



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

2015

Consultation on Risk Assessment and Capital Planning for Fund Administrators

Consultation Paper CP 100

Contents

Introduction	2
Format of this Consultation Document	3
Questions for consideration	3
Consultation responses	4

Introduction

On the 4th November 2015, the Central Bank published CP97 *Consultation on Central Bank Investment Firm Regulations 2015*¹ (“CP97”). CP97 highlighted the Central Bank’s intention to publish an Investment Firms rulebook in the form of Central Bank regulations under the Central Bank (Supervision and Enforcement) Act 2013 (referred to in CP97 and herein as the “**proposed Central Bank Investment Firm Regulations**”). It was noted that the proposed Central Bank Investment Firm Regulations would consolidate into one document all of the conditions and requirements which the Central Bank currently imposes on investment firms. In addition, CP97 outlined certain proposed policy changes in the areas of capital and outsourcing requirements applicable to Fund Administrators.

CP97 further noted that the Central Bank was examining the option of applying a capital planning requirement to certain non-MiFID firms and that the Central Bank’s intention was to consult on this issue before the end of the year. The Central Bank now wishes to consult on that issue through this consultation paper.

Proposal

The Central Bank proposes introducing a risk assessment and capital planning requirement for Fund Administrators authorised under the Investment Intermediaries Act, 1995 to reflect improvements in capital planning in recent years throughout the financial services sector. It is proposed that this requirement would be introduced by way of additional regulations to be inserted into Part 5 of the proposed Central Bank Investment Firm Regulations. We refer to these proposed additional regulations herein as “Proposed Regulations”. It is also proposed to issue guidance on the Proposed Regulations, referred to herein as “Proposed Guidance”. The text of the Proposed Regulations and the Proposed Guidance are attached to this Consultation Paper.

By introducing the new requirements by way of regulations combined with guidance, the Central Bank aims to facilitate the practice of capital planning in a manner that is proportionate to the business. The Proposed Regulations set out what must be done by all, while the Proposed Guidance sets out what may be appropriate for many firms while recognising that it is not describing what must be done by all. For some firms it will be sufficient to be able to explain why they decided not to do some of what is suggested in the Proposed Guidance. As is the current practice with respect to regulatory guidelines within the funds sector, the intention is that a Fund Administrator should either comply with all sections of the Proposed Guidance or be able to explain why a particular section is not applicable for that Fund Administrator and what alternative steps it is taking to ensure compliance with the relevant regulation.

The proposed new requirements would broadly align the capital planning requirements applicable to Fund Administrators to those already applying to MiFID investment firms in Ireland under the Capital Requirements Directive² (‘CRDIV’) and Capital Requirements Regulation³ (‘CRR’). In this regard, CRDIV is transposed into Irish Law via the European Union (Capital Requirements) Regulations, 2014 (S.I. No. 158 of 2014) and those Regulations set out various

¹ [CP97 Consultation on Central Bank Investment Firm Regulations 2015](#)

² Directive 2013/36/EU

³ Regulation (EU) No. 575/2013

requirements in relation to the proactive continuous assessment of risk and the level of capital to be held to meet such risks. In summary, CRDIV requirements include a requirement to:

- carry out an internal capital adequacy assessment process;
- assess, in that context, a number of specifically identified risks to the institution; and
- set aside capital to meet those risks based on the capital adequacy assessment undertaken.

The Central Bank considers that it is appropriate that an equivalent requirement should be applied to Fund Administrators. The Central Bank has tailored the requirement, including the list of sources of risk, to reflect the specific nature of the business of Fund Administrators and our supervisory focus for these firms. The policy intention is to build on work completed to date by our supervisors as part of their bilateral engagement with Fund Administrators to ensure that comprehensive risk assessment and capital planning is undertaken by Fund Administrators on a continuous basis. The Central Bank has had a good response to this initiative which underpins a more forward-looking and risk-focused approach to capital. The Central Bank recognises this is an important piece of prudential regulation and wishes to put on a formal legislative basis a requirement to engage in comprehensive risk assessments and capital planning. The change reflects the identification in our supervisory work of a need to ensure that those concerned in the direction and management of Fund Administrators take ownership in relation to the assessment of all of the risks in their business and ensure that their firm holds appropriate capital reserves relative to those risks.

Format of this Consultation Document

The Proposed Regulations and the Proposed Guidance form part of this Consultation Document. Your views are sought on all aspects of the Proposed Regulations and Proposed Guidance and, in particular, on the questions raised below.

