



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

2016

Feedback Statement on Consultation on Central Bank Investment Firms Regulations 2015 (CP 97)



Contents

Introduction	2
Feedback on issues raised in CP 97	3
Annex I – Guidance for fund administrators	10

Introduction

1. On 4 November 2015 the Central Bank of Ireland (the “Central Bank”) published a Consultation Paper on Investment Firms Regulations 2015 (“CP 97”). The Central Bank invited all stakeholders to provide observations and comments on the proposed regulations set out therein. The closing date for comments was 27 January 2016 and 7 responses were received.
2. CP 97 relates to the publication of an Investment Firms 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 Central Bank Investment Firms Regulations”). This is pursuant to the provisions of the Central Bank (Supervision and Enforcement) Act 2013 (“the 2013 Act”) which permit the Central Bank to make regulations for the proper and effective regulation of regulated financial service providers.
3. The Central Bank is currently in the process of finalising the Central Bank Investment Firms Regulations. The final version of the Central Bank Investment Firm Regulations is expected to issue early in the New Year.
4. In order to assist firms implementing the Central Bank Investment Firms Regulations, it is the Central Bank’s intention to publish Guidance to accompany the published Regulations. The Central Bank also intends to prepare and publish an Investment Firms Questions and Answers document to assist firms with technical queries that may arise from time to time.
5. This paper summarises the responses received to CP 97 and notes the Central Bank’s comments and decisions. It is therefore intended that this paper be read in conjunction with CP 97 as it makes reference to proposals, terms and numbering used in the consultation papers, which can be found on the Central Bank’s website¹.
6. 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.
7. Nothing in this Feedback Statement should be read with, seen as a clarification of or a supplement to the Central Bank Investment Firms 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.
8. The Central Bank would like to thank all parties who took the time to respond to CP 97 to inform the policy development process.

Markets Policy Division
Central Bank of Ireland
25 November 2016

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

Feedback on issues raised in CP 97

General Comments

9. Respondents were in broad agreement with the proposals in CP 97 and supported the decision of the Central Bank to consolidate the various rules applicable to investment firms. With respect to the outsourcing requirements, respondents welcomed the additional definitions and clarifications provided in the Central Bank Investment Firms Regulations.
10. Some respondents questioned the intention of the Central Bank to issue all the requirements as Regulations under the 2013 Act. They highlighted that some of the requirements are extremely detailed and process driven in nature and would be more suited to inclusion in guidance. An example cited was the detailed criteria that must be met before a fund administrator may outsource the release of the final NAV. There was also a comment that it is important that some of the prescriptive features included in the Central Bank Investment Firms Regulations do not inadvertently prevent organisations from structuring their operations in a manner they deem to be the most appropriate and effective structure for their business.

Central Bank: The Central Bank notes and welcomes the support of respondents for the consolidation of the various rules applicable to investment firms into one rulebook. The Central Bank acknowledges that certain requirements may be more suited to Guidance. Accordingly, this Feedback Statement also indicates those matters which will be included in Guidance rather than in Regulations and also those areas where additional Guidance will be provided.

Provisions relating to the check and release of the final NAV received the largest number of responses to the Consultation Paper. As these responses appeared to indicate that further clarity is required around the circumstances under which the check and release of the final NAV may be outsourced, the Central Bank has given further consideration to the appropriate regulation of the outsourcing regime, and in particular to the proposed Regulations 39 and 40. The feedback in relation to this matter is set out in page 6.

Finally, the Central Bank is of the view that the policy changes proposed in CP 97 are required in order to ensure effective regulation. It is not the Central Bank's intention to inadvertently prevent organisations from structuring their operations in a particular manner. However in some cases an operational change may be required to meet the new requirements and clarifications where appropriate are included below.

Question 1: Chapter 5 of the Central Bank's AIF Rulebook (June 2015) contains certain requirements applicable to Fund Administrators including those related to capital. It is proposed that those requirements including capital will be removed from the AIF Rulebook and will, in the future, form part of the proposed Central Bank Investment Firm Regulations. The requirements will remain similar to the existing requirements but there are some changes proposed as described in summary below:

- **The definitions of own funds items will be brought broadly into line with certain modernisations made by the CRR/CRD IV regime. In particular, it is proposed that tier 2 capital will be capped at one-third of tier 1 capital - presently no limit is applied.**

In addition, there are certain new deductions from capital proposed;

- **The method of calculation of the fixed overhead requirement will be refined to better align with CRR/CRD IV;**
- **Certain other definitions, amendments and clarifications are also included.**

The purpose behind these changes is to ensure that Fund Administrators are subject to a robust capital requirements regime that is broadly aligned to the CRR/CRD IV regime which applies to certain other investment firms whilst remaining proportionate to the nature and scale of their activities. Do you agree with the approach proposed?

