



Banc Ceannais na hÉireann  
Central Bank of Ireland

Eurosystem

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## Feedback Statement on Consultation on Risk Assessment and Capital Planning for Fund Administrators (CP 100)



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## Introduction

1. On 22 December 2015 the Central Bank published a Consultation Paper on Risk Assessment and Capital Planning for Fund Administrators (“CP 100”). The Central Bank invited all stakeholders to provide observations and comments on the proposed regulations set out therein. The closing date for comments was 15 March 2016 and 4 responses were received.
2. CP 100 relates to the publication of an Investment Firm Rulebook (“the Rulebook”) which consolidates into one document all of the conditions and requirements which the Central Bank imposes on investment firms. The Central Bank is issuing the Rulebook on a statutory basis. Having considered the options available to the Central Bank to achieve this, the Central Bank intends to publish the Rulebook in the form of Central Bank Regulations (the “Regulations”). This is pursuant to the provisions of the Central Bank (Supervision and Enforcement) Act 2013 which permit the Central Bank to make regulations for the proper and effective regulation of regulated financial service providers. It should be noted that there are a number of formal steps required before the publication of Central Bank Regulations, therefore, the Regulations may not be published before the end of the year. The final version of the Regulations may contain some further technical and structural changes but these changes will not affect the policy stance as set out in this Feedback Statement.
3. In order to assist firms implementing the Regulations, it is the Central Bank’s intention to publish Guidance for firms on the Regulations. This will include the guidance provided in the draft Guidance Note attached to CP 100.
4. This paper summarises the responses received to CP 100 and notes the Central Bank’s comments and decisions. It is, therefore, intended that this paper be read in conjunction with CP 100 as it makes reference to proposals, terms and numbering used in the consultation papers, which can be found on the Central Bank’s website<sup>1</sup>.
5. The Central Bank will keep its requirements under review at all times and welcomes on-going discussion on how best to protect investors, while facilitating the management of costs arising.
6. Nothing in this feedback statement should be read with, seen as a clarification of or a supplement to the Regulations. This feedback statement is published to promote understanding of the policy formation process within the Central Bank and is not relevant to assessing compliance with regulatory requirements.
7. The Central Bank would like to thank all parties who took the time to respond to CP 100 to inform the policy development process.

### Markets Policy Division

### Central Bank of Ireland

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<sup>1</sup> <http://www.centralbank.ie/regulation/poldocs/consultation-papers/Pages/closed.aspx>

## Feedback on issues raised in CP 100

**Question 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?**

### *General*

8. 1 of the 4 respondents noted general support for the proposals contained in Regulation 98 of the Regulations, 1 provided no general comment and instead focused on some of the details of the requirements, while the remaining 2 respondents were opposed to the Central Bank's proposal to introduce a risk assessment and capital planning requirement for Fund Administrators for the following reasons. Respondents questioned the appropriateness of mandating stringent requirements in relation to risk assessment and capital planning, particularly by way of statutory instrument, and highlighted that the business model of a Fund Administrator was not comparable to that of a MiFID firm and that the balance sheet of a Fund Administrator is not as vulnerable to significant and relatively quick movements such as those that banks may experience from credit losses or mark to market valuations. Respondents also made reference to the fact that Fund Administrators do not leverage their balance sheets, do not take deposits, do not have credit exposures due to lending and do not engage in proprietary trading.

**Central Bank:** Current capital requirements for Fund Administrators have been in place for nearly 20 years without any material amendments to the regime. CP 97 seeks to update the existing regime by broadly aligning capital definitions to those set out in the Pillar 1 regime under CRR/CRD IV<sup>2</sup> in order to ensure that an appropriate quality of capital is held by Fund Administrators. Similarly, CP 100 seeks to update the existing regime by introducing risk assessment and capital planning requirements similar to those that apply to MiFID investment firms under the Pillar 2 requirements in CRR/CRD IV. The Central Bank does not propose a direct transposition of the Pillar 2 requirements for MiFID investment firms to be imposed on Fund Administrators. The Central Bank aims to establish risk assessment and capital planning requirements that are similar in nature to the Pillar 2 requirements but that are tailored to a Fund Administrator's activities and take into account the more straight-forward business models of Fund Administrators. The Central Bank would also like to highlight that many of the Fund Administrators authorised in Ireland are substantially larger than many MiFID firms to whom these requirements already apply.

The aim of the proposed risk assessment and capital planning requirements is to ensure that Fund Administrators address the following in a consistent manner:

- (a) conduct an internal process to assess their current and future capital and liquidity adequacy with reference to the risks to which they are exposed and their business strategy;

<sup>2</sup> Capital Requirements Regulation (Regulation (EU) No 575/2013) and Capital Requirements Directive IV (Directive 2013/36/EU). CRD IV is transposed in Ireland by S.I. No. 158 of 2014.