When the consultation processes outlined in CP97 and this Consultation Paper are complete we will set out our approach to the timing of the implementation of any changes we decide upon in relation to capital planning and how the implementation of that change will relate to the separate process of implementing the proposed Central Bank Investment Firm Regulations. We will also consider whether any further guidance on the requirements might also be useful.

Questions for consideration

While we are consulting on all of the Proposed Regulations and Proposed Guidance, we would welcome stakeholders' views on the following questions in particular:

1. Regulation 98 of the Proposed Regulations proposes requiring Fund Administrators to have in place sound, effective and comprehensive strategies, processes and systems to identify and manage the risks that are applicable to the Fund Administrator and to assess whether the Fund Administrator has adequate own funds to cover those risks. This

requirement encourages a risk-focused approach to capital and brings requirements in this area broadly in line with those applying to MiFID investment firms in Ireland. Do you agree with the approach proposed?

2. Regulation 101 of the Proposed Regulations proposes a list of sources of risk and requires that a Fund Administrator must, at a minimum, assess whether each of the risks listed is relevant for its business and, if it is, the adequacy of the Fund Administrator's existing measures to address that risk. The Proposed Guidance provides further detail on what might be covered when considering each risk and Central Bank expectations for management of these risks. Do you agree with the proposed list of sources of risk and the guidance provided? Are there any additional risks which should be included?

Consultation responses

The Central Bank invites all stakeholders to provide comments on the Proposed Regulations and Proposed Guidance and on the questions raised in this Consultation Paper.

Please make your submissions electronically by email to invfirmpolicy@centralbank.ie or in writing, to:

**CP100 Consultation
Markets Policy Division
Central Bank of Ireland
Block D
Iveagh Court
Harcourt Road
Dublin 2**

Responses should be submitted no later than 15 March 2016.

It is the policy of the Central Bank to publish all responses to its consultations. All responses will be made available on our website. Commercially confidential information should not be included in consultation responses. We will send an email acknowledgement to all responses sent by email. If you do not get an acknowledgement of an emailed response please contact us on +353 1 2246000 to correct the situation.

**Markets Policy Division
Central Bank of Ireland
22 December 2015**

T +353 1 2246000

F +353 1 1 6716561

www.centralbank.ie

invfirmpolicy@centralbank.ie



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

**Bosca PO 559, Sráid an Dáma, Baile Átha Cliath 2, Éire
PO. Box No 559, Dame Street, Dublin 2, Ireland**

S.I. No. XX of 2016

**CENTRAL BANK (SUPERVISION AND ENFORCEMENT) ACT 2013
(SECTION 48(1)) INVESTMENT FIRMS PRUDENTIAL AND SUPERVISORY
REQUIREMENTS REGULATIONS 2016**

(ADDENDUM)

PART 5 – OWN FUNDS REQUIREMENTS AND CAPITAL ADEQUACY

Risk Analysis and Capital Adequacy Assessment Process

98. (1) A fund administrator shall have in place sound, effective and comprehensive strategies, processes and systems to:
- (a) enable it to identify and manage the sources of risk that are relevant to the fund administrator; and
 - (b) assess and maintain on an on-going basis the amounts, types and distribution of own funds that are adequate to cover the nature and level of the risks to which it is or might be exposed.
- (2) With reference to paragraph 1, a fund administrator shall consider both on and off-balance sheet exposures and contingent liabilities.
- (3) The strategies, processes and systems referred to in paragraph 1 and conclusions arising from these strategies, process and systems shall be approved by the board of directors of the fund administrator. The strategies, process and systems and conclusions arising and the plans referred to in Regulations 99 and 100 shall be subject to regular internal review to ensure that they remain comprehensive and proportionate to the nature, scale and complexity of the activities of the fund administrator. An internal review shall occur, at a minimum, on an annual basis and the conclusions arising from such reviews shall be approved by the board of directors of the fund administrator.

Own Funds Plan

99. A fund administrator shall draw up own funds plans that include profit and loss and balance sheet projections for a forward looking period of not less than three years.

Wind-down Plan

100. (1) A fund administrator shall draw up a plan setting out how the fund administrator would wind down in an orderly fashion in the event of failure.

- (2) The plan referred to in paragraph 1 shall include estimates of the own funds and liquidity required for the fund administrator to wind down in an orderly fashion within a defined time period.