11. A number of responses were received in relation to capital planning. Respondents highlighted that the proposals were very resource intensive and should only be used in specific circumstances. Some respondents assumed that it was the Central Bank's intention to impose these requirements on AIFMs².
12. One respondent proposed that the items listed under Regulation 86 (1)(a), (b) and (d) should qualify as Tier 1 capital with firms notifying the Central Bank in advance rather than having to receive prior written permission from the Central Bank.

Central Bank: While CP 97 noted that the Central Bank was examining the option of a capital planning requirement for certain non-MiFID firms, CP 97 itself did not set out any capital planning proposals. Capital planning proposals were subsequently set out in CP 100 and are applicable to fund administrators only and not to AIFMs. A Feedback Statement on CP 100 was published by the Central Bank on 4 July 2016.

The Central Bank confirms that prior written permission will be required from the Central Bank before any Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments or capital contributions may be included in a fund administrator's own funds. It should be noted that:

- there has been no change in the criteria required for capital contributions to be included in own funds;
- the criteria for the inclusion of Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments has changed;
- where pre-existing capital instruments do not meet this new criteria fund administrators should ensure they adhere to the specified transitional arrangements;
- the transitional arrangements set out the quantum of such instruments that may be included in own funds over the three-year period subsequent to the Investment Firms Regulations taking effect;
- pre-existing capital instruments/capital contributions do not require approval by the Central Bank. It is the fund administrator's responsibility to ensure such instruments either meet the new criteria or are phased out of the fund administrator's own funds in accordance with the specified transitional arrangements.

² Alternative Investment Fund Managers.

Question 2: Chapter 5 of the Central Bank’s AIF Rulebook (June 2015) also contains certain requirements applicable when Fund Administrators outsource activities. Some changes to these requirements are proposed as described in summary below:

- **The circumstances and conditions where the final check and release of the NAV maybe outsourced by the administrator are more clearly specified and defined;**
- **A new requirement for Fund Administrators to make an annual return to the Central Bank concerning outsourced activities is proposed;**
- **Certain other definitions, amendments and clarifications are also included.**

The primary purpose behind these changes is to set out clearly the limited circumstances in which a Fund Administrator may outsource the check and release of Final NAV calculations and to specify the conditions to be complied with by Fund Administrators in such circumstances. The requirement to make an annual return to the Central Bank will also assist in the supervision of Fund Administrators with regard to their outsourced activities. Do you agree with the approach proposed?

Release of final NAV by Outsourcing Service Provider- Regulations 39 and 40

13. This topic received the largest number of responses. Respondents were primarily concerned with the proposed inclusion of detailed minimum conditions that must be met before the release of the final NAV by an outsourcing service provider (“OSP”) will be permitted by the Central Bank. They were concerned that these proposed conditions were significantly more extensive than those required under Annex II of the AIF Rulebook. Respondents requested grandfathering arrangements for existing operations.
14. Detailed observations and queries on Regulation 40 included the following:
- a) The criteria do not recognise client specific service level agreements (“SLA”).
 - b) A respondent queried why weekly/monthly dealing funds were not included while another did not support any reference to dealing frequency and considered that the focus should be on the investor and market requirements.
 - c) A respondent commented that imposing a requirement which differentiates on the basis of the underlying investments within a fund could prevent the use of a consistent operating model process flow and this may result in increased operational risk.
 - d) A respondent said that Regulation 40(b) does not reflect the practice of fund administrators who outsource functions to a regulated entity outside their Group.
 - e) In relation to Regulation 40(d), the following observations were made:
 - i. the list omits US investors needing final NAV on T (NSCC);
 - ii. the list does not make reference to other Global regions e.g. Australia and the Middle East;
 - iii. “Asia” is not defined;
 - iv. the provision should be reworded to avoid a finite list of circumstances which may not be easily amended; and
 - v. the Investment Firms Regulations should provide for circumstances where the investors are themselves fund structures.

