Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Feedback Statement on CP 111 - Consultation on Second Edition of the Central Bank Investment Firms Regulations including changes related to MiFID II

2017

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Introduction

1. On 26 July 2017 the Central Bank of Ireland (the Central Bank) published Consultation Paper CP 111 *Consultation on Second Edition of the Central Bank Investment Firms Regulations including changes related to MiFID II* (CP 111). The closing date for comments was 27 September 2017 and four responses were received.

2. CP 111 outlines proposed amendments to the first edition of the Central Bank Investment Firms Regulations[1] (the first edition) which was published by the Central Bank on 13 March 2017.

3. The second edition of the Central Bank Investment Firms Regulations (the Regulations) will include the following additional Parts:

   - Part 6: which will include the existing Client Asset Regulations[2] (the CAR) with some modifications arising as a result of, *inter alia,* MiFID II[3];
   - Part 7: which will include the existing Investor Money Regulations[4] (the IMR) with some modifications; and;
   - Part 8: which will set out the capital requirements applied to market operators as outlined in CP 101[5].

4. Some other consequential amendments to the first edition were proposed arising out of MiFID II and certain matters that have arisen since the first edition became operational.

5. CP 111 sought comments generally, but also raised four specific questions for respondents to address. This feedback statement briefly summarises the responses received to each question, as well as additional comments received from respondents, along with the Central Bank's comments and decisions on these topics.

[1] S.I. No. 60 of 2017 Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Investment Firms) Regulations 2017.
[2] S.I. No. 104 of 2015 Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) Client Asset Regulations 2015 for Investment Firms.
[3] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2001/61/EU.
[4] S.I. No. 105 of 2015 Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) Investor Money Regulations 2015 for Fund Service Providers.
[5] Please see CP 101 here.

6. 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 make a submission on CP 111 to inform the policy development process.

8. The Central Bank is committed to keeping its requirements under review and welcomes on-going discussion on how best to protect investors, while facilitating the management of costs arising.

Markets Policy Division
Central Bank of Ireland
20 November 2017

Feedback on issues raised in CP 111

General Comments

9. Respondents were in broad agreement with the proposals in CP 111 and acknowledged the need to amend the CAR and the IMR in line with the single investment firm rulebook approach and in light of the 3 January 2018 implementation deadline for MiFID II.
10. One respondent noted that incorporating the proposed additional Parts (Parts 6, 7 and 8) into the Regulations should provide for clearer interpretation, consolidation, application and timely implementation of the MiFID II consequential amendments.
11. Some respondents sought clarification on whether a transition period will be provided for in the Regulations so that investment firms and fund service providers would be granted appropriate time to implement the necessary changes in a timely and efficient manner.

Central Bank: The Central Bank notes and welcomes the support from respondents for the consolidation of the CAR and the IMR into a single rulebook.

The Central Bank acknowledges that guidance may also be required to assist industry in complying with the Regulations. The Central Bank intends to review the Guidance previously issued under the CAR and the IMR and revise this Guidance where necessary in light of the amendments reflected in the Regulations.

The Central Bank confirms that there will be no transition period for investment firms or fund service providers to implement the Regulations. As the majority of requirements outlined in Parts 6 and 7 were previously contained in Central Bank legislation, and given that the requirements outlined in Part 8 reflect the Central Bank's policy position as outlined in the feedback statement to CP 101,[6] the Central Bank expects that investment firms, fund service providers and market operators will be in compliance with these requirements as at the implementation date.

Question 1: In the existing CAR, a series of defined terms are used to describe or refer to third parties with whom client assets (client funds or client financial instruments) may be held or deposited. These terms include for example 'eligible credit institution', 'eligible custodian', 'relevant party' and 'related party'. There are also separate definitions (or terms otherwise used) in relation to nominees including 'nominee', 'nominee company' and 'eligible nominee'. While this terminology appears to have been carried over from earlier versions of the client asset requirements, the terminology seems unnecessarily confusing and perhaps warrants revision in light of MiFID II. For example, MiFID II has certain specifications concerning the third parties with whom client assets may be deposited. In this regard, MiFID II specifies that client funds may only be deposited with a third party meeting the criteria set down in Art. 4 (1) of Commission Delegated Directive (EU) 2017/593 and client financial instruments may only be deposited with a third party where the criteria set down in Article 3 (1) – (4) of Commission Delegated Directive (EU) 2017/593 are met. Do you

[6] Please see feedback statement to CP 101 here.

consider that there is scope to better align definitions contained in the existing CAR to MiFID II and/or to otherwise streamline the number of defined terms (or terms otherwise referenced) in the existing CAR as outlined above? Please provide any clear suggestions you may have for improvement in this area.