Sources of risks

101. (1) With reference to Regulation 98, a fund administrator must at a minimum assess whether each of the following sources of risk is relevant and, if it is, the adequacy of the fund administrator's existing measures to address that risk:
 - (a) credit and counterparty risk;
 - (b) concentration risk;
 - (c) market risk;
 - (d) operational risk;
 - (e) liquidity risk;
 - (f) strategy or business model risk;
 - (g) group risk;
 - (h) environmental risk;
 - (i) governance risk.
- (2) With reference to point (e) of paragraph (1), the fund administrator shall measure and monitor liquidity risk over an appropriate set of time horizons, so as to ensure that the fund administrator maintains adequate liquidity management arrangements. At a minimum the set of time horizons should include intra-day, 30 day, 90 day, 180 day and 360 day periods.

Written records

102. (1) A fund administrator shall make a written record of the assessments and conclusions referred to under Regulation 98. Written records shall also be made of the plans referred to under Regulations 99 and 100. Such records must be maintained for a period of six years and must be immediately available for inspection by the Bank.
- (2) For each of the sources of risk listed in paragraph (1) of Regulation 101, the fund administrator shall have in place written policies and procedures to identify, measure and manage that source of risk.



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

2015

Fund Administrators - Risk Assessment and Capital Planning - Guidance Note

(For consultation)

December 2015

Contents

Scope	3
Definitions	3
Part I. Risk Analysis and Management	4
Part II. Testing Capital and Liquidity Adequacy	5
Part III. Own Funds, Liquidity and Wind-down Planning	7
Part IV. Risk-specific Guidance	9

Adherence to guidance

It should be evident from the fund administrator's documented policies and procedures and written records of assessments made, as well as from board minutes, that the fund administrator is acting in accordance with this guidance, if this is the case.

Scope

1. This guidance is applicable to fund administrators authorised under the Investment Intermediaries Act, 1995 (the “IIA”). Such fund administrators are required to comply with the Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) Investment Firms Prudential and Supervisory Requirements Regulations, 2016 (the “Investment Firm Regulations”). Part 5 of the Investment Firm Regulations contains requirements for fund administrators with respect to risk analysis and capital and liquidity adequacy planning. This guidance further elaborates on those requirements.
2. The provisions set out in this guidance are intended to assist fund administrators by providing an overview of the approach recommended by the Central Bank. The guidance does not purport to address every aspect of risk assessment and capital and liquidity adequacy planning in detail. Subject to the obligation to comply with the Investment Firm Regulations, the overriding approach should be that the fund administrator should design its risk analyses and capital and liquidity planning practices so as to be comprehensive and proportionate to the nature, scale and complexity of the activities of the fund administrator.

Definitions

3. For the purpose of this guidance, terms used that are defined in the Investment Firm Regulations have the meaning set out in those regulations, unless it is indicated otherwise.
4. For the purpose of this guidance, the term:
 - “internal capital” means items included under the equity heading of the fund administrator’s balance sheet that do not fall under the definition of own funds in the Investment Firm Regulations but have been identified by the fund administrator as available to cover risks or losses.

Part I. Risk Analysis and Management

5. Part 5 of the Investment Firm Regulations requires a fund administrator to have in place sound, effective and comprehensive strategies, processes and systems to identify and manage the risks to which it is or might be exposed. The board of the fund administrator is responsible for approving these strategies, processes and systems. In this regard, the board should adopt a risk management framework which:
 - a. identifies and quantifies all risks relevant to the fund administrator;
 - b. confirms the risk appetite for each risk identified;
 - c. determines how each risk identified should be mitigated in order to maintain the risk exposure within the fund administrator's risk appetite for that risk type including whether the appropriate form of such risk mitigation is controls, a change in liquidity management arrangements or additional own funds or internal capital;
 - d. estimates the amount of residual risk after risk mitigation is applied; and
 - e. incorporates appropriate policies for the measurement, management and monitoring of each risk identified, including the implementation as appropriate of any risk mitigation techniques.
6. The risk appetite statement should be appropriate and proportionate to the nature, scale and complexity of the activities of the fund administrator. The risk policies should include clear procedures, with thresholds where appropriate, for reporting to the board in order to ensure that risk exposures are maintained within the fund administrator's risk appetite.
7. The board should agree how its responsibility for risk oversight and management is discharged. The board should determine the quality, type and format of risk-related information which it requires and put in place arrangements to receive it.

8. While the board may obtain advice and recommendations on risk issues, including periodic review of the risk management framework, it should retain the ultimate decision-making capability.