Comments on other outsourcing requirements

15. Apart from the comments noted above on Regulations 39 and 40, there were a number of other comments on the section of the Regulations dealing with outsourcing:

- (a) Respondents queried whether the new definition of final NAV continues to mean that the NAV for weekly/monthly dealing funds is only final when the investors receive their statements.
- (b) A respondent expressed concern that Regulation 36 may prevent the outsourcing of transfer agency services. A number of respondents questioned the wording in Regulation 42 on maintaining the shareholder register and queried whether Regulation 42 corresponded to Requirement 3.3 in Annex II of the AIF Rulebook.
- (c) Respondents referred to the publication of the Central Bank Outsourcing Application Template (“the Template”) and noted that any potential ambiguity between the Investment Firms Regulations and the Template should be avoided. They suggested that the requirements in Regulation 43 on notification and the Template be aligned to ensure consistency and clear understanding of the outsourcing approval process. Others supported requests for clarifications both on the notification and the approval process including a call for more certainty on the timeframe.
- (d) A respondent requested clarity on the intention behind Regulation 45 which requires prior notification to the Central Bank before a model where the Preliminary NAV is outsourced is combined with a model where the final NAV is also outsourced.
- (e) Respondents queried the format, content and submission of the outsourcing annual return in Regulation 50.
- (f) With reference to Regulation 53 on intra-group outsourcing, a respondent highlighted that intra-group outsourcing could benefit from additional guidance from the Central Bank.
- (g) With reference to Regulation 55, respondents suggested that it is more appropriate to specify the unit responsible for monitoring and managing outsourcing arrangements rather than specifying named individuals.
- (h) Respondents queried the value of requiring both an Internal Audit and a Compliance Review as outlined in Regulation 69. They questioned whether the Compliance Review would still be required should a Fund Administrator not have a dedicated compliance function. Clarification was sought on the maximum deadline for submission of these reports.

Central Bank: The Central Bank appreciates the volume and detailed nature of the comments received on the outsourcing proposals set out in CP 97. The comments received related to:

- the proposed rules limiting the circumstances in which outsourcing of the check and release of the final NAV will be permitted; and
- incorporating existing AIF Rulebook requirements on outsourcing into the Central Bank Investment Firms Regulations.

The Central Bank acknowledges in particular those comments with regard to the criteria outlined in Regulation 40 of CP 97. Outsourcing by fund administrators, and by investment firms in general, is subject to ongoing review within the Central Bank and a review of outsourcing across all financial sectors is also being initiated. In light of this work and taking into account the comments on CP 97 the Central Bank has decided to:

- retain the prohibition on outsourcing the check and release of the final NAV except in circumstances determined by the Central Bank;
- set out those exceptional circumstances in guidance which will accompany the Central Bank Investment Firm Regulations. The circumstances are those set out in CP 97 except that reference to the Asian Market has been amended to refer to “time zones from UTC (GMT) + 4 to UTC (GMT)+12”;

- clarify that firms that have existing previously approved, outsourcing arrangements that do not comply with the guidance will not be required to change those arrangements; and
- retain the obligation on fund administrators to check the final NAV the day following its release by the outsourcing service provider.

The type of guidance the Central Bank intends to provide in relation to the exceptional circumstances when the check and release of the final NAV may be outsourced is set out in Annex 1 to this Feedback Statement.

The draft of the proposed Regulation 40 (d)(i) outlined in CP 97 stated that “*the final NAV is required to be received by the underlying investor in the Asian Market by T+1 Asian time*”. The Central Bank guidance setting out the exceptional circumstances will follow an approach based on time zones and will refer to: “*the final NAV is required to be received by the underlying investor in markets with time zones from UTC (GMT) +4:00 to UTC (GMT) +12:00 by market opening T+1*”.

