



Irish Fund Directors Association (IFDA) response to Consultation Paper 138 Cross-Industry Guidance on Outsourcing

Dear Sir, Madam

We welcome the publication of the Central Bank's paper entitled Consultation Paper 138 Cross-Industry Guidance on Outsourcing (February 2021) ("CP138") and the related draft Guidance and we appreciate the opportunity to provide feedback on this paper.

By way of background, the Irish Fund Directors Association ("IFDA") is the representative body for independent directors within the Irish funds industry and our purpose is to represent the interests of our members to other key stakeholders in the industry and to advocate industry best practice in corporate governance and board oversight and to encourage continuous professional development for fund directors.

IFDA has reviewed the paper and the potential impacts for directors on Fund boards and fund management companies ("FMCs") from our members' perspective, we make the following general comments.

- (i) We appreciate this will apply across all sectors and to all funds and fund service providers.
- (ii) We note that CP138 is intended to apply to fund administrators in addition to S.I. No. 604 of 2017 Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Investment Firms) Regulations 2017, ("S.I. 604"). CP138 is a welcome development and will provide a level playing field for all fund service providers regulated by the Central Bank i.e., AIFM/UCITS Management Companies, Administrators, Depositories and Distributors.

1. CP138 and Irish Regulated Investment Funds/Collective Investment Schemes including any subsidiaries ("Investment Fund" or "CIS")

We have outlined below IFDA's understanding of the unique characteristics of investment funds and would greatly appreciate feedback from the CBI in the context of outsourcing and the CP138 consultation paper and in particular as set out below.

Whether CP 138 should apply at all to Investment Funds on the rationale that Investment Funds should be distinguished from FMCs and fund service providers who are either (a) Administrator & Depositories themselves directly regulated by the CBI and subject to CBIs outsourcing requirements or (b) Investment Managers or Distributors as regulated entities, regulated by the CBI or more typically regulated by a competent authority in an equivalent jurisdiction.

- (i) CISs are regulated investment products, typically set up under a corporate structure, offering their securities for sale to investors. They are not themselves, regulated financial services firms offering regulated financial services to clients. Whereas CISs by their very nature have no discretion but to outsource and there is a practical and commercial imperative to outsource

all activities to service providers. The cornerstone of the contractual and regulatory compact between the investor and the Board, is the Prospectus which sets out all the material terms relating to the terms of the investment in the securities issued to the investor. The Board, or governing body (“Board”) of the scheme, has a fiduciary duty to the underlying investor to ensure that the CIS is managed in accordance with the terms of the Prospectus. In purchasing the securities issued by the Investment Fund the investor knowingly and voluntarily, contractually agrees to all of the terms embedded in the design of the financial product and disclosed in the Prospectus i.e., its investment objective, strategy, restrictions, borrowing and leverage limits, risk factors, fees, as well as the Board and all service providers and the terms of the appointment.

The Investment Fund is designed by its promoter who is generally the investment manager and in turn creates the product, chooses all providers and bring them together in the product. Investors “buy” into this fixed product design by investing in the Investment Fund. The Fund Board is responsible for appointing the Fund’s principal outsourced fund service providers (“OSPs”), being the Alternative Investment Fund Manager/UCITS Management Company (collectively, Fund Management Companies (“FMC”) , Depository and Auditors and for the ongoing monitoring of the performance of the Fund’s fund service providers.

- (ii) Investment Fund Boards have no discretion but to appoint regulated OSPs and they are invariably preselected by the promoter following a rigorous due diligence process. The Investment Fund Board relies on the regulated status of the OSPs they appoint, and those service providers are themselves, when providing regulated services, subject to regulatory outsourcing requirements. Investment Fund Boards conduct appropriate due diligence on its OSPs and ensure that the documentation, policies and procedures reflect their respective responsibilities and accountabilities.
- (iii) Specifically in the case of an Irish authorised CIS, the Administrator will always be directly regulated and supervised by the Central Bank and subject to S.I. 604 and CP138. Similarly, the Depository, management company and portfolio manager of an Irish regulated scheme will either be directly regulated or supervised by the Central Bank, or a competent authority in the EU, or in the case of the latter two, a supervisory body in a third country recognised as being subject to equivalent prudential supervision and as such all will be subject to equivalent outsourcing requirements.
- (iv) The creation of the Investment Fund product and strategy is initiated by the fund promoter, which in most cases is the Investment manager. In addition, OSPs are also chosen from the outset of the product design by the promoter and disclosed in the Prospectus.
 - a. This position of Investment Funds contrasts to that of regulated financial services firms offering regulated financial services to clients. The latter firms, when authorised in Ireland and regulated by the Central Bank, are authorised based on their organisational and operational set up and they can at their discretion choose their optimal set up i.e. whether to carry out all of their activities within their Irish entity or whether to outsource some of their infrastructure and activities internally or to other external parties in Ireland or abroad.
 - b. Investment funds have unique characteristics in that they operate on a fully outsourcing model and as such, the risks that are disclosed in a fund’s prospectus are