Part II. Testing Capital and Liquidity Adequacy

9. For larger, more complex fund administrators or fund administrators operating in a particularly dynamic environment, it is likely to be appropriate for the board to ensure that appropriate testing and scenario analyses of both liquidity management and capital adequacy arrangements are conducted in order to assess the nature and level of risks to which the fund administrator may be exposed in a variety of adverse circumstances.
10. Where a fund administrator carries out tests and scenario analyses, it should develop tests and scenario analyses that are appropriate to the nature, scale and complexity of the source of risk and to the nature, scale and complexity of the fund administrator's business. It should be considered whether tests and scenario analyses are required for all material sources of risk identified by the fund administrator. Where a fund administrator carries out scenario analyses, such analyses should include an appropriate set of adverse circumstances of varying nature, severity and duration relevant to the fund administrator's business and risk profile. In this regard, the fund administrator should consider:
 - a. circumstances and events occurring over a prolonged period of time;
 - b. sudden and severe events, such as market shocks or other similar events;
and
 - c. a combination of (a) and (b).
11. Where a fund administrator carries out tests and scenario analyses, such tests and scenario analyses should be defined in test documentation, which should be approved by the board. The test documentation should include the following for each test or scenario analysis to be conducted:

- a. The generation process: This should specify whether the test or scenario is based on historical data, on simulated data or a combination of the two. Where reliance is placed on a particular historical event, additional scenario analysis should be included which stresses the relationships and correlations embedded in that historical scenario. There should be an articulated rationale for the choices made. For scenario analyses that involve a number of risk correlations, these risk correlations should be described.
- b. The testing process: This should set out the sequence in which each side of the balance sheet is to be tested and how they are to be combined to generate the test outcome. For scenario analyses that involve a number of risk correlations and require a variety of calculations to be performed, this should set out the order in which the various calculations are to be performed. The rationale for the choices made in this regard should be documented.
- c. The risk assessment: This should set out how the reliability of data, statistical models and any judgements relied on should be risk assessed. This should include back-testing of the sources relied on in the immediately prior test or scenario analysis to ensure they remain fit for purpose. In back-testing, forecasting accuracy is compared against actual outcomes.
- d. The results analysis: This should set out how the test or scenario analysis results are to be reviewed within an internal challenge process in which the alignment of the test or scenario analysis results with the defined risk appetite is reviewed and conclusions documented. The procedure for making decisions to eliminate, mitigate or accept the risks highlighted by the test or scenario analysis should be clearly documented. The documentation should describe who is responsible for developing for decision makers a range of mitigants that might be considered. Changed reporting arrangements, including altered reporting thresholds, should also be considered. The results analysis process

should also consider recommendations for changes to future tests and/or scenario analyses.

12. Where a fund administrator carries out tests and scenario analyses, the fund administrator should consider and estimate the impact of risk correlations.

Part III. Own Funds, Liquidity and Wind-down Planning

Own Funds Plans

13. Part 5 of the Investment Firm Regulations requires a fund administrator to draw up own funds plans that include profit and loss and balance sheet projections for a forward looking period not less than three years. The board of the fund administrator is responsible for approving these own funds plans.
14. The board should ensure that the plans referred to in section 13 include projections under both normal conditions and under stressed circumstances considered by the fund administrator. Such plans should highlight if and when additional own funds may be required by the fund administrator and should indicate how the fund administrator intends to raise any such additional own funds. Such plans should also indicate whether any additional own funds raised would be held as eligible assets. The plans should take into account any impending changes to the fund administrator's regulatory requirements.
15. The fund administrator should ensure that it has a linked risk and capital management system and should reconcile internal capital to the fund administrator's own funds.

Liquidity Risk Analysis and Planning

16. Part 5 of the Investment Firm Regulations requires a fund administrator to measure and monitor liquidity risk over an appropriate set of time horizons so as to ensure that the fund administrator maintains adequate liquidity management arrangements.

17. When assessing liquidity risk under the various time horizons, the board should ensure that projections are completed under both the normal conditions and stressed circumstances considered by the fund administrator. Such projections should highlight if and when additional liquidity may be required by the fund administrator and should indicate how the fund administrator intends to raise any such additional liquidity. The plans should take into account any impending changes to the fund administrator's regulatory requirements.

Wind-down Plans

18. Part 5 of the Investment Firm Regulations requires a fund administrator to have in place a plan setting out how the fund administrator would wind down in an orderly fashion in a defined time period in the event of failure and to estimate the amount of own funds and liquidity required.

