



NEWSLETTER

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What Exactly Is a Factor?

Melissa R. Brown, CFA - Managing Director of Applied Research at Axioma, highlights the growing popularity of factor-based strategies.



The growing popularity of factor-based strategies begs the question: What, really, is a factor, and how can we tell how it has performed?

According to Blackrock, as of June 2018, there was \$1.9 trillion invested in these strategies, a figure expected to grow by nearly 80 percent to \$3.4 trillion by 2022. It is clear that these strategies have moved to the forefront of investing, but is there really one ‘truth’ about a factor?

There are numerous underlying metrics that can be used to define a given factor, and there are also a number of ways that stocks can be combined to create a portfolio on which to measure factor performance.

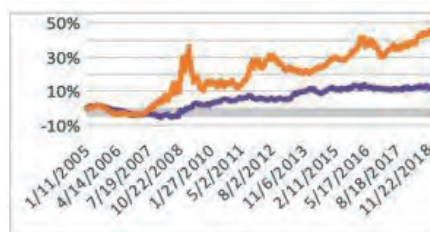
Portfolio Construction Differentiates the Good from the Bad

That performance may, in turn, drive a decision to invest in the factor. We have found that construction differences can lead to widely varying exposure to the intended factor as well as very different performance, even though the portfolios created have the same name!

One common definition, used in a number of Smart Beta ETFs, is to simply buy the highest-ranked stocks based on a factor. Another is to go long the most attractive stocks and short the least attractive. The biggest issue

for these types of portfolios is that they may end up with big exposures to other factors, such as sectors or countries, size bets, etc.

Those other bets may not be obvious to the investor, and it is difficult to disentangle the performance of the factor from these other exposures. In the chart below, much of the performance of the purple line – which represents buying the top quintile and shorting the bottom quintile on a factor – was driven by big sector underweights and overweights.



— Do I want this return stream?
— Or this?

Other construction methods may be less common but are more ‘pure’ in that the resulting portfolios are not exposed to unintended bets. Managers may use an optimizer to create a portfolio that aims to maximize factor exposure while eliminating other bets.

These portfolios may vary by investment universe, rebalance frequency, whether they are permitted to short, target levels of volatility, etc. All could reasonably

be called a ‘factor portfolio’, but they will have very different exposures to the factor and, most importantly, widely varying performance.

Testing This Theory Using Profitability

We chose a popular factor, Profitability¹, and assumed investment in a broad global developed markets benchmark to illustrate this point. We created several ‘Profitability’ portfolios, some with an optimizer and others by simply dividing the universe into quintiles based on the underlying factor.

The exhibit on the next page illustrates the vast differences in performance across these portfolios. Clearly, the ability to short and the access to a broad investment universe made a big difference in the portfolios’ returns.

Why is This Important to Know Ex-Ante?

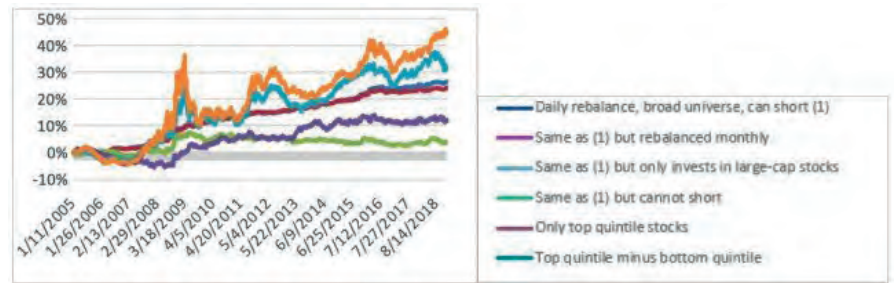
An investor may have chosen the portfolio that bought the top quintile and shorted the bottom because it had the best performance over this long period. But what would have happened if she invested at the peak in March 2009? She may have abandoned the strategy quickly and thus missed out on its recovery.

Alternately, if she held on, it would have taken more than nine years to make her money back. Clearly, these portfolio

construction alternatives could very well have driven a decision about whether the factor will produce a desirable investment.

Conclusion: The Bottom Line

There really is no one ‘true’ factor. Simple universe sorts may produce strong returns, but they do so with quite a bit of volatility. Constraints common to many investment managers, such as an inability to short or a requirement to limit the investment universe, can mean the difference between a successful factor and one that is much less attractive.



Just because a factor ‘works’ in a broad universe of stocks where the manager has the ability to short and can rebalance every day does not mean that factor will work in your portfolio.

¹ Here we define Profitability as a combination of a company's return on equity, return on assets, cash flow to assets, cash flow to income, gross margin, and sales to assets.

Non-Transparent ETFs

Paul Heffernan, Head of Business Development & Client Management, Asset Manager Sector, Europe

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Active and passive: Game on

Active managers are being confronted by a number of difficult headwinds. Since the crisis, a combination of volatile markets; increasing regulatory supervision and investor pressure on fees have been steadily chiselling away at the industry's profit margins. Escalating matters further is that active managers are facing growing competition from low fee investment products such as passive funds, many of whom have actually delivered better performance. As a result, active managers have been haemorrhaging assets as capital is increasingly redeployed into passive investment strategies such as exchange traded funds (ETFs)¹.

Due to this widespread rebalancing of flows, Moody's predicts the volume of assets controlled by passive funds will surpass active asset managers from 2021², although Morningstar suggests this shakeup could happen much earlier, potentially even this year³. Other providers give a more conservative outlook, most notably PwC, which estimates that assets in US passive funds will reach a parity with actively managed products in 2025⁴.

Drilling down non-transparent ETFs

In response, active managers are going on the offensive, as they look to identify new products and strategies to help them preserve market share. It is here where non-transparent ETFs could play a big role. A non-transparent ETF is an actively managed ETF, which

is permitted to report details about its holdings on either a monthly or even quarterly basis⁵. In contrast, passive ETFs ordinarily disclose information about the composition of their portfolios or, more accurately, a single basket of stocks (representing the smallest trade size for creations/redemptions at a fund level) on a daily basis. This information is used to generate an indicative Net Asset Value (iNAV) every 15 seconds to ensure that a fund can be accurately priced by primary market participants throughout the day.

Non-transparent ETFs were given the seal of regulatory approval in the US back in April 2019 when the Securities and Exchange Commission (SEC) authorised ActiveShares, a proprietary technology created by Precidian Investments. ActiveShares replaces the traditional approach of disclosing an ETF's portfolio to the market on a daily basis and instead inserts a black box between the issuers and market participants enabling the fund to be priced accurately at high frequency (i.e. every second) while simultaneously ensuring that details about the specific portfolio composition are kept hidden⁶.

To some commentators - particularly those with a passive ETF background, the idea of allowing ETFs to become more opaque appears counterintuitive and regressive. However, other industry experts have argued that the original purpose of the daily portfolio composition file was to

enable primary market participants to accurately price ETFs. That the value of an active ETFs underlying basket is published in real-time via ActiveShares should help assuage investors. "Seeing the value of the underlying basket via the Verified Intraday Indicative Value will give market makers some level of comfort on where they should quote the ETF since they will not know the underlying basket," says one report⁷. The key argument made by advocates of non-transparent ETFs is that, once a mechanism is in place to allow participants to price funds accurately, the portfolio disclosure processes of such funds will be similar to those at actively managed mutual funds - which typically only publish information about all of their holdings semi-annually in their financial statements.

Who benefits?

Right now, there are 6,736 ETFs globally⁸, of which 300 are actively managed⁹. Historically, active managers eschewed ETFs out of fear that the daily disclosure obligations made them vulnerable to copycat traders, predatory hedge fund short squeezes or even front-running. This is not an issue at non-transparent ETFs as their portfolio disclosures are not performed on a daily basis¹⁰. Non-transparent ETFs could also help active managers target a much wider investor audience through new marketing and distribution channels such as robo-advisory platforms.

Furthermore, if their strategy is successful and resonates with investors, there is an opportunity to accumulate greater assets and, as a result, offer more competitive fees than actively managed mutual funds. There is certainly a growing momentum behind this new product. So far, nine major fund management groups including BlackRock, Capital Group and JP Morgan Asset Management have signed up to license ActiveShares as they look to launch non-transparent ETFs¹¹.

Non-transparent ETFs provide ample advantages to end investors, enabling them to diversify their exposures beyond passive index trackers. Elsewhere, US investors are likely to enjoy significant tax advantages¹², insofar as their returns will not be subject to capital gains¹³. Investors will also not be unduly impacted by the performance drag that arises when active managers are forced to hold surplus cash to satisfy redemption requests¹⁴. From a regulatory perspective, there has been some investigation into whether the success of passive ETFs could lead to price distortions across wider markets.

To date, there has been no evidence of this occurring although the approval of non-transparent ETF products will result in greater numbers of investors acquiring exposure to a more diverse set of ETFs.

Will non-transparent ETFs be allowed in Europe?

While the SEC has given its tacit backing to the concept of non-transparent ETFs, the wrapper is yet to receive an endorsement from European regulators, most notably Luxembourg's CSSF and the Central Bank of Ireland (CBI), the two leading fund domiciles inside the EU. Last year, the CBI said it saw no reason to amend existing ETF disclosure practices, although the SEC's decision could prompt the Irish regulator to rethink its position and permit non-transparent ETFs to be distributed under the current UCITS framework¹⁵. The industry's case for allowing such products to flourish inside Europe is a compelling one.

Given that retail-orientated UCITS funds currently disclose information about their holdings on a semi-annual basis, some

experts query why non-transparent ETFs – which will also be regulated under the UCITS regime – should be held to a different standard or benchmark to actively managed mutual funds¹⁶. Others point out that the majority of long-term retail investors simply do not monitor their ETF portfolio holdings on a daily basis, and would be perfectly content with a less frequent reporting arrangement¹⁷. Should EU regulators authorise the roll-out of non-transparent ETFs, it could be a game changer for both asset managers and investors.

¹ Financial Times (January 17, 2019) US active funds suffer record \$143 billion exodus in December

² Moody's Investors Service (March 14, 2019) Moody's: Adoption of passive investment on track to overtake active in two years

³ Bloomberg (December 31, 2018) Shift from active to passive approaches tipping point in 2019

⁴ Financial Times (July 29, 2019) US passive-active fund split to reach parity by 2025

⁵ Financial Times (April 19, 2019) Non transparent ETFs set to be a boon for fund managers

⁶ Legg Mason (April 8, 2019) Precidian comments on US SEC approval of Active Shares

⁷ Franklin Templeton (April 17, 2019) ETF Capital markets desk: Non transparent active ETFs – Coming soon?

⁸ www.ETFGL.com 30 June 2019 global ETF statistics.

⁹ Investment News (April 12, 2019) Who benefits the most from non-transparent ETFs?

¹⁰ Financial Times (April 19, 2019) Non transparent ETFs set to be a boon for fund managers

¹¹ Financial Times (April 19, 2019) Non transparent ETFs set to be a boon for fund managers

¹² Barron's (April 12, 2019) A new kind of actively managed ETFs can keep their portfolios hidden: Is that a good thing?

¹³ Investment News (April 12, 2019) Who benefits the most from non-transparent ETFs?

¹⁴ Investment News (April 12, 2019) Who benefits the most from non-transparent ETFs?

¹⁵ ETF Stream (April 29, 2019) Seeking European clarity on non-transparent ETFs

¹⁶ ETF Stream (April 29, 2019) Seeking European clarity on non-transparent ETFs

¹⁷ ETF Stream (April 24, 2019) Central Bank of Ireland should follow SEC in allowing non-transparent ETFs

Social responsibility, basis.point and making a lasting impact in disadvantaged communities

Clive Bellows, Chairperson of basis.point and Executive Vice President, Head of Global Funds, EMEA, Northern Trust



basis.point was founded in 2013 as the charity initiative of the Irish funds industry. It has grown from strength to strength and today plays a key role in the CSR programmes of a large number of leading firms within the sector and through our complementary model of individual Patronage and Support, meets the personal desires to give back to society, of many individuals within the industry. Focusing on children and young people from disadvantaged communities, we work closely with six leading charities, to empower children through education.

The transformative power of education

Education is a transformative component in offering a child a better future. In partnership with established charities, basis.point funds landmark interventions to help with literacy and numeracy, at key milestones in a child's journey through the educational system. In doing so, we encourage children to stay in school, break down daunting barriers, improve self-esteem, raise aspirations and help children develop skills that they can carry on into their working lives.

We have carefully chosen a number of multi-year evidence based programmes that have demonstrated positive outcomes in the most testing of environments. The multiplier effect of an industry coming together to consistently,

over time, support communities in their efforts to educate their young people, is what makes basis.point so impactful and special.

