldsmiths. Traders of luxury cars, airplanes and yachts as well as cultural goods (like artworks) will also become obliged entities.

The provisional agreement recognises that the football sector represents a high risk and expands the list of obliged entities to professional football clubs and agents. However, as the sector and its risk is subject to wide variations, member states will have the flexibility to remove them from the list if they represent a low risk. The rules will apply after a longer transition period, kicking in five years after entry into force, as opposed to three years for the other obliged entities.

Anti-Money Laundering *(2)*

Enhanced due diligence

Specific enhanced due diligence measures have been introduced for cross-border correspondent relationships for CASPs.

Also, credit and financial institutions will need to undertake enhanced due diligence measures when business relationships with very wealthy (high net-worth) individuals involve the handling of a large amount of assets. The failure to do so will be considered an aggravating factor in the sanctioning regime.

Cash payments

An EU-wide maximum limit of €10 000 is set for cash payments, which will make it harder for criminals to launder illicit money. Member states will have the flexibility to impose a lower maximum limit if they wish.

In addition, according to the provisional agreement, obliged entities will need to identify and verify the identity of a person who carries out an occasional transaction in cash between €3 000 and €10 000.

Beneficial ownership

The provisional agreement makes the rules on beneficial ownership more harmonised and transparent. Beneficial ownership refers to persons who actually control or enjoy the benefits of ownership of a legal entity (like a company, foundation or trust), although the title or property is in another name.

The agreement clarifies that beneficial ownership is based on two components – ownership and control – which both need to be analysed to identify all the beneficial owners of that legal entity or across types of entities, including non-EU entities when they do business in the EU or purchase real estate in the EU. The agreement sets the beneficial ownership threshold at 25%.

Related rules applicable to multi-layered ownership and control structures are also clarified to make sure hiding behind multiple layers of ownership of companies won't work anymore. In parallel, data protection and record retention provisions are clarified to make the work of the competent authorities easier and faster.

The agreement provides for the registration of the beneficial ownership of all foreign entities that own real estate with retroactivity until 1 January 2014.

High-risk third countries

Obliged entities will be required to apply enhanced due diligence measures to occasional transactions and business relationships involving high-risk third countries whose shortcomings in their national anti-money laundering and counter-terrorism regimes make them represent a threat to the integrity of the EU's internal market.

Anti-Money Laundering *(3)*

The EU Commission will make an assessment of the risk, based on the financial action task force listings (FATF, the international standard setter in anti-money laundering). Furthermore, the high level of risk will justify the application of additional specific EU or national countermeasures, whether at the level of obliged entities or by the member states.

Anti-money laundering directive

Beneficial ownership registers

According to the provisional agreement the information submitted to the central register will need to be verified. Entities or arrangements that are associated with persons or entities subject to targeted financial sanctions will need to be flagged.

The Directive grants the entities in charge of the registers the power to carry out inspections at the premises of legal entities registered, in case of doubts regarding the accuracy of the information in their possession.

The agreement also establishes that in addition to supervisory and public authorities and obliged entities, among others, persons of the public with legitimate interest, including press and civil society, may access the registers.

In order to facilitate investigations into criminal schemes involving real estate, the text ensures that real estate registers are accessible to competent authorities through a single access point, making available for example information on price, property type, history and encumbrances like mortgages, judicial restrictions and property rights.

Frankfurt to host the EU's new anti-money laundering authority (AMLA)

On 22 February 2024 the European Council and the Parliament representatives reached an agreement on the seat of the future european authority for anti-money laundering and countering terrorist financing (AMLA).

AMLA will be based in Frankfurt and shall begin operations mid-2025. It will have over 400 staff members. The new authority is the centrepiece of the reform of the EU's anti-money laundering framework. AMLA will have direct and indirect supervisory powers over obliged entities and the power to impose sanctions and measures.

The final agreement on the location of AMLA's seat was made by the co-legislators in an informal inter-institutional meeting at political level, where the European Council's and Parliament's representatives voted together at the same time with 27 votes attributed to each co-legislator.

Asset Management

Amendments to Directive 2011/61/EU on alternative investment fund managers formally approved

On 26 February 2024, the EU Council has adopted the proposed Directive (AIFMD II) amending the Alternative Investment Fund Managers Directive (2011/61/EU) (AIFMD) and the Undertakings for Collective Investment in Transferable Securities Directive (2009/65/EC) (UCITS). The amendments concern delegation arrangements, liquidity risk management, supervisory reporting, provision of depositary and custody services and loan origination by alternative investment funds.

The Directive will enter into force 20 days after being published in the Official Journal. Member states will have 24 months after the Directive enters into force to transpose the rules into national legislation.

The key changes are as follows:

Delegation : It explicitly states that delegation rules only apply to activities for which AIFMs require authorisation (i.e. investment management, other functions listed in Annex I of the AIFMD, as well as ancillary services) and emphasises the need for AIFMs to ensure their delegates comply with the AIFMD. Despite discussions, AIFMD II will not prevent delegation of portfolio management by European AIFMs to third country managers; however, EU AIFMs will have to provide more detail to their local regulators about all delegation.

Depositary requirements : For EU AIFs the Depositaries may now be located in EU member states other than the AIF's home member state, but only under strict conditions. These conditions include the absence of a suitable depositary in the AIF's home member state, the lack of a significant market for depositary services in the home member state, and a supervisory assessment of such lack of relevant depositary services in the home member state.

Fund names : ESMA will be mandated to develop guidelines on permissible names of AIFs to enhance transparency for investors. Names of AIFs must not be "unfair, unclear, or misleading".

Reporting to supervisors : Reporting will become more rigorous requiring AIFMs to report on all markets, instruments, and exposures of their AIFs, going beyond the previous scope. Detailed new reporting requirements relate to the delegation of portfolio management or risk management functions and the reporting of where the AIFs are actively marketed.

Marketing non-EEA AIFs in the EU : References to prohibited jurisdictions on FATF's non-cooperative list will be replaced with references to the EU's own high-risk list, and references to non-cooperative tax jurisdictions are widened. AIFs from jurisdictions identified as high risk under the EU's AML Directive will not be able to be marketed into the EU unless that jurisdiction has entered into a separate agreement with each EU jurisdiction into which the AIF is being marketed.

Conflicts management requirements for third-party AIFMs. Third-party AIFMs will need to submit detailed information to their local regulators as to how they manage conflicts between their AIFs.

Asset Management *(2)*

AIFM Services

The list of ancillary services that can be provided by AIFMs has been extended to include:

- benchmark administration under the EU Benchmarks Regulation and credit-servicing under the EU Credit Services Directive
- originating loans and servicing securitisation SPVs
- any other services that are already provided in respect of AIFs they manage or related to an AIFM's top-up permissions provided that conflicts of interest are appropriately managed.

Organisational requirements

To enhance AIFM substance requirements, AIFM's business must be conducted by at least two natural persons domiciled in the EU. Those persons must be: (i) employed full-time, or (ii) executive members of the governing body of the AIFM who are committed full-time to its business.

It is to be noted that Cyprus has already in place such stricter substance requirements.

Liquidity Risk Management Tools (LMTs)

EU and non-EU AIFMs will be required to disclose the AIF's liquidity risk management system to investors before they enter into a subscription agreement.

An AIFM overseeing an open-ended AIF will be required to choose a minimum of two liquidity management tools, such as redemption gates, notice periods, liquidity fees, swing/dual pricing, an anti-dilution levy, or redemptions in kind. Money market funds are, as an exception, only allowed to use one tool.

The AIFM must establish and follow detailed procedures for activating and deactivating selected LMTs. Any unusual use of these tools, including suspension of redemptions or side pockets, must be promptly reported to the national competent authority ("NCA") of the home member state. The NCA then notifies without delay the host member state's NCA and the ESMA, and if there are potential risks to financial stability and integrity, the financial system is the European Systemic Risk Board. The ESMA is tasked with creating regulatory standards for loan-originating AIFs' open-ended structure and guidelines on selecting and calibrating liquidity tools for AIFM risk management and financial stability mitigation.

Cost and charges

AIFMs will be required to annually report all of the direct and indirect fees and charges incurred by the AIF. In addition, the AIFM will have to annually disclose the charges and expenses incurred by investors, regardless of whether they are incurred directly or indirectly.

Asset Management *(3)*

Loan-originating funds

The AIFMD II defines a loan-originating alternative investment fund 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.