- (b) identify all risks facing the Fund Administrator and the measurement of capital needed to address these risks, taking into account the risks specific to the jurisdictions in which they operate, the impact of new legislation, the actions of competitors etc.;
- (c) to develop and implement, as part of the risk assessment, linked risk and capital management systems;
- (d) to conduct appropriate tests/scenario analysis in cases of larger more complex Fund Administrators (for smaller, less complex Fund Administrators it is not necessary to carry out this testing);
- (e) to consider risks associated with a Fund Administrator's obligations, for example, guarantees/other similar off-balance sheet exposures. These items can represent material risks and are not captured by the regulatory requirements currently in place for Fund Administrators; and
- (f) to consider wind-down scenarios and plan for how the firm would manage this process and how much capital would be required.

In introducing these requirements by way of both regulations and guidance, the Central Bank aims to ensure consistency of approach across Fund Administrators, while facilitating the practice of capital planning in a manner that is proportionate to Fund Administrators' business models. Proportionate application may mean that smaller, less complex Fund Administrators are not required to undertake a particular requirement, such as the testing and scenario analysis, however Fund Administrators should be able to justify their approach to the Central Bank in this regard.

**Question 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?**

9. Respondents suggested that it may be more appropriate to specify the list of risks in guidance. Respondents also noted that the list of risks was not fully aligned with the risks referred to in the Central Bank's PRISM Guidelines.
10. One respondent suggested an element of materiality in terms of the risks should be included and provided the example that liquidity and market risk would not necessarily be considered material risks for Fund Administrators, whereas operational and strategic risk would be more important.
11. It was highlighted that a number of Fund Administrators use their own risk taxonomies to identify and manage risks and it was suggested that flexibility be built into the Regulations to allow Fund Administrators to use their own risk taxonomies where the Central Bank is comfortable that the risk taxonomy in use is effective in covering off all risks being borne by the Fund Administrator.

**Liquidity Risk**

12. There were a number of comments on the proposed provisions on liquidity risk. Respondents noted that liquidity risk is not necessarily material for Fund Administrators and might be a very low risk for some Fund Administrators where they hold high levels of cash and hold very few non-cash related assets. There was a suggestion that a threshold be applied, for instance where cash is regularly in excess of 100% of current liabilities, liquidity measuring or monitoring would not be required.
13. Respondents questioned the relevance of intra-day liquidity risk for Fund Administrators and suggested that the minimum monitoring for liquidity should be daily, with intra-day monitoring only applying by exception. It was suggested that liquidity time horizons could be included in guidance rather than the Regulations so that Fund Administrators could adopt a “comply or explain” approach depending on their individual business models and the applicability of liquidity risk.

**Central Bank:** The risks outlined in Regulation 101 are broadly aligned with both the risks referenced in CRD IV and those included in the Central Bank’s PRISM Guidelines. A number of banking-specific risks which are addressed in CRD IV are excluded from the list of risks in Regulation 101. Similarly, a number of the PRISM risks that are not directly linked to capital have been excluded. However, it should be noted that it is the Central Bank’s intention that the list of risks in Regulation 101 will represent a minimum list of risks which should be addressed and Fund Administrators should consider all risks that are relevant in the context of their individual business models and consider how they may impact on their capital and liquidity adequacy. For instance, conduct risk which may lead to an operational loss event that could impact on capital should be addressed under the operational risk category. The Central Bank will clarify this in Guidance.

The Central Bank considers that Fund Administrators can use their own risk taxonomies for the risk assessment and capital planning process, provided they can demonstrate that they have:

- (a) assessed the relevancy of all of the risks listed in Regulation 101;
- (b) determined which risks are material to their individual business models; and
- (c) established processes and procedures to mitigate these risks in accordance with the Regulations and Guidance.

The Central Bank also notes that the relevance of various risks may change over time and therefore Fund Administrators must revisit this assessment on an appropriately frequent basis.

**Liquidity Risk**

The Central Bank acknowledges that liquidity risk may be considered a low risk for some Fund Administrators. However, the Central Bank notes that an operational or environmental event may cause the liquidity position of a firm to change rapidly and therefore, the Central Bank believes that liquidity monitoring should be undertaken by all Fund Administrators.

In terms of the specific liquidity time horizons that should be monitored, intra-day liquidity risk is relevant in certain circumstances, such as when Fund Administrators must comply with the reconciliation requirements under the Investor Money Regulations. The policy intention is that firms must consider their liquidity risk over each of the time horizons listed and conduct an appropriate level of monitoring for each of the time horizons depending on their individual

business model. This will be clarified in the finalised Regulations and/or Guidance.

### Regulation 100 Wind-down Plans

14. In addition to the responses received to questions 1 and 2, respondents also commented on the proposal in Regulation 100 that a Fund Administrator is required to draw up a plan setting out how it would wind down in an orderly fashion in the event of failure. 2 respondents considered this to be more appropriate to systemic institutions such as banks rather than Fund Administrators. These respondents noted that Fund Administrators are often subsidiaries of major global financial institutions and, therefore, benefit from the infrastructure and support of such institutions. They also highlighted that organisations would need to ensure that the Irish requirements could be incorporated into group plans and this may take some time to complete and would benefit from further guidance.
15. Another respondent asked for clarity on the expected outcome of the requirement to prepare wind-down plans and questioned the appropriateness of this requirement being introduced as part of an initiative with respect to capital planning. They suggested that a working group would be helpful to further define this requirement.
16. The fourth respondent suggested that the requirement for Fund Administrators to prepare wind-down plans be considered on a risk based approach. This respondent argued that where a firm is part of a bigger group structure which would have the feasibility to cater for the continuation of fund administration services provided by the Irish firm, should operations fail locally, the requirement is adding an administrative burden with little additional security to the end investor or other stakeholders.

**Central Bank:** The Central Bank aims to be proactive rather than reactive in dealing with wind down situations and is aiming to ensure a consistency of approach across Fund Administrators. The expected outcome of the requirement for Fund Administrators to prepare wind-down plans is for Fund Administrators to have considered scenarios in which a wind-down may be required and have planned for a smooth, orderly and timely wind-down process in the context of these scenarios and their individual business models.

The Central Bank is aware that many Fund Administrators are part of larger group structures and recognise that they may be able to leverage off group infrastructure and support in various situations. However, the Central Bank considers that Fund Administrators cannot exclusively rely on group support when considering wind-down planning. Any assumptions in terms of group support should be clearly stated in various wind-down scenarios and consideration should be given as to the likelihood of a scenario where group support may not be available.

### Other Feedback

17. We also received a number of other comments that were not in response to a particular question. While the Central Bank has carefully considered each response received, it is not practical to address each individual response in this paper. However, the following is an overview of some of the matters raised:

- (a) CP 100 refers to a requirement to set aside capital to meet risks. One respondent questioned what form this capital should take.
- (b) Paragraph 5(d) of the draft Guidance Note specifies the obligation to “estimate” the amount of residual risk. It was suggested that it would be more appropriate to only include a requirement to quantify the residual risk types which are considered material to a Fund Administrator.
- (c) One respondent stated that paragraph 11 of the draft Guidance Note is overly prescriptive and complicated. It was noted that the use of statistical models, identification of risk correlations and back testing may not be necessary or appropriate in helping Fund Administrators produce robust internal capital assessments.
- (d) Further clarification was sought on the purpose of the requirement set out in paragraph 15 of the draft Guidance Note to reconcile internal capital to own funds.

**Central Bank:** The Central Bank responds to the points as follows:

- (a) The draft Guidance Note allows for ‘internal capital’ to be considered as a mitigant for risks where appropriate and defines such internal capital as equity items that do not fall under the definition of own funds but have been identified by the Fund Administrator as available to the firm to cover risks or losses. For example, unaudited interim profit may be considered as internal capital and may be appropriate to mitigate certain risks. Regulation 98, however, requires a Fund Administrator to identify the amount of ‘own funds’ that is required to cover the risks that it faces after other mitigants have been applied. The ‘own funds’ referred to in Regulation 98 is as defined under CP 97.
- (b) As there were a number of comments received in relation to materiality of risk, the Central Bank would like to emphasise that firms must be able to demonstrate that they have made an assessment of all risks listed in Regulation 101 in the first instance. It may be the case that a particular risk is not relevant to a Fund Administrator and therefore the Fund Administrator may make the determination that no further action is needed.
- (c) Paragraph 9 of the draft Guidance Note stated that for larger, more complex fund administrators, it is likely to be appropriate for the board to ensure that appropriate testing and scenario analyses 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. It follows from this that paragraph 11 of the draft Guidance Note only applies to larger, more complex Fund Administrators as it provides detail on what is required by tests and scenario analyses where they are carried out.
- (d) The Central Bank acknowledges the respondent’s submission in relation to the requirement to reconcile internal capital and own funds and intends to remove this reconciliation requirement.



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