Empower, Enable, Enhance

Working with ELI and Archways, we strive to empower parents to give their child the best start in life. The Early Learning Initiative run by the National College of Ireland, is a community based programme whereby local parents and guardians learn to model best parenting practice ensuring that their child is school ready. Once at school, we have worked with Archways to introduce The Early Years programme which has subsequently been taken on by the Department of Education and has been rolled out nationally.

Good literacy and numeracy skills have the power to change everything. Our numeracy programme, in partnership with Suas, helps children from disadvantaged communities aged between 7 and 9, who are falling behind national guidelines for numeracy. By making the fundamentals of maths fun and demystifying numbers, we enable the child to fully engage at school which has an extraordinary impact on a child's self-esteem and willingness to learn. By the end of 2019, we shall have supported 12,000 kids throughout the country.

Once at secondary school we partner with three further charities to enhance the opportunities available to young people. The NFTE programme in association with Foroige was set up to enhance business and entrepreneurial skills yet achieves so much more offering socializing, creativity and a connection to society. The TUD Foundation introduces and demystifies third level education, encouraging kids from communities that would otherwise rule it out to consider further education. And finally, BITC prepares young people for entry to the world of business.

The idea behind joined-up giving

The idea behind joined-up giving is that by joining together and planning our giving together as an industry, we can have a greater impact. basis.point asks its Patrons and Supporters to pledge an annual gift so that in turn, we can commit to multi-annual grants to our charity partners. Together we have raised and committed €1.6 million which allows each partner to develop, implement and evaluate programmes over a number of years. It is this consistency of effort that achieves such a great impact, reaching more children and ultimately changing more lives and creating better futures.

Looking to the future

The geographic reach of basis.point funded programmes continues to expand and we are now active in Wexford, Waterford, Kilkenny and Galway in addition to our primary locations of Dublin, Cork, and Limerick, somewhat reflecting the Funds Industry's footfall throughout Ireland.

By becoming a Patron or Supporter of basis.point and investing in securing the future of children living in disadvantage, you are participating in something truly transformative.

Our industry has demonstrated great vision by joining together and it is remarkable that we have one umbrella charity that is championed by so many of our industry leaders. Looking to the future we hope to celebrate our 100th Corporate Patron before the end of the year, a significant milestone for the charity. And thanks to the generosity of individual industry players, we continue to grow and make a lasting impact on disadvantaged communities throughout Ireland. It is our passion to grow the basis.point community and make an

even greater impact. You can change the future of a child by getting involved. If you are interested in becoming a Patron or Supporter, please visit our website for more information **www.basispoint.ie** or contact Louise at **legan@basispoint.ie**. If you feel engaged as a Patron or Supporter to help us make a greater impact, we would love the opportunity to share our story with your colleagues.

[linkedin.com/company/basis-point/](https://www.linkedin.com/company/basis-point/)
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Irish Funds Regional Roadshow Recap

Anna Fenston, Communications Manager at Irish Funds, recaps the regional roundtable events Irish Funds held in seven counties across the country from May to September this year.

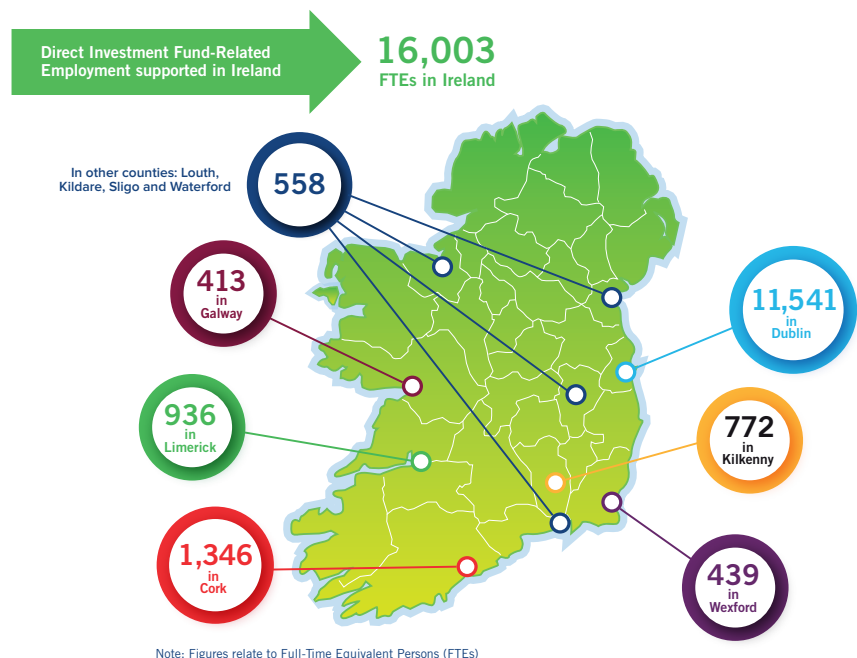


Following the publication of the Indecon Report earlier in the year, Irish Funds engaged in a Regional Roadshow across Ireland. From May to September, Irish Funds held roundtable events with business leaders, politicians and other industry participants in seven counties across the country.

These regional events sought to highlight the key findings of the report and the positive impact the funds industry is having in terms of employment and economic contribution throughout the country.

Key findings – Economic impact of the funds industry on the Irish economy

- Regional employment opportunities across a significant number of our major cities and towns
- 150+ companies directly employing over 16,000 people in 10 different counties
- The Irish funds industry makes a €14 billion contribution to economic output nationally which is dispersed in communities across Ireland
- Almost 33,000 total employment impact across the country
- The funds industry contributes €837 million annually in direct taxes to the exchequer



Regional events – locations and dates in 2019

- **Kilkenny (10 May)** – where the report found that 772 full time employees work in the funds industry.
- **Limerick (13 May)** – where the report found that 936 full time employees work in the funds industry.
- **Kildare / Naas (17 May)** – where the report found that 558 full time employees work in the funds industry in Kildare, Louth, Sligo and Waterford.
- **Galway (20 May)** – where the report found that 413 full time employees work in the funds industry.

- **Wexford (21 May)** – where the report found that 439 full time employees work in the funds industry.
- **Cork (10 June)** – where the report found that 1,346 full time employees work in the funds industry.
- **Donegal (6 September)** – where employment in the sector has been growing and represents a key opportunity for economic development.