Under AIFMD II, the loan-originating funds will be governed by the following rules:

- Loan-originating AIFs are encouraged to be closed-ended (i.e., no redemption right for the investors), unless the AIFM demonstrates compatibility with the investment strategy and redemption policy, with the ESMA developing draft regulatory technical standards for open-ended AIF compliance requirements.
- Leverage limits for loan-originating AIFs are set at 300% for closed-ended and 175% for open-ended, calculated as the ratio between exposure and net asset value.
- A 20% concentration limit on loans to a single borrower applies if the borrower is a financial undertaking, AIF, or undertaking for the collective investment in transferable securities (UCITS).
- AIFMs must retain 5% of originated loans transferred to third parties until maturity (up to eight years for consumer loans) or at least eight years for other loans.
- AIFMs are prohibited from managing AIFs with an "originate-to-distribute strategy“, with the sole purpose of transferring those loans to third parties.
- Transitional rules distinguish between existing AIFs' originating loans (with a five-year opt-in period for AIFMs) and existing loans (benefiting from a rules' implementation exemption).

UCITS regime

AIFMD II seeks to align AIFMD and the UCITS regimes as closely as possible. It reforms the UCITS Directive to add obligations on UCITS management companies:

- to report to national competent authorities’ information equivalent to the Annex IV AIFMD reporting.
- new substance requirements applicable to the management companies equivalent to those AIFMD II introduces for AIFMs.
- application for authorisation as a UCITS management company will require greater detail on (i) technical and human resources used to conduct business, and (ii) arrangements made for delegation.
- changes to liquidity management including a new Annex IIA setting out LMTs, which largely reflect the proposed amendments to AIFMD.

Further the list of non-core services management companies are allowed to provide is extended to include reception and transmission of orders, administration of benchmarks, and any other function or activity which is already provided by the management company in accordance with Article 6 of the UCITS Directive.

Contrary to the changes introduced in the AIFMD regime, AIFMD II does not give UCITS management companies a right to appoint a depositary based in a different country to the UCITS they manage.

Asset Management *(4)*

EU Commission proposes amendments to ELTIF RTS

The EU Commission has written to ESMA stating that it intends to amend the proposed ELTIF RTS before adopting them. The key amendments relate to liquidity management requirements and seek to introduce more flexibility for ELTIF managers than previously provided for under the ESMA RTS. Key changes include:

- ❑ Removal of the link between notice periods and percentage of liquid assets.
- ❑ Removal of the requirement for 12-month minimum holding period.
- ❑ Requirement for ELTIF managers to justify their approach to NCAs where redemption frequency is below three months.
- ❑ No requirement to use at least one anti-dilution mechanism (now at the discretion of the ELTIF Manager) with flexibility to use other LMTs.
- ❑ Ensure that the cost disclosure methodology and presentation are consistent with PRIIPs, MiFID and AIFMD.
- ❑ Use of redemption gates no longer limited to “certain specific circumstances” or exclusively contingent on the notice period.
- ❑ Size of redemption gates to be determined by either:
  - A calculation based on the redemption frequency and the extended notice period of the ELTIF (set out as options 1, 2 and 3 in Annex 1), or
  - A calculation based on the redemption frequency and the minimum percentage of liquid assets as set out in Annex 2.

ESMA will now have six weeks to consider these amendments and potentially respond.

The EBA consults on amendments to the operational risk Pillar 3 and supervisory reporting requirements to implement the Basel III reforms in the EU

The EBA launched on 20 February 2024 a public consultation on two draft Implementing Technical Standards (ITS) amending Pillar 3 disclosures and supervisory reporting requirements for operational risk. These consultations complement two additional consultation papers on Pillar 3 and supervisory reporting published on 14 December 2023, in line with the roadmap for the implementation of the EU Banking Package.

The consultations run until 30 April 2024.

The EBA consults on the new framework for the business indicator for operational risk as part of the implementation of the EU Banking

The EBA launched on 20 February 2024 a consultation on two set of draft Regulatory Technical Standards (RTS) and one Implementing Technical Standard aiming to clarify the composition of the new business indicator at the heart of the operational risk capital requirements calculation, mapping the business indicator items to financial reporting (FINREP) items and highlighting possible adjustments to the business indicator in case of specific operations.

The consultation runs until 21 May 2024.

The EBA publishes follow-up on the Peer Review on the Joint ESAs Guidelines on the prudential assessment of the acquisition of qualifying holdings

The EBA published on 12 February 2024 a follow-up to the EBA 2021 peer review report on the application of the Joint ESAs Guidelines on the prudential assessment of the acquisition of qualifying holdings. The review assesses the adequacy and effectiveness of the actions undertaken by the NCA subject to the previous review and finds good progress in remedying the deficiencies identified in 2021.
The follow-up report focuses on the 17 NCA assessed as having at least one supervisory benchmark which was not ‘fully applied’ in the 2021 report.

All 17 NCAs were found to have responded to the assessment of the initial peer review seriously and most have adopted measures to remedy the deficiencies identified. Particular improvements were identified in the areas of assessment of the financial soundness of proposed acquirers and of suspicions of money laundering/terrorist financing issues.

DORA and MICAR: European Commission adopts Delegated Regulation

The EU Commission adopted on 22 February 2024 two delegated acts under the Regulation on Operational Resilience (DORA) and four delegated acts under the Regulation on Markets in Crypto-Assets (MiCA).

The delegated acts are the first of a series to complement and complete the EU regulatory frameworks on cybersecurity matters for the financial sector and crypto-assets.

The European Parliament and the Council will now review the delegated acts. They have a period of three months to raise objections, which they can extend for another three months. The acts will start applying after the period elapses and no objection is raised.

The Delegated Regulations cover:

MICA

- **The procedural rules for the exercise by the EBA of its power to impose fines or periodic penalty payments on issuers of significant asset-referenced tokens (ARTs) and e-money tokens (EMTs);**
- **The supervisory fees that can be charged by the EBA to issuers of significant ARTs and EMTs;**
- **The criteria for classifying ARTs and EMTs as significant; and**
- **The criteria and factors to be taken into account by EBA, ESMA and competent authorities when exercising their product intervention powers under MiCA (i.e. their powers to restrict or ban the sale of cryptoassets or related activities).**

DORA

- Determination of the amount of the oversight fees to be charged by the Lead Overseer to critical ICT third party service providers and the way in which those fees are paid. DORA introduces an EU oversight framework for ICT third-party service providers deemed critical (**CTPPs**). As Lead Overseers each of the three European Supervisory Authorities will have the power to monitor on a pan-European scale the activity of CTPPs in the context of their ICT services to the financial sector.
- The criteria for the designation of ICT third-party service providers as critical for financial entities.

Payments

PSD3 and PSR - ECON votes to adopt draft reports

and

EMIR 3.0 final text published

The European Parliament's Economic and Monetary Affairs Committee (ECON) has published a press release on 14 February 2024 announcing that it has voted to adopt draft reports on the EU's legislative proposals for:

- A directive on payment services and electronic money services in the internal market (PSD3) amending the Payment Services Directive ((EU) 2015/2366) (PSD2), with proposed amendments relating to access to cash, the ability of new types of payment services to enter the EU payment service sector and the authorisation process for undertakings intending to provide payment services or electronic money services; and
- A regulation on payment services in the internal market (Payment Services Regulation or PSR), proposed amendments to which enhance the security of transfers, the security of personal data and disclosures concerning charges prior to the initiation of a payment transaction.

ECON states that the Parliament is expected to vote on both texts during its first plenary session in April 2024.

Securities & Markets

A political agreement has been reached on the European Market Infrastructure Regulation (EMIR) 3.0 package, aiming to make EU clearing safer and more attractive while mitigating risks from excessive reliance on central counterparties (CCPs) – which provide clearing services – located in third countries.

The new rules will enable CCPs to bring new products to the EU market faster. This will give market participants an incentive to clear and build liquidity at EU CCPs. The new rules also allow for a safer and more resilient clearing system, by improving the EU supervisory framework for CCPs, reinforcing the role ESMA, and drawing lessons from the market events of the past few years. The new framework would also contribute to reducing excessive reliance on systemic CCPs in non-EU countries, by requiring all relevant market participants to hold active accounts at EU CCPs and clear a representative portion of certain systemic derivative contracts within the single market.

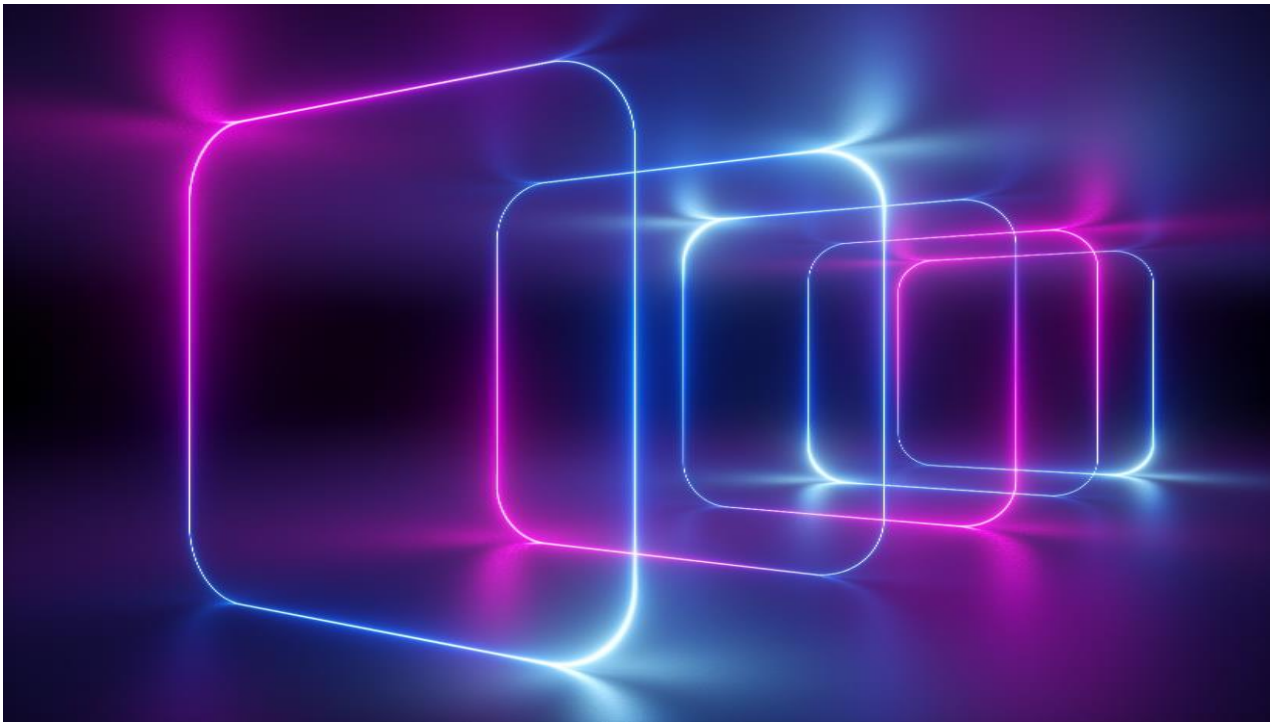
Sustainable Finance

Delay in the adoption of the sector-specific ESRS

On 7 February 2024, the European Council and the Parliament announced via press release that they have reached a provisional agreement delaying the date of adoption of the sector-specific European Sustainability Reporting Standards ("ESRS"), for use by companies subject to the Corporate Sustainability Reporting Directive6 ("CSRD"), by two years, from 30 June 2024 to 30 June 2026.

The ESRS aim to help investors understand the sustainability impact of the companies in which they invest. Delegated Regulation (EU) 2023/2772 containing the first set of ESRS, was published in the EU's Official Journal on 22 December 2023; those ESRS apply in respect of financial years beginning on or after 1 January 2024. There are currently 12 ESRS, covering the full spectrum of sustainability concerns, and comprising two cross-cutting standards and 10 topical standards.

According to the co-legislators, the delay in the adoption of the sector-specific ESRS will allow in-scope entities to focus on ensuring compliance with the first set of general ESRS (above). The provisional agreement suggests the EU Commission intends to publish the eight sector-specific ESRS as soon as those standards are ready, to facilitate preparations for the revised date of application.



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

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

MiCA Regulation of the European Parliament and of the Council on markets in crypto-assets

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)

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