12. Respondents agreed with the Central Bank's proposal to align definitions in the CAR to those contained in MiFID II. One respondent proposed that the Central Bank reviews references to terms which are not defined in EU legislation to determine if they are still valid, noting that the principle of supervisory convergence is furthered by the use of consistent terminology.
13. One respondent suggested that some terms should be defined with reference to criteria set out in MiFID II such as the requirements relating to "qualifying third parties" with which client assets can be held or deposited.
14. Another respondent noted that it may be preferable to consolidate certain terms referenced in CAR such as "eligible credit institution", "eligible custodian", "relevant party" and "related party" into a single defined term.

Central Bank: The Central Bank welcomes comments raised by respondents on the need to streamline definitions contained in Part 6 of the Regulations with those set out in MiFID II.

The Central Bank acknowledges the need to ensure that terms and definitions used in the Regulations are clear and unambiguous. The Central Bank will engage in further work to consider whether these definitions can be further consolidated or aligned to MiFID II definitions. However, Part 6 of the Regulations is intended to impose requirements over and above the MiFID II requirements on safeguarding client assets and therefore this may not be possible in all cases.

Question 2: Sections of the existing CAR have been deleted or modified in the new proposed Part 6 of the Central Bank Investment Firms Regulations in order to eliminate duplication of MiFID II requirements or to express CAR requirements in such a way that they are read as being complimentary to MiFID II requirements. For example, the requirement for an annual external auditors assurance report in CAR is linked to the overarching equivalent requirement[7] in MiFID II. The intention here is to ensure that any additional domestic rules under CAR are not read in isolation from the overarching EU wide MiFID II requirements. Do you agree with this approach and are there any rules in the existing CAR that you consider are not adequately addressed in the revised Part 6 proposed when read in conjunction with MiFID II requirements on the safeguarding of client assets?

15. Respondents supported the integration of the CAR into the Regulations as part of the single rulebook approach.
16. Respondents did not identify any provisions of the CAR which were not adequately addressed in the proposed Part 6 when read in conjunction with the MiFID II requirements on safeguarding client assets.
17. One respondent interpreted that the CAR applied to fund administrators authorised under the

[7] Article 8 of Commission Delegated Directive (EU) 2017/593.

Investment Intermediaries Act 1995.

Central Bank: The Central Bank welcomes the responses received.

The Central Bank would like to clarify that the IMR came into operation on 1 July 2016. The IMR imposes requirements on fund service providers, including fund administrators, holding investor money in collection accounts. Part 7 of the Regulations integrates the IMR into the Central Bank Investment Firms Regulations with various modifications. Therefore, the Central Bank advises that it is not intended that the CAR apply to fund administrators.

Question 3: As part of the integration of the IMR into the Central Bank Investment Firms Regulations proposed in Part 7, certain changes to the IMR have been effected as described above. Do you have any comments in relation to the drafting revisions to the IMR?