Local press releases, media coverage and interviews followed each regional roundtable event and included media outlets such as: KCLR 86 FM Radio, Leinster Leader, Galway Bay FM, Highland Radio.

Five Benefits of institutional platform innovation

Eoin Motherway, Ireland Country Head of AMX, looks at how platform innovations are benefiting institutional investors, asset managers and advisers.



Over the last 20 years, retail investors have experienced a revolution in online service offerings which have delivered greater choice, lower costs and simpler administration to private individuals. The pace of change in the institutional market has seemingly been much slower by comparison leaving a fragmented process that can often be inefficient and costly to investors.

However, the institutional market is evolving and investors and their advisers no longer have to settle for a lower level of service in the asset management market. Here are five ways that AMX believes innovative institutional platforms are now helping asset managers meet their clients' demands and are forging a new and better way of working:

1. Greater choice of funds and management styles, to facilitate efficient asset allocation through open architecture

Many institutional investors follow a multi-asset approach but can be challenged by the need to connect with multiple systems and contact points that can involve complex, sometimes manual, processes. This complexity can also restrict the asset manager's ability to serve a larger, more diverse client base and can make it harder for new managers to enter the market.

Multi-asset platforms, can offer investors the ability to diversify

risk more easily across global (active and passive) equity and credit funds as well as hedge funds. They can also make it easier for asset managers to launch new strategies that meet specific investor needs, such as offering stewardship overlays on funds to support environmental, social and governance (ESG) policies. The most flexible platforms for institutional investors are those that offer multiple asset classes and are open architecture, where the investor has an avenue to express their needs for new or additional strategies to a collaborative audience of investment managers.

2. Increased transparency and control of costs, including lower fees

Institutional investors are increasingly demanding more granular cost breakdowns from asset managers. They want to know exactly where they are incurring costs and what they get for the fees they pay. For example, if an asset manager offers passive management at near zero fees, will it stop providing added-value services (that cost time and money) or will it find ways to make a profit elsewhere in the process?

Institutional platforms can provide the transparency that investors need to compare the value of the many different services on offer. Open-architecture platforms can integrate with the wider

funds ecosystem, effectively consolidating the market in one place. This can help reduce costs, for instance, by standardising processes around KYC and AML paperwork, and legal reviews, during manager onboarding.

Platforms can also allow robust management of counterparty and delegate costs through leveraging scale. Importantly, pension schemes can find savings, through, for example, managing withholding tax efficiently, using tax transparent global equity fund vehicles such as Irish-domiciled Common Contractual Funds (CCFs). A platform is able to set up and operate the funds leaving the asset managers to focus on the investment strategy.

3. A customer experience as good as that provided to retail investors

As private individuals, we are used to accessing our personal investment data through efficient digital dashboards and getting 'next day delivery' of goods and services. In contrast the institutional market often receives investment data in many forms and this may also be hard to access at speed or scale.

A platform can smooth the process by offering easy access to multiple asset managers through a single secure online client portal and with streamlined presentation of investment data. This can make reporting and monitoring more

efficient for all parties, ultimately improving the institutional client experience. Processes such as onboarding of new managers and de-risking of assets can be faster and more efficient. Data elements from different strategies can be normalised and stratified for more useful analysis, decision making and governance.

4. A route to improved governance and ESG reporting

Underpinning innovation is a need to provide substance to support regulatory and governance requirements. An institutional platform can standardise, centralise and streamline the relationship between institutional investors and asset managers. This not only helps to improve transparency but can also reduce compliance costs, to the benefit of the institutional investor and end savers. In addition, it can make it much easier for asset managers to meet the service requirements demanded by institutional investors and regulators.

Many discussions at industry events during 2019 have identified environmental, social and governance (ESG) strategies as a prime driver for investors and managers. However, picking truly ESG compliant investments can be challenging because the industry lacks standardisation. Platforms generally have the ability to support ESG demands and keep up with regulatory changes, particularly by reducing

the administrative burden through smarter execution. While market standard reporting on ESG is still emerging, platforms typically have more resources and a wider vantage point to give best in class reporting while the market standard solidifies.

Platforms in their various guises can alleviate the burden of governance through smarter, coordinated execution, while also yielding cost savings and transparency to the betterment of the end institutional investor or end saver.

5. Opening new channels of distribution

Ireland has a reputation as a fund-friendly domicile, with a pragmatic regulatory environment that enables managers to passport their funds across the EU. However, to benefit from these opportunities, managers must operate through a Management Company (ManCo) or Self Managed Investment Company (SMIC) domiciled in Ireland. That recently became more onerous after the Central Bank of Ireland strengthened governance, compliance and supervisory requirements.

Management Companies must now maintain most of their Designated Persons in residence in Ireland, with specific responsibility for areas such as Investment Management and Fund Risk Management, Compliance and Finance and Capital.

It must also have operational and administrative capabilities and independent directors. This, of course, comes at a cost: not least identifying and recruiting the right expertise on the ground.

A platform with real substance can support its clients' regulatory and governance requirements by operating as a ManCo with its own in-house Designated Persons and the ability to manage funds under the Alternative Investment Fund Managers Directive (AIFMD) and Undertakings for Collective Investments in Transferable Securities (UCITS).

A parting thought

Institutional asset management is continuing to grow at pace. AMX believes that the future of the Irish domiciled products from tax transparent vehicles like the Common Contractual Fund (CCF), to the nimble structure of the Irish Collective Asset-management Vehicle (ICAV) and the pending conclusion of the Irish Limited Partnership (ILP), offer global asset managers a full, robustly regulated suite of vehicles from which to service investor monies.

With greater transparency, tighter governance and better risk control at the top of the agenda for many investors and managers, the need for institutional platforms which are aligned to these industry requirements, and offer future-proofed flexibility, is growing.

European Union Action Plan on Sustainable Finance: Disclosures Regulation

Lorena Dunne, Partner, Asset Management & Investment Funds at William Fry



The EU Action Plan on Sustainable Finance (the 'Action Plan'), is an ambitious package of measures aimed at directing private sector finance towards the mitigation of climate change and other environmental threats. The Action Plan will impact all UCITS management companies (including self-managed investment companies), AIFMs and MiFID-authorized investment firms, whether or not they label their financial products 'green'.

