Regulatory News

Q2 2023

Japan Fund Management (Luxembourg) S.A.

Executive Summary (1 of 2)

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Ukraine Crisis

26-Jun-23: CSSF updated its webpage compiling all the relevant information for the financial sector in relation to the Ukraine crisis.

https://www.cssf.lu/en/ukraine-crisis/

The CSSF maintains a webpage compiling all the relevant information for the financial sector in relation to the Ukraine crisis. The webpage relates to the CSSF's effort to draw attention of the professionals of the financial sector subject to its supervision to the restrictive measures decided by the EU in response to the current situation in Ukraine. The webpage is regularly updated as the situation continues to evolve. It currently comprises the following sections:

- **Laws, regulations and directives**, which includes EU regulations binding in their entirety and directly applicable in national law, such as:
  - Council Implementing Regulation (EU) 2023/1216 of 23 June 2023 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine: http://data.europa.eu/eli/reg_impl/2023/1216/oj

- **Other reference texts**, which currently includes:
  - EU Best Practices for the effective implementation of restrictive measures: https://data.consilium.europa.eu/doc/document/ST-10572-2022-INIT/en/pdf
  - FAQs on Russia-Ukraine war and ECB Banking Supervision: https://www.bankingsupervision.europa.eu/press/publications/html/ssm.faq_Russia_Ukraine_war_and_Banking_Supervision~8360ccdf6f.en.html
  - FAQs regarding International Financial Sanctions: https://www.cssf.lu/wp-content/uploads/FAQ_International_financial_sanctions.pdf

- **Publications**, which includes among others:
  - Council Decision (EU) 2022/2332 of 28 November 2022 on identifying the violation of Union restrictive measures as an area of crime that meets the criteria specified in Article 83(1) of the Treaty on the Functioning of the EU: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32022D2332

- **Useful links**, which currently provides direct access to:
  - EU sanctions adopted following Russia's military aggression against Ukraine (incl. FAQ): https://ec.europa.eu/info/business-economy-euro/banking-and-finance/international-relations/restrictive-measures-sanctions/sanctions-adopted-following-russias-military-aggression-against-ukraine_en
  - EU Sanctions Whistleblower Tool: https://eusanctions.integrityline.com
  - EU Sanctions Map of the European Commission in order to keep abreast of the sanctions regime into force: https://sanctionsmap.eu/#/main

Sustainable Finance (1 of 6)

06-Apr-23: CSSF released its supervisory priorities in the area of sustainable finance.

https://www.cssf.lu/en/2023/04/the-cssfs-supervisory-priorities-in-the-area-of-sustainable-finance/

The CSSF's supervisory priorities in the area of sustainable finance aim at fostering a cohesive implementation of the sustainable finance framework across the financial sector and ensuring the integration of ESG requirements in the CSSF's supervisory practice, taking into account regulatory developments as well as developing practices.

Supervisory priorities for the asset management industry

- Organisational arrangements of IFMs and integration of sustainability risks
- Compliance of pre-contractual and periodic disclosures with SFDR, the SFDR RTS and the Taxonomy Regulation
- Consistency of information in fund documentation and marketing material
- Compliance of product website disclosures with SFDR
- Consistency of portfolio holdings with fund characteristic and documentation disclosed to investors

Schedule of supervision exercises at the initiative of the European authorities

NATURE OF EXERCISE	RELEVANT FOR	2023 Q1	2023 Q2	2023 Q3	2023 Q4
ESMA CSA Marketing communications and advertising under MiFID II	Credit institutions Investment firms			*CSA roll-out*	
ESMA European Common Enforcement Priorities for non-financial reports	Issuers			*Exercise roll-out*	
ESMA CSA Sustainability risks and disclosures in asset management	IFMs UCIs			*CSA roll-tout (continued in 2024)*	
ESAs 'JC Survey Stocktake of the extent of voluntary disclosures	IFMs UCIs Credit institutions Investment Firms	*Survey roll-out*			

Sustainable Finance (2 of 6)

12-Apr-23: ESAs published a consultation paper on the review of SFDR Delegated Regulation.

https://www.esma.europa.eu/sites/default/files/2023-04/JC_2023_09_Joint_consultation_paper_on_review_of_SFDR_Delegated_Regulation.pdf

The consultation paper reviews the SFDR Delegated Regulation regarding PAI and financial product disclosures with the aim to broaden the disclosure framework and address some technical issues that have emerged since the SFDR was originally agreed, as well as to propose amendments to RTS on pre-contractual documents, on websites and in periodic reports.

Specifying the details of the content and presentation of the information in relation to the principle of 'do no significant harm': New DNSH disclosures design options, such as the proposal to disclose quantitative thresholds related to the PAI indicators to determine whether the sustainable investments do not significantly harm any environmental or social objectives, as well as to base and align the DNSH under the SFDR on the technical screening criteria under the Taxonomy.

Specifying the content, methodologies and presentation of information in relation to sustainability indicators and adverse sustainability impacts: Extension of the list of social indicators for principal adverse impacts mostly based on the first set of draft European Sustainability Reporting Standards (ESRS) and refinement of the content and applicable methodologies of some other indicators (formulas for the PAI indicators that did not already have one, clarifications about existing metrics with respect to data sources disclosures, current value of investments definitions, investee companies' value chain and treatment of derivatives).

