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Submitted via email to: outsourcingfeedback@centralbank.ie

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Dear Sir/Madam,

**AIMA's Response to Consultation Paper on Cross-Industry Guidance on Outsourcing (CP138)**

The Alternative Investment Management Association Limited (AIMA)[1] appreciates the opportunity to provide its feedback to the Central Bank of Ireland (the Central Bank) in relation to its proposed Cross-Industry Guidance on Outsourcing (the "Guidance").[2]

An increasing number of AIMA members are subject to, or becoming subject to, the Central Bank's outsourcing requirements either directly because they are entities regulated by the Central Bank or indirectly because they are acting as outsourced service providers ('OSPs') to those regulated entities. As a result, members have reviewed the draft guidance with interest.

The continued ability to outsource is important to our members. Given the relatively small size of most of our member firms, compared for example to a global bank or insurance company, the best way to access technologically sophisticated and cost-effective support is often to use high quality OSPs. These providers have expertise and scale to manage complex technology and train and retain staff with specialised expertise. Many investors request or require that firms use third party administration service providers to ensure there is a separate set of eyes on the asset valuations, fund redemption and other key operational processes. We acknowledge that outsourcing can create additional risks that need to be identified, managed and mitigated where

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[1] The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with around 2,000 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors).

[2] See, Central Bank of Ireland Draft Cross-Industry Guidance on Outsourcing: https://www.centralbank.ie/docs/default-source/publications/consultation-papers/cp138/draft-cross-industry-guidance-on-outsourcing.pdf.

they cannot be avoided, but prescriptive risk management requirements around outsourcing should be imposed with care so they do not stifle outsourcing unnecessarily.

We would also like to highlight that the COVID-19 pandemic put investment managers' outsourcing arrangements and operational resilience to the test and the industry proved itself to be highly adaptable and resilient in the face of huge disruption. Operations not only continued in an unprecedented, decentralised setting but worked almost seamlessly with little or no interruption. Indeed, the COVID-19 experience has proven that investment managers' operations and their ecosystem's capabilities are robust, that many processes can be managed remotely, and that – even during the lockdowns – the industry remains agile and resilient.

Our view is that the key to good outsourcing is appropriately managing the associated risks. In turn, allowing investment managers to benefit from economies of scale, specialisation and access to an adequate pool of service providers. This is ultimately beneficial to the end investors. Introducing inappropriate restrictions on outsourcing could risk resulting in further frictions and costs in investment managers operations, which would be detrimental for the end investor, as well as in further fragmentation of the market.

Overall, we are in broad agreement on the intent of the draft outsourcing guidance as a measured approach to proportionally balance risk and complexity, while promoting flexibility to support increased future outsourcing. However, our members did have some comments in a few areas:

**The role of the board and senior management**

One of the operational issues with the Guidance is more blurring of the line between non-executive directors ("NEDs") and senior management of the oversight of the management company. The increased oversight that will be required makes it look as though NEDs may be needed to regularly step into management roles. In order to fully approve and oversee the outsourcing strategy and frameworks of a firm, this increased workload will require greater time commitment with some executives needed on the job the whole time with NED support to oversee, for example, certain outsourced functions and what the executive members and management are doing. Consideration could be given to providing additional guidance on what are the oversight expectations from NEDs and what is the estimate of work time needed to implement the oversight requirements envisaged. Another concern is whether or not Ireland will have enough effective NEDs on the ground in the country to carry out the requirements if they are having to work for one company in an executive or near executive capacity rather than in an oversight capacity for multiple firms.

**Treatment of delegation**

We acknowledge that "delegation" and "outsourcing" are not considered by the Central Bank to be different concepts. Our members fully rely on the possibility to "delegate" some functions such as portfolio management to expertise located anywhere in the world to efficiently serve their clients. They view the delegation of functions under the Alternative Investment Fund Managers Directive ("AIFMD") as strictly regulated in order to avoid any "letter-box entity" by Article 20 of the AIFMD and related portions of the Level 2 delegated regulation which have recently been reinforced with detailed and prescriptive guidance opinions from the European Securities and Markets Authority

(ESMA).[3] It is natural for supervisory procedures to evolve over time as new requirements are applied and national competent authorities ("NCAs") gain experience of how market practice has been impacted. This supervisory evolution has also been guided by the 2017 ESMA opinions and our members have recently seen the effects of this supervisory evolution through further specific guidance in the form of the CBI Fund Management Companies Guidance,[4] for example. Similar evolutionary processes have also been experienced with other NCAs. Our view is that delegation also allows fund managers to benefit from economies of scale, specialisation and access to an adequate pool of service providers as they are able to domicile their operations in financial centres which offer this ecosystem. This is ultimately beneficial to EU capital markets and investors.