Published in May 2018, the Action Plan includes three core legislative proposals as well as proposed amendments to the UCITS, AIFMD and MiFID frameworks, to ensure the integration of sustainability risks and other sustainability factors into existing rules (see table opposite for an overview of key elements of the Action Plan).

This briefing will focus on the proposed Regulation on disclosures relating to sustainable investments and sustainability risks (the 'Disclosures Regulation'), the final text of which is expected to be published in the Official Journal of the European Union (the 'Official Journal') over the forthcoming weeks.

Disclosures Regulation

Political agreement on the Disclosures Regulation has been reached, with the European Parliament adopting its position on first reading on 18 April 2019. A provisional edition of the text of the legislative resolution

adopted has been published and the following is a summary of the obligations this contains.

Scope and Requirements

The Disclosures Regulation, along with other measures, is intended to ensure that "financial market participants", including UCITS management companies, AIFMs and investment firms providing portfolio management:

- Systematically consider and integrate sustainability risks and consider adverse sustainability impacts in their processes; and
- Provide investors with sustainability-related information on the financial products they offer or advise on.

'Financial advisers', including UCITS management companies, AIFMs and investment firms which provide investment advice,

also fall within the scope of this legislation.

Requirements applicable to all Financial Market Participants and Financial Advisers

All FMPs, irrespective of whether they hold their financial products out as 'green' and all financial advisers must:

- Publish information on their **policies on the integration of sustainability risks** in their investment decision-making process (FMPs)/their investment or insurance advice (financial advisers) on their websites;
- Include information in their **remuneration policies** on how their remuneration policies are consistent with the integration of sustainability risks – this information also to be published on their websites; and



- Provide ‘**pre-contractual disclosures**’ to investors (to be included, in the case of UCITS and AIFs, in their prospectuses) relating to the integration of sustainability risks, addressing:

- i. the manner in which sustainability risks are integrated into the investment decisions of FMPs/the investment or insurance advice provided by financial advisers; and
- ii. the result of the assessment of the likely impacts of sustainability risks on the returns of the relevant financial products; and

where sustainability risks are deemed not to be relevant, these disclosures must include a clear and concise explanation of why this is considered to be the case.

Additionally, FMPs will be required to publish and maintain on their **websites** either:

- i. in cases where they do consider the adverse impacts of investment decisions on sustainability factors: a statement (including prescribed information) on the **due diligence policies applied with respect to these principal adverse impacts**, taking account of their size, nature and the scale of their activities and the types of their financial products; or
- ii. where consideration is not given to the adverse impacts of investment decisions on sustainability factors: **clear reasons** for this (and, where relevant, information as to whether and when they intend to do so).

Likewise, financial advisers will be required to publish and maintain on their websites either information as to whether (taking account of their size, the nature and scale of their activities and the types of financial products they advise on) they consider in their investment advice or insurance advice the principal adverse impacts on sustainability factors or information as to why they do not consider

adverse impacts of investment decisions on sustainability factors in that advice, including, where relevant, whether and when they intend to do so.

Requirements applicable to Financial Market Participants in respect of ‘green’ financial products only

Enhanced disclosure requirements apply where either the financial product offered by the FMP

(i) is presented as promoting environmental or social characteristics; (ii) has as its objective ‘sustainable investments’ (as defined); or (iii) has as its objective the reduction of carbon emissions. To this end the draft legislation includes prescribed:

- **Pre-contractual disclosures;**
- Information to be maintained in a prominent, easily accessible area of the **website** of the relevant FMPs; and
- Information to be published in **periodic reports**.

Technical Standards

The European Supervisory Authorities (‘ESAs’) (ESMA, the EBA and EIOPA) are required under the Disclosures Regulation to develop regulatory technical standards (‘**RTS**’) further specifying the details of the presentation and content of the information on sustainability investment targets to be disclosed in pre-contractual documents, periodical reports and websites of financial market participants. The ESAs are also required to develop implementing technical standards to establish the standard presentation of sustainable investments in marketing communications.

Timing

The Regulation will enter into force 20 days after its publication in the Official Journal and will apply 15 months following this publication in the Official Journal. Certain RTS will be required to be published 12 months after the date of the Regulation’s entry into force and the remaining RTS are required to be published 24 months after its entry into force.

While the majority of obligations under the proposed Disclosures Regulation will apply 15 months after its publication in the Official Journal, entry into force of the requirements relating to the provision of first annual reports containing information under Article 7 (transparency of sustainable investments in periodical reports) is delayed for a year.

Challenges

As recently as last month, EFAMA and a number of other trade associations issued a request to the Commission to delay implementation of the Disclosures Regulation. Their primary concern is the risk that, in line with the timings set out above, certain of the RTS will not be published before the application date of the Disclosures Regulation.

They warn that this will create significant compliance challenges and liability risk for the financial services industry. The Commission’s response of 2 October has made clear, however, that a delay will not be granted and indicates that the Regulation will ‘*be formally adopted and published in the Official Journal in the forthcoming weeks*’.

Industry has further warned that significant challenges to compliance with the Disclosures Regulation will be presented by the delayed implementation of the proposed ‘Taxonomy’ Regulation. Financial industry associations have stressed the need for a common and reliable taxonomy to be put in place before any enhancements of existing financial market regulations come into effect. However, a table published by the Council of the EU on 15 October 2019, comparing the positions of the EU institutions on the draft Taxonomy, reveals significant divergences of view. Political agreement on the taxonomy is therefore unlikely to be achieved until sometime next year yet the final text of the Disclosures Regulations is expected any day.

The Fourth Industrial Revolution Is Going To Change Our World

Hector McNeil is Co-Founder and CEO of HANetf, the UK-based white label platform for fund managers interested in launching ETFs.



The fourth industrial revolution follows the first three major periods of industrial innovation in human history, namely mechanization and steam power, assembly line manufacturing and thirdly automated production and sophisticated electronics. We are now right in the middle of the next industrial revolution, 4.0, which we believe is going to change everyone's lives.

The fourth industrial revolution is defined by the Internet of Things, smart manufacturing, cyber-physical systems and the digital transformation of our day to day lives. The impact of the Internet has been massive since the 1990s and is leading to the convergence of some of the key technologies that comprise this new revolution: big data, artificial intelligence and robotics.

This revolution will transform the way human beings live and interact over the next century and lead to massive innovation in new technology like autonomous vehicles, nanotech, materials science and energy storage.

But what does this mean from an investment perspective?

Each of the previous three industrial revolutions have produced huge corporate revenues for those companies that have stood at the centre of that revolution, many of which are still with us today (e.g Ford

Motor Company, IBM). From an investment perspective, it is important to identify those sectors that are likely to benefit the most from this technological innovation.

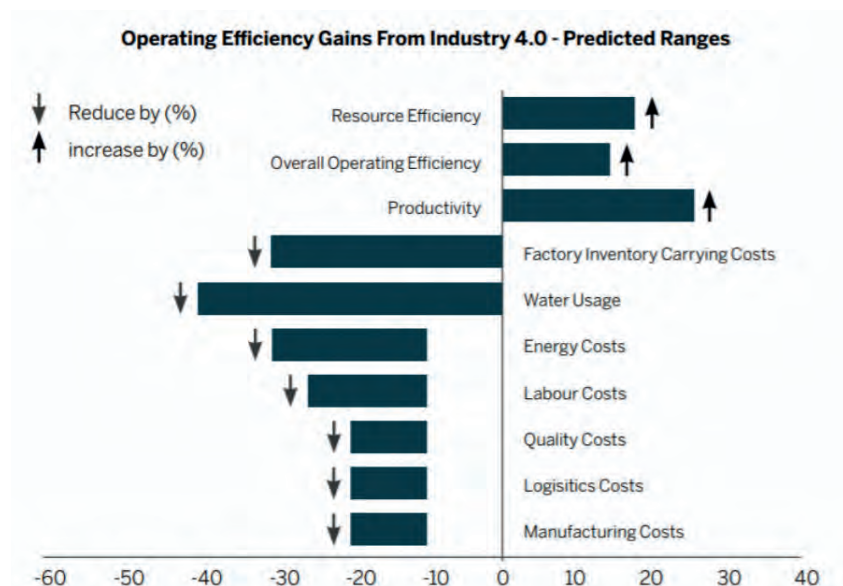
The impact of this revolution will be felt across all sectors, and in some there will be job losses, just as in others new jobs will be created. The software industry now employs millions of people around the globe, but it was a tiny sector only three decades ago.

Innovation is going to create new industry sectors that will grow rapidly. Using recent research from a combination of companies, including McKinsey & Co, PWC, Roland Berger and the Smart Manufacturing Leadership Coalition, we can estimate some of the specific business benefits:

Cloud computing

Cloud computing involves the delivery of computer services via the Internet. Most of the everyday tasks we carry out over the Internet are being made possible by this technology – for example, email, online banking, file storage and social media. This market is seeing growth as it provides benefits to businesses and their customers like lower cost and ease of access.

Many people take the benefits of the cloud for granted already - it is just there, operating behind the scenes, backing up data and delivering functionality and desktops and tablets, but it is changing the way most big companies do business. The companies that have chosen to specialize in the delivery of the cloud are now responsible for



Source: McKinsey & Company, PWC, Roland Berger and the Smart Manufacturing Leadership Coalition

much of the day to day data traffic across the globe. They sit at the nexus of the data revolution. The growth of this sector is being tracked by the HAN-GINS Cloud Technology UCITS, an ETF created specifically to tap into the theme of the growing importance of these organisations.

The Internet of Things

The Internet of Things - or IoT - is going to play a huge role in our daily lives in the future. It is connecting systems, sensors, devices and assets to the Internet. This can be everything from a mobile phone to a coffee maker or a washing machine. Components of larger machines are also being connected to the Internet, to allow for ease of monitoring, feeding data back of manufacturers for example.

For consumers, it will make life easier. For companies it means new opportunities. Rolls Royce, for example, has embedded IoT sensors across its product lines, generating vast amounts of live data that are aggregated and analyzed in the cloud. This data provides Rolls Royce with unprecedented insights into the live performance of its products, helping to predict equipment issues and maintenance requirements.

Big Data

The concept of data analytics has been around for years. Most organisations understand that by capturing data that streams into their business, they can analyse

and derive significant value from it. The new benefits that big data analytics bring are speed and efficiency, helping to identify insights for immediate decisions, cost reduction and the development of new products and services.

At General Electric the use of big data analytics has allowed the company to identify the trend of customers wanting to optimise inspection, maintenance and repair processes of their machines. This has spurred the decision to enable machines to communicate with one another and generate sensor data. For example, sensors collect signals on the health of blades on a gas turbine engine to show things such as stress cracks. Such technology will become widely accepted in years to come, but the innovation is happening now.

Robotics

Full automation of manufacturing has been a goal pursued for some years now but companies in this sector are going to be major game changers over the next decade. According to Deloitte and the Manufacturing Institute, up to 2 million manufacturing jobs will be left unfilled over the next decade due to improperly trained talent or a lack of individuals interested in careers in the manufacturing space.

Technology like this will be used to address skill shortages in developed markets like the US. What is changing from the days when major Japanese auto conglomerates embraced high

levels of robotics is that the technology is getting cheaper and therefore more widely adopted. Penetration rates for robots in the manufacturing sector are still low, no more than 74 per 10,000 workers in the manufacturing space, but that is destined to change.

Industry 4.0 as an investment theme

Industry 4.0 is a major trend that is changing the way we manufacture globally. It is akin in its importance to the transformations that the first industrial revolution delivered, but is different in that its benefits will be felt globally. Businesses are being granted unprecedented insights into their manufacturing processes, the machines they operate and the services they can provide.

Investing in a theme like this can be an onerous and difficult task. One route to accessing its growth potential is via ETFs, like the HAN-GINS Innovative Technologies UCITS - SKYY (domiciled in Ireland) which tracks the Solactive Innovative Technologies Index. It seeks to provide exposure to a diverse basket of companies from developed and emerging markets whose products and services are driving innovation, transforming lifestyles across the world.

Past performance is not a reliable indicator of future performance. As with all investing, your capital is at risk.

IFRIC 23 – Uncertainty on Income Tax Treatments – assessing the impact for investment funds



Rio Howley is a director with KPMG in Ireland specialising in funds and investment management. Rio sits on the Irish Funds UCITS Regulation and Innovation Working Group.

On 7 June 2017, the IFRS Interpretations Committee (IFRS IC) issued IFRIC 23, which clarifies how the recognition and measurement requirements of IAS 12 'Income taxes' are applied where there is uncertainty over income tax treatments. This new interpretation is effective for annual periods beginning on or after January 1, 2019 with early adoption permitted. It is comparable but not identical to ASC 740-10 under US GAAP (formerly known as FIN 48).

IFRIC 23 was released following a question which was put to the IFRS Interpretations Committee regarding the circumstances in which it is appropriate for entities to recognise a current tax asset when tax law requires an entity to make a payment in respect of a disputed tax treatment. However, IFRIC 23 goes further than simply addressing this question and provides general guidance on when an entity should recognise a current or deferred tax asset in relation to any 'uncertain tax treatment', in addition to how to measure any such recognition.

IFRIC 23 addresses:

- (i) whether an entity considers uncertain tax treatments separately;
- (ii) the assumptions an entity makes about the examination of tax treatments by taxation authorities;

- (iii) how an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and
- (iv) how an entity considers changes in fact and circumstances.

On application, full retrospective application is permitted or the requirements are applied by recognising the cumulative effect of initially applying them in retained earnings, or in other appropriate components of equity, at the start of the reporting period in which an entity first applies them, without adjusting comparative information.

The impact of this new standard on investment funds and the potential issues that may arise on transition are outlined below.

Impact on investment funds Assessment

IFRIC 23 clarifies how to apply the recognition and measurement requirements in respect of current and deferred tax which are outlined in IAS 12, relating to Income Taxes. In the context of an investment fund, it will therefore apply where to capital gains (realised and unrealised), interest income and dividend income.

This interpretation will place an obligation on investment managers to consider whether there is any 'uncertain tax

treatment' in respect of any of the positions held by funds which it manages. Practically speaking, this will require an assessment to be completed of the following in respect of each investment position:

- whether there is any uncertainty in relation to whether the tax authorities in each investment jurisdiction will accept the tax treatment which has been adopted in respect of investment return;
- and
- whether it is probable that the relevant tax authority would accept such uncertain tax treatment.

An uncertain tax position could arise for an investment fund as certain foreign jurisdictions have domestic tax legislation that can impose a capital gains tax payment obligation and / or filing requirement, where a non-resident investor realises a gain on disposal of certain securities related to that foreign jurisdiction.

Such a circumstance would likely result in an 'uncertain tax treatment' arising, which would give rise to the need to consider whether the tax authorities would accept such uncertain tax treatment – where the tax legislation of an investment jurisdiction imposes a tax payment and / or filing obligation

on a non-resident investor, it will unlikely be possible to assert that the tax authorities of that jurisdiction would accept non-compliance by the non-resident investor.

Where it is concluded that it is not probable that any tax authority will accept an uncertain tax treatment, there will be a requirement to reflect the impact of any uncertainty in determining taxable profit, tax bases, unused tax losses or tax rates. In the context of an investment fund, this will involve booking a provision, which will reduce the overall NAV.

Under IFRIC 23, any tax liability recorded as a result of any analysis may be theoretical only, as the likelihood of examination and enforcement may be remote. Therefore a liability may be recorded based on the tax legislation of an investment jurisdiction but may never be collected by the relevant tax authority. This will give rise to the ongoing need to monitor any provisions which are booked, to ensure such provisions are released once the statute of limitations expires in the investment jurisdiction.

In assessing the above, there is a requirement to assume that a taxation authority has the right to examine any amounts reported to it, will examine those amounts and will have full knowledge of all relevant information when doing so.

The need to consider investment jurisdiction tax treatment as a result of IFRIC 23 will likely present a new requirement for many investment managers. Therefore, it will be important that appropriate consideration is given to IFRIC 23, and a process is put in place to appropriately document any conclusions which have been reached to support the position adopted in the financial statements of each fund which is managed.

Disclosure

There are no new disclosure requirements under IFRIC 23 however in accordance with IAS 1, an entity must disclose any judgements or estimates made in assessing their uncertain tax treatment.

Considerations on transition

For investment funds which identify a tax liability upon the application of IFRIC 23, investment funds should consider the following:

- Given that the standard applies retrospectively, investment funds need to identify the cumulative effect of the standard which could go back to inception of the fund or the date which any tax legislation giving rise to 'uncertain tax treatment' came into effect in the relevant investment jurisdiction. If a tax liability is recognised in the current year, will it solely affect current investors?
- When a decision is made to terminate the investment fund which has accounted for tax liability in accordance with IFRIC 23 which has not been collected by the tax authority of an investment jurisdictions, the investment manager will need to make decisions on how to treat any historic accrual which has been booked (including whether to satisfy the technical obligation which gave rise to the 'uncertain tax treatment').

Irish Funds Member Update

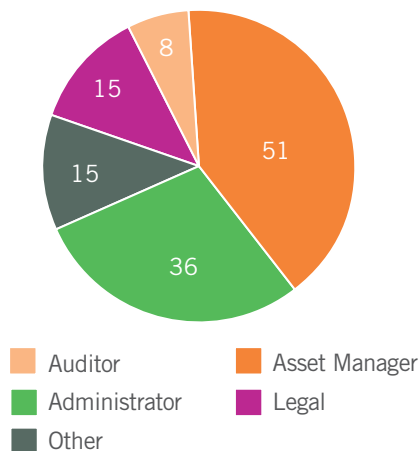
Read about member engagement, CSR, sustainable finance and ESG, available resources, upcoming events, and sponsorship and promotional opportunities for 2020.

New Member Welcome

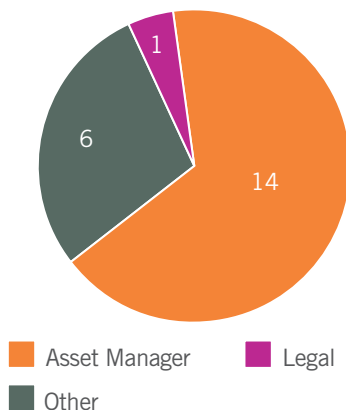
A warm welcome to our most recent new members **Coutts, Equity Trustees Fund Services (Ireland) Limited, HANetf, Manulife, and Northern Trust Fund Managers Ireland**. We now represent more than 145 member companies from across the funds industry and appreciate your continuing support.

Membership breakdown

Full Members: 125



Associate Members: 21



Connecting our members

Irish Funds and the Member Engagement Working Group have several initiatives underway to increase engagement and connect our members.

- **Irish Funds Lunch and Learns** – These are held by member firms to inform and engage their own staff about the association and the resources available. There is a PowerPoint available on the member portal and several firms have taken part already with more holding Lunch and Learns in November and into the new year. If you are interested in finding out more, please contact the Chair of the Working Group, Alison Manley at Alison.L.Manley@goodbody.ie.
- **Communications Champions (CCs)** – There are now more than 50 Irish Funds member CCs as this initiative continues to grow. The purpose of the CC is to help communicate, promote and increase engagement throughout your organisation, encouraging awareness of Irish Funds resources, events and updates. For more information, please contact Aine McClelland at amcclelland@dmsgovernance.com from the Member Engagement WG.
- **Membership Engagement Lunches** - We continue to see strong interest in these networking and information sharing events with 83 firms confirmed to participate over

the next 6 months (November to April). These lunches are an opportunity to discuss matters important to you and to get additional detail on our current priorities. For more information or to attend a lunch, please contact karen.gildea@irishfunds.ie

- **Member Portal Resources** – The member portal continues to be a success with over 2,000 users from 134 member firms registered, accessing more than 1,900 document resources. If you or your colleagues do not currently have access to this important information resource, you can register using the Member Login button at the top of irishfunds.ie.

Sponsorship opportunities for 2020

We have released our 2020 events sponsorship opportunities. Irish Funds sponsorship is an opportunity to maximise your brand's visibility to a global audience. Our experience from recent years is that the available sponsorship slots go quickly – we deal with them on a first-come, first-served basis. We currently have two remaining premium sponsor spots available and a variety of other sponsorship opportunities to suit your needs. If you have any questions, please contact David Shirley at david.shirley@irishfunds.ie or on +353 1 6753205 for more information.

We are in Asia in the beginning of the new year and in the US and London in the spring (Philadelphia, Greenwich and New York) in our ongoing efforts to support managers and promote Irish funds across the globe. For more information or to register for any of our upcoming events, visit www.irishfunds.ie/events

Focus on sustainable finance

Sustainable investment is an integral part of our preparation for the future. A combination of the right mind-set, toolkit and skill sets will help Ireland build on its success and we are committed to play our part. Recent developments include:

- **ESG Working Group** – We established our ESG Working Group to develop industry's sustainability agenda, consider the EU's Sustainable Finance Package as well as the innovation, talent and skills needed in our industry regarding sustainability.
- **ESG Newsletter** – The ESG WG and Communications & Publications WG coordinated an online-only ESG-focused newsletter in the run up to Climate Finance Week 2019. View the ESG Newsletter on irishfunds.ie.
- **Climate Finance Week Event** – As part of the Climate Finance Week 2019 programme of events, Irish Funds held an informative and well-attended briefing session on 'Sustainability and the Funds Industry - the Challenge and Opportunity Ahead'.
- **Statement of intent** – As part of the recent Climate Finance Week events and the industry's ongoing commitment to sustainability, Irish Funds CEO Pat Lardner joined other industry leaders in a pledge to take action to mitigate climate change risk through sustainable finance.

- **The Irish Funds Grant Thornton Sustainathon** – The Sustainathon will involve entrants from across the Irish funds industry working together to identify and propose solutions that drive sustainability. This competition will ask teams to identify and assess achievable and impactful measures that industry can implement to help realise these goals. Keep a look out for further information over the coming weeks with an official launch and call for participants in January.

Funds industry CSR News

Our member firms participate in a wide range of Corporate Social Responsibility activities and are involved in the community on many levels. A few recent highlights are:

Shine a Light Night Focus Ireland

On Friday, 18 October Yvonne Connolly and Lisa Kealy as Chair and Vice Chair of Irish Funds participated in a one night to sleep-out on the grounds of the Law Society of Ireland for the Focus Ireland's Shine a Light Night. They raised €36,000 from the funds community to support Focus Ireland in the fight against homelessness.

Focus Ireland is Ireland's leading not for profit working to prevent people becoming, remaining or returning to homelessness. There are over 10,000 people homeless in Ireland and of that number 1 in 3 is a child. Focus Ireland believe that homelessness can be ended and work to break the cycle of homelessness by giving people access to information, housing, childcare and a range of education services throughout Dublin, Cork, Kilkenny, Limerick, Sligo, Waterford, Clare and Wexford.

NEIC Work Placements in the Funds Industry

During the summer period of 2019, 20 young people from the NEIC secondary schools participated in a summer work placement in 11 funds industry organisations, including Irish Funds. Six Dublin inner city post-primary schools participated in the programme and all schools have had students placed on the programme. The Programme has been coordinated by Business in the Community (BiTC).

The feedback from the NEIC has been that the 2019 programme has been a resounding success for both the companies and the students and also for the NEIC.



This is significant given this is the first programme since it was last operational in 2008.

About the programme

- Programme existed 2001 – 2008 following a request from the DFIA for school leavers
- 177 students from 16 city centre schools secured paid summer placements
- 50% of the students were retained at the end of their contract

We hope to build on this success and expressions of interest will be circulated again in January 2020 for next year's Programme.

Continued Support for Funds Industry Charity basis.point

basis.point was founded in 2013 as the charity initiative of the Irish funds industry. It has grown from strength-to-strength and plays a key role in the CSR programmes of a large number of leading firms within the sector.

Focusing on children and young people from disadvantaged communities, they work closely with six leading charities to empower children through education.

For detailed information, please read the full newsletter article earlier in this edition.

Q4 Technical Briefings

We run a number of member-only technical briefings and seminars throughout the year. Q4 2019 briefings are:

- **AML - Beneficial Ownership Register** - Date: Tuesday, 19 November, Time: 8:00AM - 10:30AM, Location: Chartered Accountants, 47/49 Pearse St, Dublin 2. This is a member-only event.
- **Financial Reporting and Tax Seminar** - Date: Monday, 25 November, Time: 8:15AM - 10:15AM, Location: Chartered Accountants, 47/49 Pearse St, Dublin 2. This is a member-only event.

Irish Funds Annual Global Funds Conference – 21 May 2020

The Irish Funds Annual Global Funds Conference will be held on Thursday, 21 May 2020 at the Convention Centre Dublin. With competitions, presentations, panels and great networking opportunities, next year's conference is shaping up to be a highly anticipated and engaging event. Early bird registration will open in January.

Find out more at irishfunds.ie/conference2020.

Irish Funds

Annual Global Funds Conference 2020

SAVE THE DATE

Thursday / 21 May 2020

irishfunds.ie/events

#IFConf2020

if irish
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