New proposed mandatory indicators	New proposed opt-in indicators
• Earnings in non-cooperative tax jurisdictions • Exposures to tobacco companies • Interference with formation of trade unions or election of worker representatives • Share of employees earning less than the adequate wage	• Excessive use of non-guaranteed-hour employees, temporary contract employees, non-employee workers • Insufficient employment of persons with disabilities • Lack of grievance/complaints handling mechanisms

Specifying the content and presentation of the information regarding the promotion of environmental or social characteristics and sustainable investment objectives in pre-contractual documents, on websites and in periodic reports: Amendments regarding GHG emissions calculation methodology (use of PCAF's Standards) and reduction targets (still optional), including intermediary targets and milestones, actions pursued and distinction between a product-level commitment to achieve a reduction in financed emissions and a commitment to achieve a reduction in investee companies.

Simplification of the templates and other technical adjustments: Among others, the introduction of a dashboard for both pre-contractual and periodic disclosures to investors containing 4 elements: (i) Sustainable investments; (ii) Taxonomy aligned investments; (iii) PAI consideration; and (iv) GHG emissions reduction targets.

Sustainable Finance (3 of 6)

14-Apr-23: EC published its answers to questions on the interpretation of SFDR that were submitted by the ESAs in September 2022.

https://www.esma.europa.eu/sites/default/files/2023-04/Answers_to_questions_on_the_interpretation_of_Regulation_%28EU%29_20192088.PDF
https://www.esma.europa.eu/sites/default/files/2023-04/Amendments_to_answers_to_questions_on_the_interpretation_of_Regulation_%28EU%29_20192088_SFDR.PDF

The European Commission's answers to the questions on the interpretation of SFDR include:

Definition of sustainable investment: SFDR does not prescribe any specific approach to determine the contribution of an investment to environmental or social objectives. Financial market participants must disclose the methodology they have applied to carry out their assessment of sustainable investments, where reference to economic activities target cases in which funds are allocated to a specific project or to a company engaged in one single type of activity, or whether the notion of sustainable investment is measured at the level of a company and not only at the level of a specific activity.

Contribution to environmental or social objective: The SFDR does not set out minimum requirements that qualify concepts such as contribution, do no significant harm, or good governance, i.e. the key parameters of a 'sustainable investment'. Financial market participants must carry out their own assessment for each investment and disclose their underlying assumptions. Referring to a transition plan aiming to achieve that the whole investment does not significantly harm any environmental and social objectives in the future cannot for instance not be considered as sufficient.

Financial products with carbon emissions reduction as an objective: Where no Paris-Aligned or Climate Transition benchmark is passively tracked, the SFDR requires a detailed explanation of how the continued effort of attaining the objective of reducing carbon emissions is ensured in view of achieving the long-term global warming objectives of the Paris Agreement using an active investment strategy.

Promotion of carbon emissions reduction as an environmental characteristic: Article 8 of the SFDR does not limit the types of characteristics that can be promoted by financial products. The SFDR does not prevent a product from promoting carbon emissions reductions as part of its investment strategy if the product does not have a sustainable investment, given that marketing documents do not lead investors into believing that the product pursue a sustainable investment.

Principal Adverse Impacts (PAIs) at financial product-level: The description related to the adverse impacts shall include both a description of the adverse impacts and the procedures put in place to mitigate those impacts.

Principal Adverse Impacts (PAIs) at financial entity-level: Considering the average number of 500 employees threshold that qualifies a FMP for PAIs reporting, Since SFDR does not contain a definition of who constitutes an employee, it must therefore be determined by reference to the applicable national law.

Sustainable Finance (4 of 6)

17-May-23: ESAs published a consolidated Q&A on the SFDR and the SFDR Delegated Regulation.

https://www.esma.europa.eu/sites/default/files/2023-05/JC_2023_18_-_Consolidated_JC_SFDR_QAs.pdf

ESAs published a consolidated Q&A on the SFDR and the SFDR Delegated Regulation, which combines responses given by the European Commission to questions requiring interpretation of Union Law, and responses generated by the ESAs relating to the practical application or implementation of SFDR and its delegated acts.

The ESAs gathered all the answers to the questions on the implementation of SFDR and its delegated acts provided by the EC and the ESAs over the period from 14 July 2021 until the latest answers from the EC on 14 April 2023.

No additional questions were answered in the documents.

Sustainable Finance (5 of 6)

31-May-23: ESAs published their Progress Report on Greenwashing in the financial sector.

https://www.esma.europa.eu/sites/default/files/2023-06/ESMA30-1668416927-2498_Progress_Report_ESMA_response_to_COM_RfI_on_greenwashing_risks.pdf

The European Commission issued a “Request for input related to greenwashing risks and the supervision of sustainable finance policies” to ESAs in May 2022. This Progress Report (the Report) aims to support a better understanding of greenwashing and to assess which areas of the sustainable investment value chain (SIVC) are more exposed to greenwashing risks. It lays the ground for effective monitoring, prevention and remediation of greenwashing risks.

Definition of greenwashing. According to ESAs, greenwashing is a practice where sustainability-related statements, declarations, actions, or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product or financial service. This practice may be misleading to consumers, investors, or other market participants. Such sustainability-related misleading claims can occur and spread either intentionally or unintentionally. Greenwashing does not require investors being actually harmed. Moreover, greenwashing can occur in relation to entities and products outside the remit of the EU regulatory framework.

Greenwashing risks and preliminary remedial actions.