**Intra-group arrangements**

We believe that proportionality should apply to intra-group outsourcing arrangements hence a reduced assessment should be considered sufficient for such arrangements. Certain aspects can be managed differently in practice and therefore a lighter assessment approach should be adopted. The Central Bank could permit firms to have different policies for external and intra-group outsourcing and provide more examples of areas where a reduced assessment can be applied. For example, in relation to exit strategies, material deterioration in service is more likely to be resolved by internal escalation, rather than moving to a new service provider.

As acknowledged by the International Organization of Securities Commissions (IOSCO):

> "risks associated with outsourcing tasks to an affiliated service provider may be different to those encountered in outsourcing to an unaffiliated external service provider. Risks may, in certain cases, not be as pronounced within an affiliated group. For example, the regulated entity may have the ability to control or influence the actions of the affiliated service provider, and the regulated entity may be more familiar with the affiliated service provider's business attributes."[5]

We agree that for intra-group agreements, a lighter touch approach to the expectations for the outsourcing arrangement would be more appropriate.

There also remains a lack of clarity in the draft guidance on the delineation between external and intra-group relation termination processes, which in reality are practically quite different. For example, many subsidiary entities are heavily reliant on intra-group outsourced services (i.e., core business process and IT infrastructure and applications). Exit strategies and plans in many

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[3] Opinion to support supervisory convergence in the area of investment management in the context of the UK withdrawing from the EU, ESMA, July 2017 – available at: https://www.esma.europa.eu/document/opinion-support-supervisory-convergence-in-area-investment-management-in-context-united.

[4] Central Bank of Ireland Thematic review of fund management companies' governance, management and effectiveness, October 2020 – available at: https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/funds/industry-communications/dear-chair-letter---thematic-review-of-fund-management-companies-governance-management-and-effectiveness---20-october-2020.pdf.

[5] See, IOSCO Principles on Outsourcing Consultation Report: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD654.pdf.

instances are not relevant, in that should the group related entity cease, the local subsidiary would also in practical terms cease as well. Greater guidance in this regard would be welcomed.

**Management of concentration risk**

Concentration risk is not always transparent, and individual firms are not well-positioned to measure this risk across service providers. Although firms may ask service providers about their clients, the level of detail the service providers are willing to provide is not often sufficient for the regulated firms to make any truly informed conclusions about systemic concentration risks that may exist. Indeed, service providers may not even know with any accuracy how much of a market share they have given that there is no single source of reliable data on market size.

We would also suggest that the sharing of information about outsourcing arrangements with other regulators may be helpful in this regard. If such information were to be collected by regulators, it would also need to be available at least on a headline basis to regulated firms if they are to be required to identify and avoid this risk rather than simply acknowledging that it exists and managing the arrangement in light of that risk.

**Evolving regulatory environment**

We would encourage the Central Bank to consider international policy developments in the area of outsourcing. As highlighted by the Central Bank, the regulatory framework for outsourcing continues to evolve. Investment managers with operations in multiple jurisdictions will be compelled to adapt their policies and practice according to the local regulations and therefore a fragmented approach to rulemaking could lead to a patchwork of regulatory frameworks ultimately increasing costs for the end investor. We believe it is essential that financial regulators and supervisors' efforts work in a harmonised and convergent manner to the greatest extent possible. We have been engaging with policymakers at the Financial Stability Board (FSB), IOSCO, ESMA and other regulatory bodies where new consultations on outsourcing have recently been issued, to seek greater coordination and consistency across their respective outcomes.

As a result of the operational risks for individual firms and the reputational risks to firms and the industry as a whole, AIMA has published its own 'Guide to Sound Practices for Outsourcing by Investment Managers'. We would be pleased to share with you a copy of this guide if that would be of interest. We would also be happy to elaborate further on any of the points raised in this letter. For further information please contact James Delaney, Director of Asset Management Regulation, at jdelaney@aima.org.

Yours faithfully,

Jiří Król
Deputy CEO, Global Head of Government Affairs
AIMA