



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

2014

Consultation on carrying out depository duties in accordance with Article 36 of the AIFMD

Consultation Paper CP 78

Contents

Introduction	2
Conflicts of interest	3
Proposal	3
Rationale for the proposal	4
Question for consideration	4
Consultation responses	4

Introduction

Article 36 of Directive 2011/61/EU ('AIFMD') provides that Member States may allow an authorised EU alternative investment fund manager ('AIFM') to market units of non-EU alternative investment funds ('AIFs') it manages to professional investors in their territory. This marketing is subject to a number of restrictions including *inter alia* a requirement that the AIFM ensure that one or more entities are appointed to carry out the duties referred to in Article 21(7) (monitoring of cash flows of the AIF), 21(8) (safe-keeping of the AIF assets) and Article 21(9) (oversight of AIFM operations).

Article 36 does not set out eligibility criteria for entities proposing to provide these duties. ID 1021 of the Central Bank's AIFMD Questions and Answers deals with the question of whether an Irish authorised entity can provide the duties and what specific authorisation requirements apply as follows.

"ID 1021

Q. May an Irish authorised entity provide the safe-keeping and oversight duties set out in Article 21(7)-(9) of the AIFMD in respect of non-EU AIF as set out in Article 36 (1)(a)? If so is a specific authorisation required?

A. Article 36(1)(a) does not set out eligibility criteria for entities, who will provide the safe-keeping and oversight duties prescribed in Article 21(7), (8) and (9), in respect of non-EU AIF where Article 36 applies.

If an Irish entity proposes to provide the safe-keeping duties set out in Article 21(8) it must have authorisation to provide "custodial operations involving the safe-keeping and administration of investment instruments" under the Investment Intermediaries Act 1995.

Where an entity is only providing one or both of the services referred to in Article 21(7) and Article 21(9), the Central Bank will not issue an authorisation under the IIA.

Also, an Irish entity authorised under the Investment Intermediaries Act 1995, for example to provide fund administration services, may be appointed by an AIFM to provide the services set out in Article 36(1)(a) where these refer to Article 21(7) and 21(9) without seeking additional authorisation. In accordance with Paragraph 1.1, Chapter 1 of the Prudential Handbook for Investment Firms, the entity is required to consult with the Central Bank prior to -

- (i) engaging in any significant new activities; or
- (ii) establishing new branches, offices or subsidiaries.

Submissions to the Central Bank in this regard will be asked to demonstrate their capacity to provide the proposed activities without inappropriate conflicts.

An Irish based entity appointed by an AIFM in accordance with Article 36 to carry out the duties referred to in Article 21(7), (8) and (9) must carry out those duties in accordance with the relevant requirements of Chapter IV of the Level 2 Regulation."

Questions have been raised with us regarding the possibility of fund administrators conducting these duties. As noted in the Q&A above, any entity who proposes to provide safe-keeping of assets must have authorisation to provide "custodial operations involving the safe-keeping and administration of investment instruments" under the Investment Intermediaries Act 1995. This includes assets referred to in both Article 21(8)(a) and (b).

The question which this Consultation Paper will deal with is what requirements should apply to manage conflicts of interest where a fund administrator proposes to both provide administration services and perform the depositary duties set out in Articles 21(7) and 21(9), for the same non-EU AIF. The key question which we must address is how to mitigate the conflicts of interest which arise in this instance.

Conflicts of interest

It is clear that such conflicts will arise and we believe that they may be substantial. However, we have identified what we believe are proportionate risk mitigants which make an outright ban on fund administrators providing both administration services and Article 21(7)/Article 21(9) depositary duties, to the same non-EU AIF, unnecessary. In designing these, we note that there is no legal or regulatory impediment to delegation of an administration activity by an AIFM to a depositary. However the AIFMD, in providing for the possibility for depositaries to carry out other activities for AIFs, requires that in such instances:

A depositary shall not carry out activities with regard to the AIF or the AIFM on behalf of the AIF that may create conflicts of interest between the AIF, the investors in the AIF, the AIFM and itself, unless the depositary has functionally and hierarchically separated the performance of its depositary tasks from its other potentially conflicting tasks, and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the AIF.¹

Likewise, where a depositary proposes to provide services regarding the valuation of AIFs, the following requirements apply:

The depositary appointed for an AIF shall not be appointed as external valuer of that AIF, unless it has functionally and hierarchically separated the performance of its depositary functions from its tasks as external valuer and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the AIF.²

Proposal

The Central Bank proposes to include the following requirements in Chapter 5 – Fund Administrator Requirements - of the AIF Rulebook:

Where a Fund Administrator provides both administration services and any of the services listed in Regulation 22(7) and/or 22(9) of the AIFM Regulations ('depositary services') to the same non-EU AIF, it shall:

- 1. functionally and hierarchically separate the depositary services and the administration services by carrying out the depositary services through a separate subsidiary;*
- 2. require the individual responsible for managing the subsidiary to report directly to an*

¹ See Article 21(10) of the AIFMD.

² See Article 19(4) of the AIFMD.

individual at PCF level within the parent fund administrator; and

3. *advise the Central Bank of the reporting structure which it has put in place.*

Rationale for the proposal

The problem with a fund administrator providing both administration services and certain depository duties to the same non-EU AIF, in practice, arises from an overlap of roles and reporting lines between the administration services and the depository duties within the fund administrator. This creates conflict for individual staff members. To address this, the Central Bank proposes that this overlap occurs only at the highest management levels and there must be strict Chinese walls at lower levels.

This provides protection for the investor in separating out the exercise of the depository duties from the administration services. It should provide a reasonable assurance that problems with the administration of the non-EU AIF will be identified and escalated, in the same way that in any organisation there is a level of confidence that internal audit will act on problems it identifies.

Question for consideration

We would welcome stakeholders' views on the proposal set out in this Consultation Paper.

Consultation responses

The Central Bank invites all stakeholders to provide comments on the proposal set out in this Consultation Paper. Where a respondent disagrees with the proposal, he/she should set out reasoned arguments as to why the proposal is not necessary or appropriate and/or should suggest viable alternatives.

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

**Article 36 Consultation
Markets Policy Division
Central Bank of Ireland
Block D
Iveagh Court
Harcourt Road
Dublin 2**

Responses should be submitted no later than 30 May 2014

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 2246000 to correct the situation.

**Markets Policy Division
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