- With regards to issuers: Forward-looking information and pledges about future ESG performance are more exposed to greenwashing risk. Enhanced transparency on underlying assumptions and parameters, clarifications on the use and calculation of estimates, external verification and auditing would be important.
- With regards to investment managers: Sustainability claims particularly exposed to greenwashing risks are those about a fund’s or the manager’s engagement with investee companies; ESG strategy, policies and credentials; ESG governance; claims on sustainability impact. Fund names are also exposed to greenwashing risks. Mitigating these risks would require among others: clarifying the concept of contribution to a sustainable objective; standardising disclosures for engagement; establishing a reliable and well-designed labelling scheme for sustainable financial products.
- With regards to benchmarks: Areas more exposed to greenwashing risks are impact claims related to specific climate and ESG benchmarks; misleading naming practices; lack of transparency regarding holdings; ESG data methodologies. In terms of mitigation, enhancing the Benchmark Regulation’s interaction with more recent pieces of the sustainable finance framework would be important as well as the introduction of a reliable labelling scheme for ESG benchmarks.
- With regards to investment service providers: Areas more exposed to greenwashing risks are claims about the extent to which advice offered to retail investors takes sustainability into account and situations where an advisor may not provide suitable personalised advice when presenting the sustainability features of products. In terms of mitigation, the regulatory framework could be strengthened concerning the concept of sustainability preferences, and financial advisors’ expertise improved.

Building on this Report, the Final Report will be published in **May 2024**.

Sustainable Finance (6 of 6)

13-Jun-23: EU Commission published a new package of measures to strengthen the EU sustainable finance framework including, among others, EU Taxonomy Delegated Acts and a proposal for a regulation of ESG ratings providers.

https://finance.ec.europa.eu/publications/sustainable-finance-package-2023_en

EU Taxonomy Delegated Acts: the new set of EU Taxonomy criteria for economic activities now covers the six environmental objectives.

- **Amendments to the EU Taxonomy Climate Delegated Act:** addition of economic activities contributing to climate change mitigation and adaptation. The amendments were made in accordance with the recommendations of the Platform on Sustainable Finance.
- **EU Taxonomy Environmental Delegated Act:** addition of the four remaining environmental objectives: sustainable use and protection of water and marine resources, transition to circular economy, pollution prevention and control, protection and restoration of biodiversity and ecosystems.
- **EU Taxonomy Disclosures Delegated Act:** reflects the reporting obligations for users laid down in the Taxonomy Environmental Delegated Act and in changes to the Climate Delegated Act. Amendments to all the Annexes to include the four environmental objectives to the summary tables.
- **Commission Staff working documents:** accompanies the Environmental Delegated Act and Climate Delegated Act targeted amendments providing an overview of the technical substance (technical screening criteria), uses and impacts.

Proposal for a Regulation on the transparency and integrity of Environmental, Social and Governance rating activities: new organisational principles and clear rules on the prevention of conflicts of interest to increase the integrity of the operations of ESG rating providers.

- **Regulation Proposal:** will require that ESG rating providers offering services to investors and companies in the EU be authorised and supervised by ESMA.
- **Impact assessment on the proposal:** based on a comparison of the effectiveness and coherence of the options analysed, the preferred option would be a combination between ESG rating providers rules on authorisation, organisational requirements and supervision, and ESG ratings with minimum transparency and comprehensiveness of disclosures on methodologies and objectives of ratings to the general public, users of ESG rating providers and rated companies.

Commission Recommendation on transition finance: aims to show how companies can use the various tools of the EU sustainable finance framework on a voluntary basis to channel the investments into the transition and manage their risks stemming from climate change and environmental degradation.

Commission notice on minimum safeguards under the EU Taxonomy and its interactions with SFDR: ‘sustainable investments’ under the SFDR include investments into environmentally sustainable economic activities within the meaning of the Taxonomy Regulation.

AML/CTF (1 of 3)

19-Apr-23: EU Parliament approved its negotiating mandate for the legislative proposals contained in the EU AML package.

https://www.europarl.europa.eu/news/en/press-room/20230414IPR80123/stopping-the-flow-of-dirty-money-parliament-ready-for-negotiations

On 19 April 2023, the EU Parliament announced that it has approved its negotiating mandate for the remaining three legislative proposals contained in the EU AML package: AMLA, the AML Regulation, and AMLD6. Earlier in April, the EU Parliament published its detailed reports on those three legislative proposals. In May, the EU Parliament started the negotiations with the EU Council and the EU Commission. Once consensus is reached, the legislative proposals must then be formally approved by the EU Parliament and the EU Council.

Background

The EU AML Package consisted of four legislative proposals:

- **A regulation providing for the creation of a new EU-wide AML/CTF authority (AMLA):** The draft regulation would establish a new European Anti-Money Laundering Authority (AMLA) with supervisory and investigative powers to enforce the rules consistently. In particular, AMLA will: establish a single integrated system of AML/CTF supervision across the EU; directly supervise some of the riskiest financial institutions operating in the EU; monitor and coordinate national supervisors; support cooperation among national Financial Intelligence Units, facilitating coordination between them.
- **A regulation on AML/CTF focusing on customer due diligence aspects (AML Regulation):** The draft regulation aims to set up a single EU rulebook for AML/CTF, ensuring a greater level of harmonisation and convergence in the application of AML/CTF rules across the EU. The proposed regulation includes, among others, more detailed rules on customer due diligence, beneficial ownership and the powers and task of supervisors and Financial Intelligence Units.
- **A 6th directive on AML/CTF focusing on supervisory and Financial Intelligence Unit aspects (AMLD6):** The proposed directive, among others: enables Member States to extend the requirements of the accompanying draft Regulation to other sectors not covered in the scope of that Regulation; sets out specific regulatory requirements that Member States are to implement in national law for certain sectors; allows supervisors of the Member States where electronic money issuers, payment service providers and crypto-assets service providers are active via freedom to provide services to appoint contact points in those Member States.
- **A revised version of the Transfers of Funds Regulation:** On 9 June 2023, Regulation (EU) 2023/1113 of 31 May 2023 on information accompanying transfers of funds and certain crypto-assets (the Transfers of Funds Regulation) has been published in the EU Official Journal. It extends the scope of the EU legal framework to the transfer of crypto-assets when certain conditions are met.

AML/CTF (2 of 3)

23-Jun-23: FATF updated its black and grey lists.

https://www.fatf-gafi.org/en/countries/black-and-grey-lists.html

High-risk jurisdictions subject to a FATF call for action to:

i. apply countermeasures: **Democratic People's Republic of Korea** (unchanged); **Iran** (unchanged).
ii. apply enhanced due diligence measures: **Myanmar** (unchanged).

Jurisdictions under increased monitoring by FATF (added jurisdiction: blue; removed jurisdiction: ~~strikethrough~~):

Albania	Croatia	Jordan	Philippines	Tanzania	Yemen
Barbados	Democratic Republic of Congo	Mali	Senegal	Türkiye	
Burkina Faso	Gibraltar	Mozambique	South Africa	Uganda	
Cameroon	Haiti	Nigeria	South Sudan	United Arab Emirates	
Cayman Islands	Jamaica	Panama	Syria	Vietnam	

Background

High-risk jurisdictions have significant strategic deficiencies in their regimes to counter money laundering, terrorist financing, and financing of proliferation. For all countries identified as high-risk, the FATF calls on all members and urges all jurisdictions to apply enhanced due diligence and, in the most serious cases, countries are called upon to apply countermeasures to protect the international financial system. This list is often externally referred to as the “FATF black list”.

Jurisdictions under increased monitoring are actively working with the FATF to address strategic deficiencies in their regimes to counter money laundering, terrorist financing, and proliferation financing. When the FATF places a jurisdiction under increased monitoring, it means the country has committed to resolve swiftly the identified strategic deficiencies within agreed timeframes and is subject to increased monitoring. This list is often externally referred to as the “FATF grey list”.

AML/CTF (3 of 3)

23-Jun-23: FATF Plenary concluded that Luxembourg has reached a high level of technical compliance with the FATF's requirements and its AML/CTF regime is delivering good results.

https://www.fatf-gafi.org/en/publications/Fatfgeneral/outcomes-fatf-plenary-june-2023.html

The FATF discussed and adopted the mutual evaluation report of Luxembourg which assessed the effectiveness of that country's measures to combat money laundering and terrorist financing, and their compliance with the FATF Recommendations.

The Plenary concluded that Luxembourg has reached a high level of technical compliance with the FATF's requirements and its AML/CTF regime is delivering good results. Luxembourg has achieved a good understanding of the money laundering and terrorist financing risks it faces, particularly important given its status as a regional and international financial centre. The country achieved robust domestic co-operation and co-ordination at both policy and operational levels, including in the use of financial intelligence and access to beneficial ownership information, and constructive cooperation with its international counterparts.

Luxembourg needs to focus on strengthening its measures in certain areas, including improving the detection, investigation and prosecution of more complex money laundering cases, in line with the country's risk profile. Luxembourg should also strengthen the risk-based supervision of its non-financial sector, further develop and disseminate its understanding of terrorist financing risks to both the public and private sectors and apply proportionate and dissuasive sanctions for non-compliance to its financial and non-financial sectors.

The FATF will publish the report by September after the FATF's quality and consistency review is completed.

AIFs and UCITS

14-Jun-23: ESMA updated its Q&A on the application of the AIFMD and its Q&A on the application of the UCITS Directive.

https://www.esma.europa.eu/sites/default/files/library/esma34-32-352_qa_aifmd.pdf
https://www.esma.europa.eu/sites/default/files/library/esma34_43_392_qa_on_application_of_the_ucits_directive.pdf

AIFMD pre-marketing. Pursuant to Art. 30a AIFMD, pre-marketing can be conducted by a third party on behalf of an authorised EU AIFM only if that third party is authorised as an AIFM in accordance with AIFMD, as a UCITS management company in accordance with the UCITS Directive, as an investment firm or tied agent under MIFID II, or as a credit institution under CRD. Moreover, such third party is subject to the conditions for pre-marketing set out in Art. 30a AIFMD. Unless otherwise required under national rules, registered EU AIFMs are not subject to the pre-marketing provisions laid down in AIFMD.

AIFMD de-notification. AIFMD contains an explicit exemption referring to closed-ended ELTIFs. In all other cases, all de-notification obligations laid down in Art. 32a AIFMD shall be complied with, making sure that there are no investors uninformed about the AIFM's market exit, that all marketing is publicly terminated and any marketing arrangements with the third parties are terminated or modified to prevent any further marketing of the de-notified AIF.

UCITS de-notification. All de-notification obligations set out in Art. 93a of the UCITS Directive (UCITSD) shall be complied with, making sure that there are no investors uninformed about the UCITS' market exit, that all marketing is publicly terminated and any marketing arrangements with third parties are terminated or modified to prevent any further marketing of the de-notified UCITS.

AIFMD passporting. An AIFM cannot passport ancillary activities into a host Member State without also passporting the investment management function.

AIFMD leverage. Pursuant to Art. 6(3) AIFMD Level 2 Regulation, when calculating the leverage of an AIF whose core investment policy is to invest in real estate directly or indirectly, the AIFM shall include the exposure contained in financial or legal structures involving third parties controlled by that AIF where such structures are specifically set up to directly or indirectly increase the exposure at the level of the AIF.

Management of AIFs by UCITS management companies. UCITS management companies are allowed to manage AIFs as AIFMs registered under Art. 3 AIFMD. Pursuant to Art. 6(2) UCITSD, management companies can manage other collective investment vehicles for which the management company is subject to prudential supervision. AIFMs registered in accordance with Art. 3(3) AIFMD can be considered as prudentially supervised according to Art. 6(2) UCITSD.

Management of pension schemes by UCITS management companies. UCITS management companies are allowed to manage pension schemes under the IORP Directive if authorised by national legislation. Member States can authorise UCITS management companies, in addition to the management of UCITS, to manage investment portfolios of pension funds only on a mandate basis, acting as service providers and not as investment managers of the pension funds.

ELTIF

23-May-23: ESMA published a consultation paper on draft RTS under the revised ELTIF Regulation.

https://www.esma.europa.eu/sites/default/files/2023-05/Consultaton_Paper_on_RTS_under_the_revised_ELTIF_Regulation.pdf

The draft RTS within the consultation paper include among others:

- Criteria for establishing whether FDIs shall be considered as used by an ELTIF solely for **hedging** purposes (their use must result in a verifiable and objectively measurable reduction of risks at the ELTIF level, including in stressed market conditions);
- Circumstances in which the **life of an ELTIF** is considered compatible with the life-cycles of each of its individual assets (the manager of an ELTIF shall consider among others: liquidity profile of the individual assets; investment objective of the ELTIF; redemption policy and cash management needs of the ELTIF);
- Criteria to determine the **minimum holding period** for an ELTIF (among others: underlying assets and their liquidity profile; investor base of the ELTIF; timeframe for the investment phase of the strategy);
- Requirements in relation to an ELTIF **redemption policy** (the redemption policy shall include among others: procedures, requirements and timing limitations, if any, applicable to the redemptions process; description of the liquidity stress test);
- Requirements in relation to an ELTIF **liquidity management tools** (the manager of the ELTIF shall select and implement at least one liquidity management tool, among anti-dilution levies, swing pricing and redemption fees; in certain circumstances, the manager of the ELTIF shall also implement redemption gates);
- Circumstances for the use of the **matching mechanism** under which transfer requests by exiting investors could be matched with transfer requests by potential investors (among others: role of the manager of the ELTIF or the fund administrator in conducting transfers; determination of the execution price and the pro rata conditions; fees, costs and charges related to the transfer process);
- Criteria for the assessment of the **market for potential buyers** and for the valuation of assets to be divested;
- Definitions, calculation methodologies and presentation formats of **costs** borne by investors.

Responses to the consultation paper shall be submitted to ESMA on or before **24 August 2023**. ESMA expects to publish a final report and submit the draft RTS to the European Commission for its endorsement by **10 January 2024**.

DAC

19-May-23: The Law of 16 May 2023, implementing DAC7 in Luxembourg, has been published in the Luxembourg Official Journal.

https://legilux.public.lu/eli/etat/leg/loi/2023/05/16/a237/jo

On 16 May 2023, Luxembourg Parliament adopted the Law of 16 May 2023, which implements Council Directive (EU) 2021/514 of 22 March 2021 amending Directive 2011/16/EU on administrative cooperation in the field of taxation (DAC7). On 19 May 2023, the Law has been published in the Luxembourg Official Journal. The new rules apply as from **1 June 2023**, except for certain provisions on joint audits, which will apply from **1 January 2024**.

The Law introduces new rules and amends other laws on exchange of information, such as the Law on Common Reporting Standards (CRS Law). In particular:

- **Obligations for Platform Operators:** Platform Operators must register with the Luxembourg Tax Authorities (LTAs), or notify the LTAs if they are already registered in another EU Member State. Platform Operators must carry out specific due diligence procedures and report to the LTAs certain information on sellers.
- **Amendments to the CRS Law:** The CRS law is amended to ensure that personal data is protected as per Regulation (EU) 2016/679 (General Data Protection Regulation, GDPR). Luxembourg reporting financial institution must: (i) inform each reportable individual concerned that information relating to that individual will be collected and transferred in accordance with the CRS Law; and (ii) transmit to each individual concerned all the information that the individual is entitled to receive from the data controller, providing sufficient time for the individual to exercise his/her data protection rights and, in any event, transmitting the information before it is communicated to the LTAs.
- **Exchange of information upon request:** The Law clarifies the definition of “foreseeable relevance” to prevent unjustified refusals to exchange information between tax authorities of different Member States. The legal framework of requests for information concerning groups of taxpayers that cannot be identified individually is clarified as well: in such cases, the foreseeable relevance of the requested information must be described on the basis of a common set of characteristics.
- **Automatic exchange of information on the ownership of real estate:** The Law introduces automatic and mandatory exchange of information on persons resident in other Member States with respect to their ownership of real estate assets.
- **Joint audits:** The Law introduces joint audits as a tool for administrative cooperation and clarifies the framework and principles that apply to a joint audit. A joint audit is an administrative inquiry conducted jointly by the competent authorities of two or more Member States and relating to one or more persons of common or complementary interest to these competent authorities.

Digital Finance (1 of 3)

11-May-23: EU Parliament published its draft compromise amendments to the draft Artificial Intelligence Act.

https://www.europarl.europa.eu/meetdocs/2014_2019/plmrep/COMMITTEES/CJ40/DV/2023/05-11/ConsolidatedCA_IMCOLIBE_AI_ACT_EN.pdf

The Internal Market Committee and the Civil Liberties Committee of the EU Parliament adopted a draft negotiating mandate on the first ever rules for Artificial Intelligence. In their amendments to the Commission's proposal, Members of EU Parliament (MEPs) aim to ensure that AI systems are overseen by people, are safe, transparent, traceable, non-discriminatory, and environmentally friendly. They also want to have a uniform definition for AI designed to be technology-neutral.

Risk based approach to AI. The rules follow a risk-based approach and establish obligations for providers and users depending on the level of risk the AI can generate. AI systems with an unacceptable level of risk to people's safety would be strictly prohibited, including systems that deploy subliminal or purposefully manipulative techniques, exploit people's vulnerabilities or are used for social scoring.

Extended list of intrusive and discriminatory uses of AI systems. The amended list includes: Real-time remote biometric identification systems in publicly accessible spaces; Ex-post remote biometric identification systems, with the exception of law enforcement for the prosecution of serious crimes and only after judicial authorization; Biometric categorisation systems using sensitive characteristics; Predictive policing systems; Emotion recognition systems in law enforcement, border management, workplace, and educational institutions; Untargeted scraping of facial images from the internet or CCTV footage to create facial recognition databases.

Expanded classification of high-risk areas. Harm to people's health, safety, fundamental rights or the environment have been added to the high-risk areas. Also, AI systems to influence voters in political campaigns and in recommender systems used by mainstream social media platforms have been added to the high-risk list.

Transparency and risk management measures. Providers of 'foundation models' would have to assess and mitigate possible risks (to health, safety, fundamental rights, the environment, democracy and rule of law) and register their models in the EU database before their release on the EU market. Generative AI systems based on such models, like ChatGPT, would have to comply with transparency requirements and ensure safeguards against generating illegal content.

Exemptions. Exemptions have been included for research activities and AI components provided under open-source licenses.

On 14 June 2023, the draft negotiating mandate has been approved by the EU Parliament plenary, and negotiations with the Council have started.

Digital Finance (2 of 3)

2-Jun-23: ESMA updated its Q&A on the DLT Pilot Regime Regulation (DLTR).

https://www.esma.europa.eu/sites/default/files/library/esma70-460-189_qas_dlt_pilot_regulation.pdf

DLT financial instruments issuance. DLT financial instruments can be issued either directly or by representing in tokenised form an existing non-DTL financial instrument. It cannot be excluded that DLT Pilot participants might put forward issuance mechanisms that do not clearly fit into one of those two modalities of issuance.

Partial tokenisation. DLTR does not explicitly prohibit partial tokenisation of an issuance.

Non-ETF UCITS. DLTR does not require a UCITS fund to be also an ETF within the meaning of Art. 4(1) MIFID II to be eligible for the DLT Pilot Regime.

CIU represented by shares. Shares in collective investment undertakings fall under Art. 3(1), point (c), DLTR. They do not fall under Art. 3(1), point (a), which concerns shares, which are transferable securities.

SFTs. Securities Financing Transactions (SFTs) are not admissible within the DLTR.

DLT MTFs. DLT Multilateral Trading Facilities can organise trading off-chain, and can operate their matching engine using technology that does not leverage DLT.

DLT TSS. An entity can apply for the permission to operate a DLT MTF, without the need to operate a DLT Trading and Settlement System (TSS). A DLT TSS combines services performed by a DLT MTF and a DLT Settlement System (SS).

E-money tokens. DLTR defines e-money tokens as electronic money issued in compliance with the E-Money Directive. Once MiCAR starts applying, the notion of e-money tokens under DLTR should also be interpreted in light of MiCAR, which will comprehensively regulate the issuance and use of e-money tokens.

Exemptions. DLT SS/TSS applicants need to request the exemption from Art. 40 of CSDR for settling the cash leg of a transaction differently than as laid down in Art. 40 CSDR. DLT TSS are expressly exempted from the application of Art. 9 CSDR. Unless the DLT MTF is authorised as DLT TSS and obtains an exemption from applying Art. 3 of CSDR, where a transaction in transferable securities takes place on a DLT MTF, the relevant securities shall be recorded in book-entry form in a CSD.

Digital Finance (3 of 3)

9-Jun-23: The Markets in Crypto-Assets Regulation (MiCAR) and the Transfer of Funds Regulation (TFR) were published in the EU Official Journal.

https://eur-lex.europa.eu/eli/reg/2023/1114/oj

By adopting MiCAR (Regulation EU 2023/1114), the EU aims to bring legal certainty to the crypto-asset ecosystem and support innovation while safeguarding consumer protection, markets integrity and financial stability. The harmonised regulatory framework for the crypto-asset market applies to both traditional institutions of the financial sector and new players emerging in the crypto ecosystem that are engaged in the issuance, offer to the public and admission to trading of crypto-assets or that provide services related to crypto-assets in the EU. These institutions must meet a set of specific requirements to benefit from a regulated status recognised at Union level, thereby permitting the passporting of these services across the EU market.

MiCAR will come into full application from **30 December 2024**, except for Titles III and IV (the framework for asset-referenced tokens and e-money tokens issuers) which will apply from **30 June 2024**.

http://data.europa.eu/eli/reg/2023/1113/oj

The Transfer of Funds Regulation or TFR (Regulation EU 2023/1113) complements the implementation of recommendation R.15 from the FATF with regard to the money laundering and terrorist financing risks linked to virtual assets, by extending the existing rules on information accompanying the transfers of funds to transfers of crypto-assets (the so-called “travel rule”) within the Union.

The definition of “crypto-asset” in the TFR is aligned with MiCAR and covers the same categories of crypto assets in scope of MiCAR. The TFR requires crypto-assets transfers carried out with the involvement of a crypto-asset service provider (CASP) having its registered office in the EU to be accompanied with information on the originators and beneficiaries of those transfers, with the purpose of facilitating the traceability of transfers of crypto-assets and therefore the prevention, detection and investigation of money laundering and terrorist financing. CASPs will be required to obtain, hold and share, in a secure manner, that information with their counterpart on the other end of the crypto-asset transfer, and this in advance of, or simultaneously or concurrently with the transfer and make it available on request to competent authorities. The TFR will also apply to transfers of crypto-assets executed by means of crypto-ATMs.

The Transfer of Funds Regulation will apply from **30 December 2024**.

Miscellaneous (1 of 5)

17-May-23: ESAs published a consolidated Q&A on the PRIIPs Key Information Document (KID).

https://www.esma.europa.eu/sites/default/files/2023-05/JC_2023_22_-_Consolidated_JC_PRIIPs_Q_As.pdf

ESAs published a consolidated Q&A on the PRIIPs Regulation and the PRIIPs Delegated Regulation, which combines responses given by the European Commission to questions requiring interpretation of Union Law, and responses generated by the ESAs relating to the practical application or implementation of the PRIIPs Regulation and its delegated acts.

24-May-23: EU Commission published a proposal for a Retail Investment Strategy (RIS) Directive amending, among others, MiFID II, AIFMD, UCITSD and the PRIIPs Regulation. (continue to next page)

https://finance.ec.europa.eu/publications/retail-investment-strategy_en

Key amendments to the PRIIPs Regulation: The amendments aim at making the PRIIP KID more consumer friendly and at strengthening the level of investor protection. They include, among others:

- The introduction of a new **'Product at a glance'** section in the PRIIP KID, summarising the essential characteristics of the investment product;
- The introduction of new rules for presenting **costs of multi-option products** to ease the investor's choice between available investment options;
- The exclusion of **retail products providing immediate annuities** without a redemption phase from the scope of the PRIIPS Regulation;
- The exclusion of **corporate bonds with make-whole clauses** from the scope of the PRIIPS Regulation, as long as they are redeemed at fair value;
- The withdrawal of the **'comprehension alert'** due to its limited effectiveness;
- The introduction of a new section in the PRIIP KID titled **'How environmentally sustainable is my product?'**, providing key information on the sustainability profile of the investment product, for which the ESAs will specify the content in a dedicated regulatory technical standards; and
- The preference for PRIIP KIDs to be provided in an **electronic format**.

Miscellaneous (2 of 5)

24-May-23: EU Commission published a proposal for a Retail Investment Strategy (RIS) Directive amending, among others, MiFID II, AIFMD, UCITSD and the PRIIPs Regulation. (continued from previous page)

Key amendments to MiFID II, AIFMD and UCITSD:

- **Particularly risky products.** The requirement for investment firms under MiFID II to display appropriate warnings in information materials provided to potential or existing retail clients about specific risks of potential losses carried by particularly risky financial instruments.
- **Professional investor's qualification.** The easing of restrictions to qualify as professional investors under MiFID II, by reducing the wealth criterion from EUR 500k to EUR 250k, and by adding a fourth possible criterion relating to relevant education and training.
- **Undue costs.** AIFMD and UCITSD would be amended to include additional requirements to prevent undue costs from being charged to funds and their investors.
- **Inducements.** MiFID II would be amended to ban investment firms providing portfolio management services from paying inducements (in addition to the ban on receiving inducements). Furthermore, a new ban would be introduced on inducements from manufacturers to distributors with regards to the reception and transmission or execution of orders to or on behalf of retail clients (some exceptions would apply).
- **'Best interest' test.** MiFID II would be amended with the introduction of a 'best interest' test, requiring investment firms to: base their advice on an assessment of an appropriate range of financial products; recommend the most cost-efficient financial product; offer at least one financial product without additional features which are not necessary to the achievement of the client's investment objectives and that give rise to additional costs.
- **Suitability and appropriateness tests.** The enhancement of the suitability and appropriateness tests by introducing, among others: the obligation for investment firms to explain the purpose of the assessments to clients in a clear and simple manner and to obtain all relevant information necessary for such assessments, and to inform retails investors about the consequences of providing inaccurate or incomplete information; the possibility for retail investors to receive a suitability assessment report and seek additional clarifications; the addition of portfolio diversification as one of the elements to assess.
- **Cross-border activities.** The requirement for investment firms and credit institutions providing investment services or activities to report specific information annually to the competent authority of its home Member State when they provide investment services to more than 50 clients on a cross-border basis.
- **Marketing communications.** The introduction of rules to protect retail investors from misleading marketing communications including, among others: a requirement for investment firms to have a policy on marketing communications and practices, as well as effective organisational and administrative arrangements in place; the obligation to clearly identify marketing communications and divide the responsibility with respect to their content and use between manufacturers and distributors.

The RIS will need to be reviewed by the EU Parliament and the Council before its formal adoption.

Miscellaneous (3 of 5)

24-May-23: ESMA published its Final Report on the CSA carried out in 2022 on the valuation of UCITS and open-ended AIFs.

https://www.esma.europa.eu/sites/default/files/2023-05/ESMA34-45-1802_2022_CSA_on_Asset_Valuation_-_Final_Report.pdf

In January 2022, ESMA launched a CSA with National Competent Authorities (NCAs) on the supervision of the asset valuation rules under the UCITS and AIFM Directives. The CSA's aim was to assess, foster and enforce the compliance of supervised entities with the organisational requirements with respect to asset valuation, as well as adherence to valuation principles and methodologies with a view to reflecting a true and fair value of their financial positions both under normal and stressed market conditions in line with the applicable rules. The report presents ESMA's views on the CSA's main findings, on the following topics:

- **Appropriateness of valuation policies and procedures:** NCAs reported a satisfactory level of compliance by supervised entities, however there is room for improvement on deficiencies detected regarding: (i) lack of documented and established valuation policies and procedures (including regular reviews) that clearly allocate operational tasks and responsibilities for asset valuation; and (ii) lack of a clear definition of the valuation model to be applied, as well as its validation;
- **Valuation under stressed market conditions:** Most NCAs reported that the majority of managers in scope of the exercise periodically perform stress tests to monitor the liquidity level of their portfolio, however issues were spotted on valuation policies and procedures that do not distinguish between normal and stressed market conditions and lack of systematic incorporation of the outcome of Liquidity Stress Testing, particularly for less-liquid assets;
- **Independence of the valuation function and use of third-party valuers:** Despite an overall positive assessment from NCAs, issues arose in some specific cases with regards to: (i) lack of independence of the valuation function, particularly from the portfolio management and (ii) smaller managers which appeared to over-rely on third-party data providers for the pricing of less liquid assets, without performing the appropriate checks, controls and back testing;
- **Early detection mechanisms for valuation errors and transparency to investors:** Notwithstanding a broad level of compliance, the analysis suggests that remedial procedures to ensure an early detection of valuation errors and full investors' compensation are not always appropriately formalised.

In light of the current economic environment, it is important that NCAs' supervision addresses the deficiencies identified in the course of the CSA exercise and keeps paying close attention to potential valuation issues arising from less liquid assets, whose nature can amplify the structural liquidity mismatches of certain types of investment funds. This is particularly true for funds investing in Private Equity and Real Estate assets which might be more exposed to revaluation risks in light of the heavy reliance on long-term models and the illiquidity of their assets.

Miscellaneous (4 of 5)

6-Jun-23: ESMA published a report on the results of the stress testing conducted on MMFs.

https://www.esma.europa.eu/sites/default/files/2023-06/ESMA60-1389274163-2572_TRV_article_-_MMF_stress_tests.pdf

Stress tests are a key tool to assess entity-level stress resilience on an ex-ante basis and help identify vulnerabilities that can be mitigated before reality strikes. The objective of Article 28 of the MMF Regulation is to promote sound stress testing process as part of MMF's regular risk management, and to assess the resilience of funds in severe but plausible scenarios designed by supervisors. The lessons from 2021 MMF stress tests reported at the end of 2021 are as follows:

- The liquidity stress test and the credit stress test had a significant negative impact on VNAVs and LVNAVs. In absolute terms VNAVs were the most affected, with a median impact of 1.57% in the liquidity scenario. However, more than 80% of LVNAVs would need to switch to variable NAV in both scenarios, potentially leading to disorderly asset liquidations. In contrast CNAVs appeared to be relatively insensitive to credit risk and liquidity risk, but more exposed to the default of large exposures.
- The impact of the interest rate scenario was generally benign. While the scenario was not extreme in comparison with the recent interest rate surge, MMFs managers have also demonstrated since 2021 their capacity to reduce their sensitivity to interest rates as a rise was becoming more likely. Regarding the foreign exchange scenario, results were generally not meaningful.
- The redemption stress tests showed a great capacity of CNAV and LVNAV funds to meet redemption requests, especially with highly liquid assets. In comparison most VNAVs would need to use assets with a lower degree of liquidity, and 21% of funds may still face challenges to meet the redemption requests. In addition, the self-assessment provided by managers reflected a certain confidence (but also a huge dispersion) in their capacity to face significant outflows without distorting portfolio allocation while still remaining compliant with all regulatory requirements.
- The macro systemic stress test confirmed these results, with a good capacity to meet redemption requests but a more significant impact on VNAVs and LVNAVs.

The results generally indicate a good resilience of the industry to most market factors. They also highlight the relative proximity of the LVNAV 20 bps threshold. Although the risk of breaching the threshold has not yet materialised during real-life stress events (including the COVID-19 related stress), this supports the concerns expressed in both ESMA's opinion and ESRB Recommendation regarding the ability for LVNAVs to use amortised cost.

ESMA is currently reviewing the methodology of the stress testing Guidelines in light of these results and aims to include the revised methodology in the MMF stress test Guidelines in 2023.

Miscellaneous (5 of 5)

7-Jun-23: ESMA updated its Q&A on SFTR data reporting.

https://www.esma.europa.eu/sites/default/files/library/esma74-362-893_qas_on_sftr_data_reporting.pdf

Reporting of the SFTs concluded by IORPs and pension funds. The entities that have the reporting responsibilities under SFTR are the counterparties to the SFTs that they have concluded. Where a financial counterparty concludes an SFT with a non-financial counterparty which on its balance sheet dates does not exceed the limits of at least two of the three criteria laid down in Article 3(3) of Directive 2013/34/EU, the financial counterparty shall be responsible for reporting on behalf of both counterparties.

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