managed by its OSPs on a day-to-day basis, i.e., investment manager, administrator, depositary and distributor. The aforementioned is fully disclosed in the Prospectus and the Investment Fund never has the intention, the authorisation nor the human or technical capacity to assume these functions directly. We suggest this distinction be reflected in the guidance.

- c. An Investment Fund operating on a fully outsourced model with no employees appoints only regulated firms who are themselves directly regulated by the Central Bank and will therefore be obliged to comply with the draft guidance directly (or if regulated in a recognised equivalent jurisdiction will be subject to an equivalent regime).

- (v) Considering the unique characteristics of CISs as outlined above, could the CBI kindly clarify the rationale as to why the Guidance does not distinguish between the application of the outsourcing regime to Investment Funds and regulated financial services firms, such that the outsourcing requirements should not apply to Investment Funds where they outsource to regulated service providers?. The absence of any such distinction creates a dual layer (or triple layer in the case of an FMC outsourcing to a similar regulated entity) of outsourcing requirements at both fund and service provider levels. Doing so is unnecessary, serves no regulatory objective and adds complexity in addition to increasing costs which are ultimately borne by the Investment Fund's investors.

2. CP138 and FMCs

- (i) Similarly, members of IFDA have also questioned whether CP138 should apply to FMCs who outsource functions to Irish regulated OSPs or OSPs regulated by a Competent Authority who themselves are subject to an equivalent regime to CP138 and or S.I. 604. Members note that the CBI's Management Company Guidance clearly outlined a relationship and framework where by FMCs are responsible for the oversight of their OSP.

- (ii) Members note that not all FMCs are the same in either the services they provide or their operational set up. Some are third party FMCs who outsource all functions away and just retain risk so as not to be a letter box entity, others may be "captive" FMCs set up solely to manage an FMC/promoter's product. Regardless of their speciality and sector of the market they inhabit, where they outsource functions away it will invariably be to a regulated OSP. Such OSPs, when either authorised and regulated in Ireland by the Central Bank or elsewhere in the EU (if a distributor or portfolio manager) will be subject to regulatory outsourcing requirements directly by the CBI or a competent authority. For this reason could the CBI kindly clarify why CP138 should not be disapplied to FMCs where they outsource to OSPs who are themselves subject to the Central Banks or another Competent Authorities outsourcing regime, subject to the FMC undertaking its usual initial and ongoing due diligence, oversight and monitoring as set out in CP86 on the OSP. Similar to the case for CIS above, in the absence of any such distinction in CP138, it would be fair to argue that it could potentially create a triple layer of outsourcing requirements i.e. at fund, FMC and service provider levels. In doing so would the CBI agree with IFDA that it is unnecessary, serves no regulatory objective and adds complexity in addition to increasing costs which are ultimately borne by the fund's investors?

(iii) In summary, would the CBI agree that CP138 should not apply to CISs and FMCs where they in turn outsource to regulated entities subject to equivalent outsourcing regimes? This being the case can the CBI provide clarity on the impact of CP138 on the CBI's Management Company Guidance, and whether it will be updated in light of CP138.

Other than as set above we support the guidance as it will enhance robustness and transparency of the outsourcing regimes in place and ensure that service providers apply the new enhanced standards to their new and existing outsourcing arrangements.

For the reasons noted above, and given the importance of the fund industry in Ireland, we would appreciate consideration of our feedback in the next iteration of your draft guidance.

Yours sincerely,

IFDA