18. Respondents generally supported the revisions, with one respondent in particular noting that they provide clearer prominence for investor protection and for governance as regards operational risk and data records. Respondents raised the following specific comments.
    (a) One respondent noted that Part 7 does not include definitions and references to collection accounts, credit institutions and related parties.
    (b) One respondent queried the expected time limits for obtaining and maintaining an Investor Money Facilities Agreement under Regulation 78(2).
    (c) One respondent noted that Regulation 78(2)(i) extends reporting to partners in a partnership in anticipation of new partnership structures.
    (d) One respondent welcomed the extension of items to be included in the Investor Money Management Plan under Regulation 79(4).
    (e) One respondent queried whether a fund service provider is still required to conduct the Investor Money Examination where it does not hold investor money during the period.
    (f) One respondent requested that the process to revoke the authority to act as a fund service provider for the purposes of the IMR be outlined, and sought clarification on whether Regulation 80(6) continues to apply.
    (g) Two respondents sought confirmation that existing Investor Money Facilities Letters do not need to be redrafted as a result of these now being referred to as Investor Money Facilities Agreements.
    (h) One respondent requested that the Central Bank consider introducing governance requirements where investor money is held in an IMR collection account but this money is not claimed by the investor, for example where the fund service provider has been unable to contact the investor for a specified period of time.

Central Bank:

(a) In integrating the IMR into the Regulations, a number of definitions were amended or deleted, for example "collection account" was amended to "third party collection account" and, as the term "related party" is no longer referred to in the text of the IMR, this definition was subsequently

deleted. In addition, the Central Bank does not propose to define terms which are already defined in the Investment Intermediaries Act 1995 or other related legislation and there is an interpretation provision in the Regulations which deals with the issue.

(b) Regulation 82 provides that every Investor Money Facilities Agreement between the fund service provider and a third party must be maintained by a fund service provider in a readily accessible form for a period of at least 6 years.

(c) Regulation 78(2) has extended reporting to partners in a partnership in order to align with the corresponding requirement in the CAR.

(d) Additional items included in the Investor Money Management Plan were previously included in the IMR Guidance, however the Central Bank is of the view that these additional items should be placed on a legislative footing.

(e) Regulation 80(6), as consulted on, states that where a fund service provider claims not to have held investor money throughout the period to which the investor money examination relates, the fund service provider shall arrange for an external auditor to provide an assurance report to confirm that the fund service provider has not held investor money during that period. Regulation 8(7) of the IMR clarifies that this requirement only applies to a fund service provider "which is permitted to hold investor money". This text was inadvertently deleted and will be re-inserted into Regulation 80(5). The Central Bank confirms that only those fund service providers which are permitted in their authorisation to hold investor money are required to complete an investor money examination and submit an assurance report to the Central Bank.

(f) A fund service provider that wishes to revoke its permission to hold investor money may submit a request to the Central Bank. Where the Central Bank consents to such a revocation request, the fund service provider will no longer be required to arrange for the completion of an investor money examination or submit an assurance report to the Central Bank. Any such requests to revoke permission to hold investor money (or client assets) should be addressed to the Central Bank's Client Asset Specialist Team (CAST) – CAST@centralbank.ie.

(g) It is not the Central Bank's intention to require a firm to revise a current Investor Money Facilities Letter in light of the amendment of the terminology to "Investor Money Facilities Agreement" provided that such a letter represents a legally binding agreement between the relevant parties.

(h) It is not proposed to introduce new policy initiatives in the Regulations to deal with circumstances where investor money is held in an IMR collection account but has not been claimed by the investor.

Question 4: Certain established defined terms in the existing CAR and the IMR have been amended for clarity, consistency and to ensure that the defined term better reflects its meaning. Do you have any comments in relation to the amendments proposed? Is it envisaged that such amendments would have any significant operational impact?

19. Respondents did not raise any material comments with regard to the amendments to defined

terms contained in the CAR and the IMR. Minor technical points were raised which are outlined in further detail below.

Central Bank: The Central Bank welcomes the responses received and is of the view that amendments to the defined terms provide clarity and consistency to the Regulations.

Other Feedback

20. In addition to the comments summarised above, respondents submitted detailed comments on various other aspects of the Regulations. While the Central Bank has carefully considered each response received, it is not practical to address each individual comment in this feedback statement. However, the following is an overview of the matters raised.

(a) One respondent queried the introduction of the term "regional office" instead of the term "branch" under Regulation 4(1)(b) in relation to the requirement to consult with the Central Bank before taking certain actions.

(b) Two respondents proposed that the reference to "senior staff member" in Regulation 19(1)(a) should be amended to "suitably skilled and experienced member of staff" as this term may set out clearer expectations from investment firms on this matter.

(c) Two respondents observed that under the Regulations, the auditor is required to provide an assurance as to whether the investment firm or fund service provider was in compliance with the relevant regulations, "throughout the period", rather than "at the period end date", as outlined in the CAR and IMR, and questioned the rationale for this change.

(d) One respondent queried whether the auditor who performs the client asset examination must be the same auditor who audits the financial statements of the investment firm.

(e) Clarification was sought on whether the investment firm or the external auditor is responsible for submitting the assurance report to the Central Bank.

(f) One respondent highlighted inconsistencies in the use of the terms "lodged" and "deposited" in Regulation 72(2) as regards when a fund service provider is deemed to hold investor money.

(g) One respondent highlighted possible duplication of requirements in Regulation 73(1)(b) and 74(1)(c) on designating the name of a third party collection account to make it clear that investor money does not belong to the fund service provider.

(h) Two respondents suggested that due diligence reviews of third parties with whom investor money is deposited should be completed on an annual rather than a semi-annual basis.

(i) One respondent suggested the removal of the initial due diligence and on-going review requirements as outlined under Regulation 72(6) and 72(7) for accounts which are held inside the EEA.

(j) One respondent noted that the Regulations do not make sufficient provision for resolving instances of shortfall or excess where the relevant currency market is closed for trading. In addition, the respondent noted that there appears to be no provision for foreign currency third party accounts held inside the EEA.

(k) One respondent noted that the proposed annual requirement to provide

management/annual accounts (upload and data entry) within a one-month period after the firm's reporting year end may cause some difficulty and suggested a two month timeframe.

Central Bank: The Central Bank has considered these items and advises as follows:

(a) Regulation 4(1)(b) will be amended to clarify that an investment firm shall consult the Bank before establishing any office in the State or any subsidiary.

(b) The Central Bank has decided to retain the reference to "senior staff member" as the Central Bank is of the view that a senior staff member must complete, sign and date the review of the check and release of each investment fund final NAV[8] prior to the release of that final NAV.[9]

(c) The Central Bank will amend the Regulations to clarify that the auditor is required to provide assurance as to whether the investment firm or fund service provider was in compliance with the Regulations as at the period end date.

(d) It is not the Central Bank's intention to require that the statutory auditor of the investment firm/fund service provider completes the client asset examination/investor money examination.

(e) The Central Bank will clarify in the Regulations that the investment firm/fund service provider is responsible for submitting the assurance report to the Central Bank.

(f) The Central Bank will amend Regulation 72 to refer to the term "deposited" rather than "lodged". This will ensure consistency in the language used.

(g) The Central Bank acknowledges that a similar requirement is contained in Regulation 73(1)(b) and Regulation 74(1)(c). However, Regulation 73(1)(b) places an obligation on the fund service provider while the requirement in Regulation 74(1)(c) refers to terms of the Investor Money Facilities Agreement.

(h) The Central Bank proposes to amend the Regulations to require that due diligence reviews of third parties with whom investor money (or client assets) is deposited be conducted if there are any material changes in the arrangements for the depositing of investor money (or client assets), and in any event at least on an annual basis.

(i) The Central Bank is of the view that fund service providers should fulfil the due diligence and review requirements outlined in Regulation 72(6) and 72(7) for accounts held both inside and outside the EEA.

(j) The Central Bank proposes to delete the reference to a third party collection account "that is held outside the EEA" in Regulation 77(5), to take into account situations where foreign currency third party collection accounts are located within the EEA.

[8] Net asset value.
[9] Please see ID 1025 of the Central Bank Investment Firms Q&A for further information.

(k) The Central Bank will retain the requirement for management/annual accounts (upload and data entry) to be submitted one month after firm reporting year end.

Next Steps

The Central Bank expects to publish the Regulations in advance of the MiFID II implementation deadline of 3 January 2018.

The CAR and IMR will remain in force and effect until replaced by the Regulations.

The final Regulations will have further technical and structural changes, including those required to align with other Central Bank Rulebooks where appropriate.

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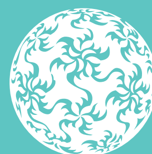

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