19. When drawing up a wind-down plan, a fund administrator should consider and incorporate the following elements:
 - a. There should be an assumptions section setting out the assumed circumstances of the wind-down scenario including reference to legal risk and determination of ownership of client assets or investor money where relevant.
 - b. The fund administrator should define a time period for the orderly transfer of assets under administration to other fund administrators and should complete the wind-down plan with reference to this time period.
 - c. The fund administrator should consider which staff would be required to ensure the orderly transfer of assets under administration to other fund administrators within the defined time period.

- d. The fund administrator should estimate the revenues that it would expect to receive within the defined time period for winding-down, bearing in mind that revenue inflows may reduce at a faster rate than costs.
- e. The fund administrator should consider whether it would expect to incur any additional expenses in the wind-down scenario.

Part IV. Risk-specific Guidance

20. Part 5 of the Investment Firm Regulations requires a fund administrator, at a minimum, to assess whether each of the following sources of risk is relevant and, if it is, the adequacy of the existing measures to address that risk:

- a. credit and counterparty risk;
- b. concentration risk;
- c. market risk;
- d. operational risk;
- e. liquidity risk;
- f. strategy or business model risk;
- g. group risk;
- h. environmental risk; and
- i. governance risk.

21. In addressing these sources of risk, the fund administrator should consider taking sections 22 to 36, below, into account.

Credit and Counterparty Risk

22. Credit and counterparty risk refers to the risk of financial loss arising from a counterparty who fails to meet its obligation in accordance with agreed terms. Credit risk arises any time a fund administrator's funds are extended, committed, invested or otherwise exposed.

23. When addressing credit and counterparty risk, the fund administrator should take into account all credit exposures, both on and off-balance sheet, and should in particular address problem credits in order to ensure that it makes adequate value adjustments and provisions for problem credits.

Concentration Risk

24. Concentration risk refers to the risk of loss arising from a relatively large exposure to a single counterparty or to a group of related counterparties. It can also arise where there is a relatively large exposure to a particular business line, geographic area or market segment.

25. When addressing concentration risk, the fund administrator should address concentration risk arising from all exposures, both on and off-balance sheet.

Market Risk

26. Market risk refers to the risks of losses arising from adverse movements in market prices including in equities, derivatives, interest rates, commodities and FX rates.

27. When addressing market risk, the fund administrator should address market risk arising from all exposures, both on and off-balance sheet.

Operational Risk

28. Operational risk refers to the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk should include:

- a. insurance risk, specifically whether insurance policies in place to cover compensation on errors arising are adequate;
- b. legal risk arising from any potential claims or disputes; and
- c. the risk arising from any outsourcing arrangements entered into by the fund administrator.

29. The fund administrator’s assessment of operational risk should cover low frequency high-severity events.
30. The fund administrator should have in place contingency and business continuity plans to ensure the fund administrator’s ability to operate on an on-going basis and limit losses in the event of severe business disruption.

Liquidity Risk

31. Liquidity risk refers to the risk that a fund administrator may not be able to fund its cash outflows as they fall due.
32. When addressing liquidity risk the fund administrator is likely to need to:
 - a. distinguish between encumbered and unencumbered assets;
 - b. categorise assets into buckets based on current evidence of their relative liquidity;
 - c. take into account the legal entity in which assets reside and the country in which such legal entity is situated and should assess whether assets can be mobilised in a timely manner;
 - d. take into account all relevant liabilities including off-balance sheet items and contingent liabilities;
 - e. take into account the fund administrator’s dividend policy;
 - f. consider different liquidity risk mitigation tools; and
 - g. include effective liquidity contingency and recovery plans taking into account the outcome of tests and scenario analyses carried out.

Strategy or Business Model Risk

33. Strategy or business model risk refers to the risk that fund administrators face if they cannot compete effectively, namely that, in a market economy, others will offer better products or services, or substitute products or services, at better prices and that they may fail because they may not be able to cover their costs. Strategy or business model risk also includes the inherent risk in the strategy, for example overly excessive business growth, merger and acquisitions activity and/or

significant business diversification. Business model risk may also include a cost base that is materially out of line with the rest of the market.

Group Risk

34. Group risk refers to the risk of loss arising from transactions with and exposures to group entities. Both on and off-balance sheet exposures should be considered, including in particular any guarantees given to group entities.

Environmental Risk

35. Environmental risk encompasses all risks stemming from the fund administrator's external operating environment including regulatory changes, the economic environment and financial market activity.

Governance Risk

36. Governance risk refers to risk arising from internal governance structures, including internal control, audit and compliance and oversight mechanisms.

T +353 1 224 6000 F +353 1 671 6561 www.centralbank.ie invfirmpolicy@centralbank.ie



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem