



MiFID Regulatory Update Webinar

Thursday, 30th March 2023

09:30AM – 10:30AM

Introduction

With You Today

Agenda



Ciaran Flynn, CFA
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The current state of play
Recent regulatory developments



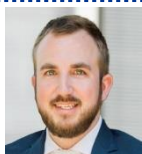
Áine MacDonnell
Director, Risk & Regulatory Consulting

CP153, SEAR, and Individual Accountability
Preparing for IAR
The Revised Client Assets Requirements
Evolved framework with broader
application and increased requirements

Adrian Toner
Managing Director, Risk & Regulatory Consulting



The impact of IFR/IFD and CP152 on Capital Requirements
Embedding IFR/IFD for firms in scope and expanding
use of k-factors for other MiFID firms



Andrew Farmer
Director, Sustainable Futures

ESG Reporting considerations for MiFID firms
Impact of SFDR on investing activities

01

The Current State of Play

Ciaran Flynn & Ian Nelson

Ever increasing regulatory demands

- **Significant increase in CBI scrutiny of and expectations for MiFID firms over past 18-24 months. Specific areas of focus include:**
 - Market Integrity and Market Conduct Risk
 - Cybersecurity, Operational Resilience (CP140), DORA, Data Quality and Digital Innovation
 - Existence and activity of Internal Audit functions – increasingly a requirement for all new licensees
 - CBI Cross Industry Guidance on Outsourcing (CP138) - including intra-group arrangements
 - Enhanced ESMA Product Governance requirements, and CBI focus on Structured Retail Products
 - Fund costs and fees
 - Control Frameworks and Risk Appetite Statements – Dear CEO March 2023
- **Reform of MiFID regulations on European-wide agenda**
- **Individual Accountability Regime (CP153)**
- **Client Asset Requirements**
- **Bedding down of IFR/IFD and introduction of a subset of K-Factors for ManCos with MiFID permissions (CP152)**
- **Sustainability agenda and ESG Reporting – SFDR and CSRD**

02

Individual Accountability Framework (CP153)

Áine MacDonnell

Individual Accountability Framework – CP153

The Central Bank of Ireland (Individual Accountability Framework) Act 2023 was enacted on 09 March 2023. A three month consultation ([CP153](#)) period is now live, closing on **13 June 2023**. The IAF will result in significant changes across in-scope organisations and will impact all aspects of in-scope firms’ operating models and the employee lifecycle.



Investment firms in scope for the SEAR element of IAF from 1 July 2024 are those which underwrite on a firm commitment basis and/or deal on own account and/or are permitted to hold client assets. The CBI will carry out a review of the Framework’s operation three years after implementation.

Effective Date	Requirement
From 31 December 2023	Conduct Standards including the accountability of senior individuals for running their parts of the business effectively (i.e. Additional Conduct Standards)
From 31 December 2023	F&P Regime enhancements including firm certification requirements and the inclusion of holding companies within the regime
From 01 July 2024	SEAR for those firms in-scope

03

Revised Client Assets Requirements (CAR)

Áine MacDonnell

Background and Scope

- New Client Asset Regulations effective for investment firms 1 July 2023, following consultation with the aim of ensuring that client assets remain appropriately safeguarded, especially in the event of insolvency.
- Regulations published in July 2022 following consultation with the aim of ensuring that client assets remain appropriate safeguarded, especially in the event of insolvency. Consultation issued to address shortcomings in previous regime and to provide for complex business models where client assets are held, including wholesale market activity in the Irish market as a result of Brexit.



Client asset principles - New requirements

	Summary	Key Considerations
 Segregation	<ul style="list-style-type: none"> Client assets should be deposited directly into a third party client asset account. Where this is not possible those circumstances should be documented in the firm's CAMP. Cheques should be recorded immediately in the firm's books and records and deposited promptly. Physical assets should be stored securely and movements should be logged 	<ul style="list-style-type: none"> Identify circumstances where it's not possible to deposit funds directly into the client asset account
 Designation & Registration	<ul style="list-style-type: none"> The existing requirement to clearly identify client assets in records will apply to in scope credit institutions going forward. Firms should review relevant documentation including for third party relationships to ensure that client asset account(s) opened prior to the application of the CAR to credit institutions are correctly designated. 	<ul style="list-style-type: none"> Identify in-scope accounts and implement robust process to ensure compliance
 Reconciliation	<ul style="list-style-type: none"> Client funds reconciliations must take place at least daily (or monthly where client funds are held in the form of fixed term deposits). Client financial instruments reconciliations to third parties must take place at least monthly. Where a firm enters into Securities Financing Transactions or is using financial instruments for its own account, for the purpose of the reconciliation it must record the client on whose instruction the transaction has been entered, along with their consent and balance of financial instruments. Where financial instruments are not deposited with a third party, but rather held internally, a reconciliation must be performed at least monthly against the records of the entity responsible for holding legal entitlement. Physical assets must be reconciled monthly (bi-annually against external records where they are held on behalf of certain eligible counterparty clients). Firms must maintain a record of actions taken to remediate reconciliation differences or discrepancies. 	<ul style="list-style-type: none"> Review and update existing records and processes to ensure they are adequate to meet requirements

Client asset principles - New requirements

Summary of Requirements

Key Considerations



Calculation

- Firms must perform a “calculation” of client financial instruments to ensure that the client financial instrument resource is equal to the client financial instrument requirement at least on a monthly basis.
- In the event of a shortfall of client funds, an investment firm shall deposit, promptly and within one working day, funds from its own assets into a third party client asset account. In the event of an excess of client funds, a firm shall withdraw from a third party client asset account, promptly and within 5 working days, the excess funds.
- Any shortfall of client financial instruments should be addressed by the firm as soon as possible and within five working days and can be in the form of the firm’s own funds or financial instruments. Excesses of client financial instruments should be addressed by the firm as soon as possible and within five working days.
- Where a shortfall or excess of client assets arises because of a breach of CAR, notification must be made to the Central Bank (irrespective of the amounts involved), and firms must maintain a record of actions taken to address the shortfall or excess. Firms should consider whether it is appropriate to notify the affected client(s) of the situation.

- **Review and update processes (taking account of any required system changes) to meet this new obligations**
- **Assess whether records are adequate to conduct the new calculation process**
- **Define material reconciliation differences and material shortfall/excess thresholds**
- **Ensure firm is in a position to fund any shortfalls identified**





Client Disclosure & Consent

- Certain disclosures will need to be included in the impacted firm’s terms of business.
- Credit institutions will need to disclose to clients how their assets are being held
- In respect of transfers of client assets, notifications need to be made to the Central Bank where the transfers are material, and client consent needs to be obtained.
- In wholesale market activity, consent will need to be acquired and agreements put in place for financial instruments, and title transfer collateral arrangements. Additionally, disclosures will need to be provided by firms providing prime brokerage services.

- **Review client communications and agreements and conduct gap analysis against new disclosure and consent requirements**
- **As a credit institution conducting MiFID services, assess whether client assets are held as deposits or in third-party accounts**

Client asset principles - New requirements

	Summary of Requirements	Key Considerations
 Risk Management	<ul style="list-style-type: none"> • Credit Institutions must appoint a Head of Client Assets Oversight (PCF-45) • Within the CAMP, firms must produce a Client Asset Applicability Matrix (CAAM) to ensure that the firm has identified where client asset obligations arise across its business lines and services. The CAAM should set out a clear rationale as to why a product or service is in or out of scope of each client asset provision • Within the CAMP, firms must also produce a Client Asset Risk Matrix (CARM) which reflects the risks to safeguarding client assets of that specific business model and descriptions of relevant processes and controls to manage these risks • The location of the client asset breach and incident log should be referenced in the CAMP, by hyperlink or other such pathway 	<ul style="list-style-type: none"> • Develop and implement a CAMP that reflects the changes and is based on a detailed assessment • Ensure revised CAMP is meaningfully addressing risk • Implement robust process to keep the CAMP updated
 Client Assets Examination	<ul style="list-style-type: none"> • Client Asset Examinations (CAE) will need to incorporate the new requirements • Credit institutions will undertake the CAE for the first time in the 2025 	<ul style="list-style-type: none"> • Consider the operational and financial impact of changes in scope to your client assets examination

04

The impact of IFR/IFD and CP152 on Capital Requirements

Adrian Toner

Capital Requirements for MiFID firms – IFD/IFR

Since June 2021, Class 2 MiFID firms have been subject to capital requirements under EU Investment Firms Regulation 2019/2033 (“IFR”)

- The K-Factor methodology has been introduced to calculate a range of risks which an investment firm presents to the **market**, **customers** and the **firm itself**.
- The requirements are tailored to the respective activities of an investment firm, to create a **capital requirement that is more directly proportional to its risk profile**.
- This K-factors aim to quantify the services and business practices for a particular investment firm in a **risk sensitive manner**.
- The K-Factor methodology is **applicable to those firms categorised as Class 2** under the new requirements.

Minimum capital requirements are determined as:

Class 1 Firms

The sum of exposures to mitigate:

- Credit Risk;
- Market Risk; and
- Operational Risk.

Class 2 Firms

The highest of:

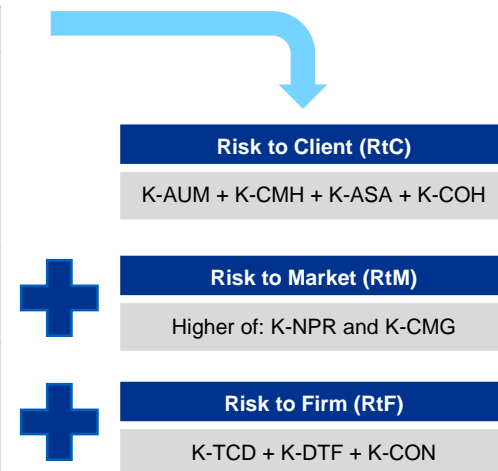
- Permanent Minimum Capital PMC)
- Fixed Overhead Requirements (FOR); and
- **K-Factor Capital Requirements**

Class 3 Firms

The highest of:

- Permanent Minimum Capital PMC); and
- Fixed Overhead Requirements (FOR)

Category	K-Factor	Description
Risk to Customer (RtC)	K-AUM	Assets under management (discretionary and ongoing non-discretionary advisory).
	K-CMH	Client money held (on a segregated or non-segregated basis).
	K-ASA	Assets under safeguard and administration.
	K-COH	Client orders handled (cash trades and derivatives).
Risk to Market (RtM)	K-NPR	Net position risk on own account trading book positions.
	K-CMG	Total margins required by firm's clearing member (if permitted by component authority).
Risk to Firm (RtF)	K-TCD	Trading counterparty default (own account trading book exposures).
	K-DTF	Daily trading flow for cash trades or derivatives
	K-CON	Concentration risk on own account trading book transactions.



As the framework continues to mature, **the incorporation of K-factors into ICAAP** is an area of increasing focus for both Internal Auditors and Regulators.

CP152 – K-factor requirements

Under the new CP 152 proposal, Mancos providing individual portfolio management services will be required to consider K-factors in determining their minimal capital requirements.

Minimum Capital requirements will be determined by applying the higher of:

A

Minimum Capital Requirements under the UCITS/AIFM Regulations as applicable.

B
new

“Risk-to-Client k-Factor” requirement (new for ManCos, but similar to regs applicable to MiFID firms under IFR).

Existing CBI minimum capital requirements

I. Initial Capital plus Additional Amount

‘Initial capital’ of €125k + ‘additional amount’ of 0.02% of AUM in excess of €250bn

Or

II. Expenditure Requirement

one quarter of previous year’s expenditure as set out in most recent annual accounts

Plus

III. Professional Liability Risks

0.01% of AIF AUM (only applicable in the case of AIFMs to AIFM AUM)

K-Factor	Coefficient
K AUM	0.02%
K CMH	0.4% on seg accounts 0.5% on non-seg accounts
K ASA	0.04%
K COH*	0.01% on cash trades** 0.01% on derivatives

The purpose is to create a level playing field in the calculation of own funds requirements for Mancos using their MiFID top-up licences.

Small and non-interconnected* ManCos are out of scope for CP 152

They must satisfy all of the following conditions:

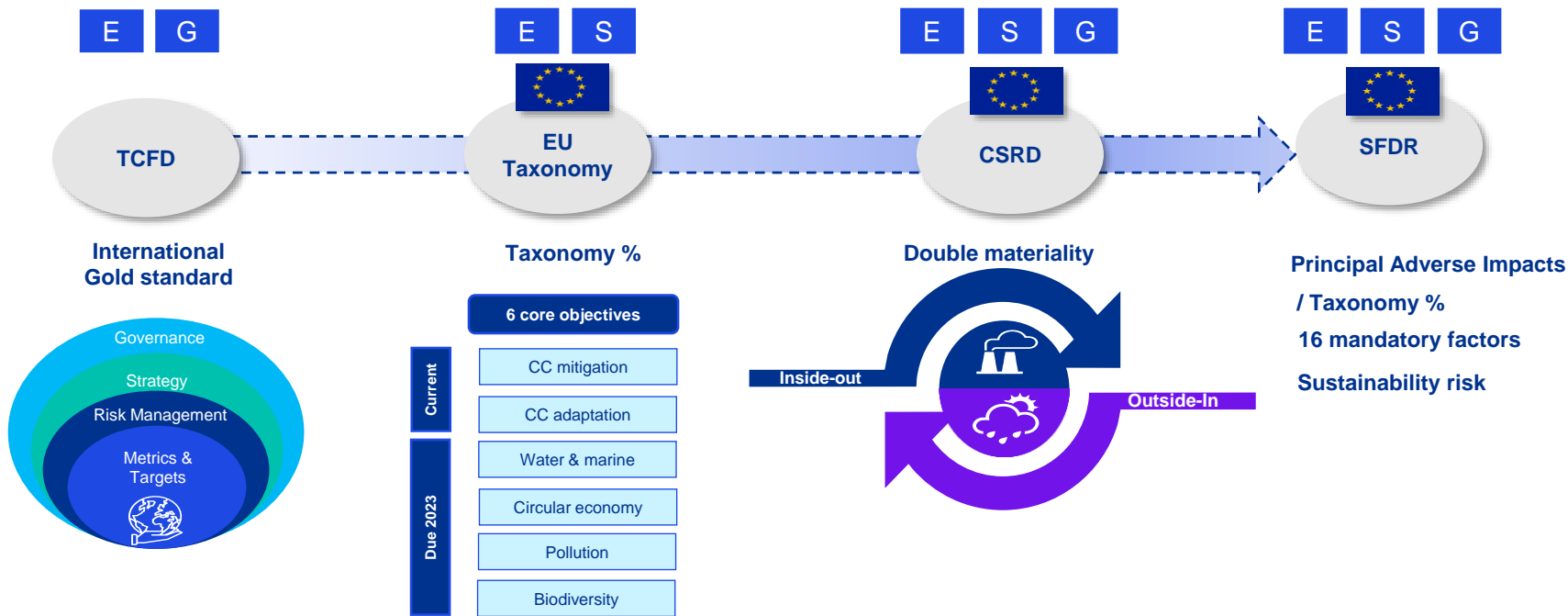
K AUM	< €1.2Bn
K CMH	zero
K ASA	zero
K COH	< €100M per day for cash trades < €1Bn per day for derivatives
On & off bal. sheet total of ManCo	< €100M
Annual ManCo gross revenue from IPM	< €30M

05

ESG Reporting Considerations for MiFID Firms

Andrew Farmer

Identifying interlinkages across EU frameworks...



What does SFDR do for transparency?

SFDR came into force in March 2021. It introduced mandatory sustainability disclosures for EU based asset managers. It also introduced a product classification system and associated disclosures for products managed from or marketed into the EU that have ESG characteristics



Entity/Manager Level Disclosures

- Sustainability Risk Policy
- Remuneration Policy
- Principal Adverse Impact Statement (comply or explain)



Product Classification System

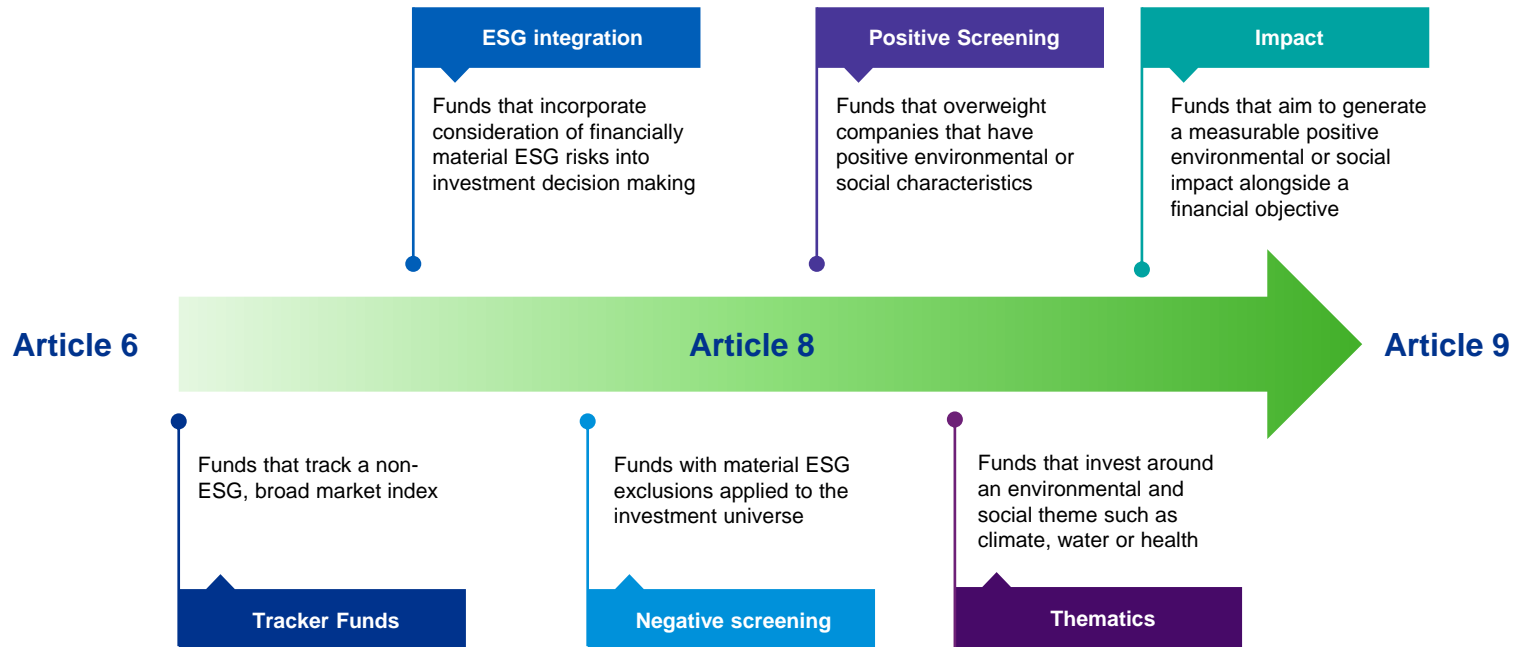
- Article 9 (dark green) – products that have “sustainable Investment” as their objective
- Article 8 (light green) – products that promote environmental or social characteristics without a commitment to making “sustainable investments”
- Article 6 – everything else



Product Level Disclosures

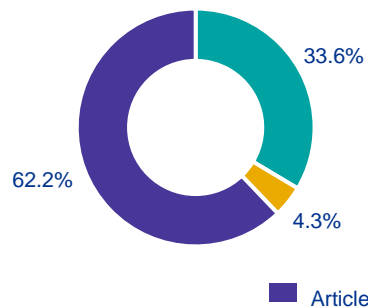
- Pre-contractual disclosures
- Periodic disclosures
- Website disclosures

SFDR: Example Product Classification

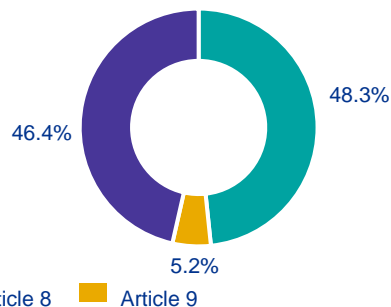


SFDR: State of the Market

SFDR fund type breakdown, by number of funds



SFDR fund type breakdown, by assets



- Based on prospectus data collected by Morningstar, of 97.4 percent of funds¹ available for sale in the EU, Article 8 and 9 currently represent up to 37.8 percent of the total European funds and up to 53.5 percent of total European fund assets.
 - About 8,459 funds (33.6 percent) have been classified as Article 8, while 1,080 funds (4.3 percent) have been classified as Article 9.
 - In terms of assets, Article 8 represents 48.3 percent of the European fund assets, while Article 9 funds 5.2 percent of the fund assets. Together, these two funds amount to a total of EUR4.3 trillion¹.

Outlook: According to Morningstar. In recent months, managers have been busy preparing to implement the regulatory technical standards that will come into effect in January 2023. Ahead of this upgraded disclosure regime, some managers have reviewed their funds' classification and downgraded Article 9 products to Article 8.



Room for interpretation

- There continues to be a **lack of consistent market practice** on the boundaries between SFDR Article 6, Article 8 and Article 9 funds
- **Certain asset classes and strategies present particular challenges** including private equity and real estate 'buy to improve' strategies, short-selling, use of derivatives and commodities



Some managers more likely to brand funds as sustainable than others

- **Divergent treatment** of negative screens and the integration of financially material ESG factors into investment decisions has led to inconsistency in the boundary between Article 6 and 8 products
- Firms are setting **different thresholds** for the minimum proportion of sustainable investments required in their Article 9 products












Asset managers' reputation at risk

- According to an analysis by Morningstar, **one in four Article 8 funds has exposure to companies involved in controversial weapons and one in five to tobacco**. The analysis also noted that 33 percent of Article 8 and 9 funds have more than 5 percent exposure to fossil fuel firms.
- The ESAs are considering **minimum criteria for Article 8 funds**. This is likely to lead to large scale reclassification exercises and product changes

Flow of Investments - 4Q 2022

- The global universe of sustainable funds attracted €37 billion of net new money in the fourth quarter of 2022, representing a rise of 51% relative to the €24.5 billion of inflows in the third quarter of 2022.
- The rebound in sustainable fund flows was felt in only three regions: Europe, Australia, and Canada, while the rest of the world, including the United States, experienced outflows.
- While product development slowed down over 2022 compared with 2021, the number of newly launched ESG funds in the fourth quarter at 159 almost levelled with the restated number per the previous quarter.

Country*	4Q 2022 Flows (in €Bn)	Total Assets (in €Bn)	% of All Flows
  Europe	€40.0	€2,078	109%
 United States	- €6.2	€286	-17%
  Asia Ex. Japan	€1.5	€51	4%
  Australia/New Zealand	€1.6	€29	4%
 Japan	-€0.6	€25	-2%
 Canada	€0.5	€28	1%

*Based on Morningstar study: "Global Sustainable Fund Flows: Q4 2022 in Review"

Periodic Reporting

Annex I

- PAI Metrics and definitions
- PAI Data Table

Annex II

- Article 8 Pre-contractual disclosure

Annex III

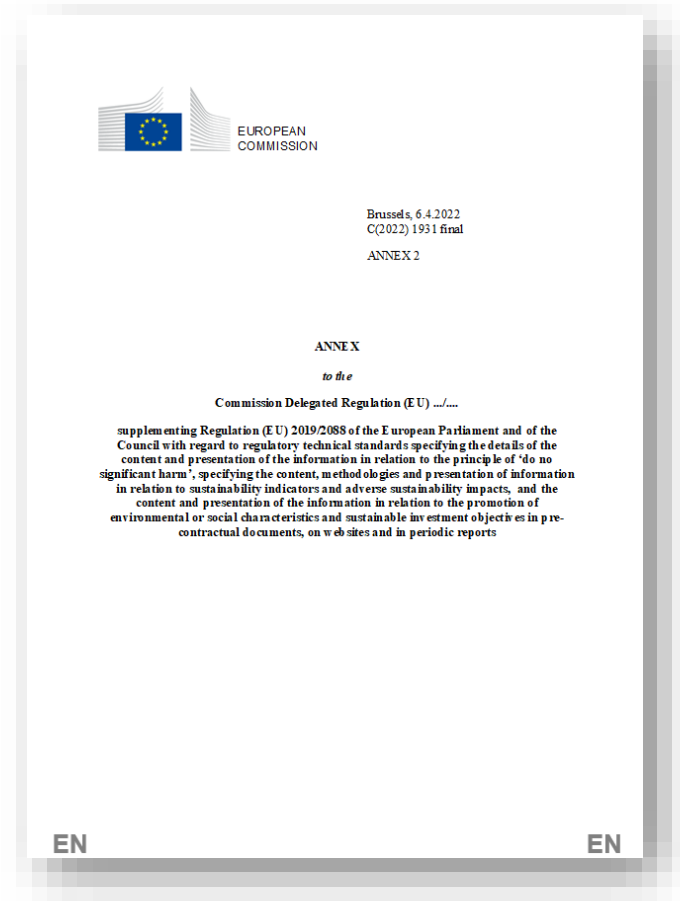
- Article 9 Pre-contractual disclosure

Annex IV

- Article 8 Periodic Report

Annex V

- Article 9 Periodic Report



Intersection of MiFID & SFDR

Suitability Preferences Assessment

- Advisors to consider clients' sustainability preferences when conducting suitability assessments.
 - minimum proportion of their investments in sustainable investments, or;
 - consider principal adverse impacts on sustainability factors on a quantitative or qualitative basis



Sustainable under SFDR 2(17): *"...an investment in an **economic activity** that contributes to an environmental objective or an investment in an economic activity that contributes to a social objective..."*

How is this economic activity measured?

- Activity-Based Approach: proportion of revenue and consideration of each PAI
- Stringent Approach: proportion of revenues at the company level
- Threshold level: revenue above a certain threshold and is aligned with a sustainable objective (SDGs) and the DNSH objective

Disclosure: Quantitative

Suitability Assessment

- At onset, representation of sustainable investment thresholds
 - Art. 9: Clear % on environmental & social and Taxonomy alignment
 - Art. 8: Percentage of sustainable investments even without the objective
- Allocation %
 - E/S
 - Sustainable
 - Taxonomy Aligned

Sample Quantitative Representations

Article 9

Article 8

Did this financial product have a sustainable investment objective? *[tick and fill in as relevant, the percentage figure represents the minimum commitment to sustainable investments]*

Yes **No**

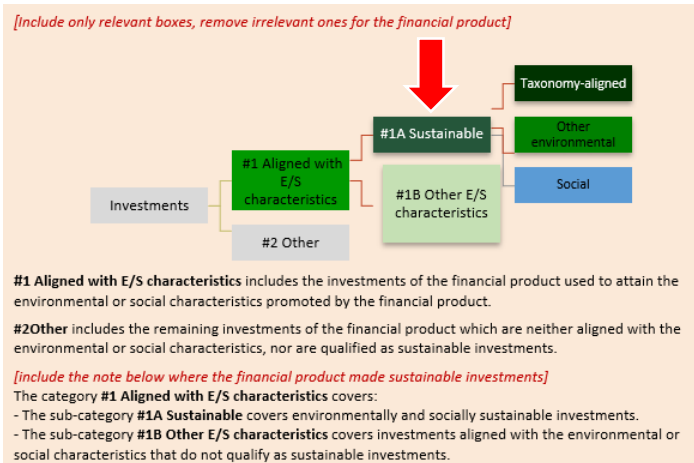
It made **sustainable investments with an environmental objective**: ___% It promoted **Environmental/Social (E/S) characteristics** and while it did not have as its objective a sustainable investment, it had a proportion of ___% of sustainable investments

in economic activities that qualify as environmentally sustainable under the EU Taxonomy with an environmental objective in economic activities that qualify as environmentally sustainable under the EU Taxonomy

in economic activities that do not qualify as environmentally sustainable under the EU Taxonomy with an environmental objective in economic activities that do not qualify as environmentally sustainable under the EU Taxonomy

with a social objective with a social objective

It made **sustainable investments with a social objective**: ___% It promoted E/S characteristics, but **did not make any sustainable investments**



Disclosure: Qualitative

Suitability Assessment

- Multiple areas of disclosure probing sustainability
- Quantitative disclosure is supported by qualitative disclosure
- Funds must respond to Taxonomy related concepts;
 - DNSH
 - OECD Guidelines
 - UN Principles



What was the share of sustainable investments with an environmental objective not aligned with the EU Taxonomy? *[include section only for the financial products referred to in Article 6, first subparagraph, of Regulation (EU) 2020/852 where the financial product included sustainable investments with an environmental objective that invested in economic activities that are not environmentally sustainable economic activities, and explain why the financial product invested in economic activities that were not Taxonomy-aligned]*



What was the share of socially sustainable investments? *[include only where the financial product included sustainable investments with a social objective]*



What investments were included under “other”, what was their purpose and were there any minimum environmental or social safeguards?



How did the sustainable investments that the financial product partially made not cause significant harm to any environmental or social sustainable investment objective? *[include where the financial product includes sustainable investments]*

How were the indicators for adverse impacts on sustainability factors taken into account?

Were sustainable investments aligned with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights? Details:

06

Q&A

All Panellists

Thank you



Further Reading

Asset Management Regulatory

[Asset Management - Funds & Investments - KPMG Ireland](#)

[Asset Management updates - March 2023 - KPMG Ireland](#)

[Asset Management updates - February 2023 - KPMG Ireland](#)

[Asset Management updates - January 2023 - KPMG Ireland](#)

[MiFID structured retail product review - KPMG Ireland](#)

Individual Accountability Framework (CP153)

[The Individual Accountability Framework \(“IAF”\) - KPMG Ireland](#)

Client Assets

[Revised Client Asset Regulations – are you ready? - KPMG Ireland](#)

Product Governance

[KPMG Regulatory Horizon \(kpmgrc.com\)](#)

ESG Thought Leadership

[Avoiding the Greenwash Peril - KPMG Ireland](#)

[ESG & Asset Management - KPMG Ireland](#)



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