Turning to the other comments received on the outsourcing provisions referred to in paragraph 15 above:

- (a) The Central Bank has decided to retain a definition of the final NAV in order to provide clarity on this important issue. The definition as set out in CP 97 applies irrespective of the dealing frequency of the fund.
- (b) References to core administration services will be clarified to retain the policy as set out in the AIF Rulebook. Guidance will clarify that the reference to maintenance of the shareholder register means that the fund administrator maintains oversight and control of the register and can reproduce the full register at any time.
- (c) The Outsourcing Application Template will be revised as necessary following the publication of the Investment Firms Regulations. Guidance will be provided in order to assist fund administrators in completing the template.
- (d) Further clarification on the concept of preliminary NAV will be provided in Guidance.
- (e) A specific template will be developed and submission will be via online reporting (ONR). The Central Bank will provide guidance on how to complete each section of the return and will provide examples of outsourcing models in use.
- (f) The requirements outlined in the Investment Firms Regulations will apply equally to both intra group and external outsourcing arrangements.
- (g) The Central Bank considers that the individuals responsible for monitoring and managing outsourcing arrangements should be identified.
- (h) Compliance and Internal Audit Functions carry out two distinct roles. Therefore, a separate report is required from each function detailing the distinct reviews undertaken. In relation to the timelines outlined in the Regulation for completion of Internal Audit and Compliance Reviews, the following clarification should be helpful: A fund administrator must examine the operation of its outsourcing arrangement within the first 12 months of operation. This review will likely occur towards the end of the first year of operations, e.g. if the outsourcing activity is initiated in January 2016, the review is likely to be completed in the period between October and December 2016 in order for the firm to get an accurate view of its operations. If the review is completed in October, a copy of the report must be submitted three months after this date, i.e. January 2017. If the review is completed in December, a copy of the report must be submitted three months after this date, i.e. March 2017.

Other feedback

16. In addition to the main comments summarised above, respondents submitted a large number of detailed comments on various aspects of the Central Bank Investment Firms Regulations.

While the Central Bank has carefully considered each response received, it is not practical to address each individual comment in this paper. However, the following is an overview of the matters raised.

- (a) In the absence of a definition of “administration activities”, uncertainty may arise as to the actual meaning of the term.
- (b) Regulation 4(a) should be limited to a requirement to notify the Central Bank of the commencement of legal proceedings by or against the firm in relation to services provided and should not require notification to the Bank of the commencement of proceeding in relation to matters unrelated to the provision of services.
- (c) Regulation 7 should require firms to provide the Central Bank with an Internal Audit report only when it includes a material finding that affects or impacts the firm.
- (d) Regulation 8(3) imposes too onerous responsibilities on the Compliance Officer, particularly taking into account the overall responsibility of the Board for compliance. The Compliance Officer’s remit should be restricted to financial services law or regulation.
- (e) The rationale behind the increase in the retention period for telephone recordings in Regulation 11(3) was queried.
- (f) Clarification was requested on whether the Central Bank intends that the additional reporting which may be required under Regulation 13(4) will be applied to specific firms or across all reporting firms.
- (g) A respondent considered that Regulation 22 appeared to impose a new obligation. A fund administrator could create controls to seek to meet this obligation on best endeavours basis, but as the fund administrator is not the owner of the prospectus the firm should not be responsible for its contents.
- (h) The calculation of eligible assets in Regulation 97(4), should provide for the accounts used by the fund administrator for the day to day running of its business as an additional item to be subtracted from total assets.
- (i) One respondent requested clarification on certain aspects of the regulatory relationship between retail investment intermediaries authorised under the Investment Intermediaries Act 1995 (the “IIA”) and MiFID investment firms authorised under the European Communities (Markets in Financial Instruments) Regulations 2007 (the “MiFID Regulations”).

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

- (a) The Central Bank intends to include a definition of “administration services” in the Regulations which will reflect the definition of administration of collective investment schemes in point (g) of Section 2 of the IIA.
- (b) In order for the Central Bank to maintain adequate supervisory oversight of firms, the Central Bank must be informed of significant situations or events which may impact on the reputation or good standing of the firm and this includes the commencement of any legal proceedings by or against the firm.
- (c) Where Internal Audit flags a number of minor findings in a report, this may indicate an underlying control issue. Accordingly, it is intended to retain Regulation 7 in its current form.

- (d) Regulation 8(3) is based on an existing requirement in the Prudential Handbook for Investment Firms. Nevertheless, the Central Bank intends to clarify the remit of Compliance Officer in the Investment Firms Regulations.
- (e) Regulation 11(3) should have obliged firms to retain telephone recordings for a period of at least six months. This will be rectified in the final Regulations.
- (f) The possibility to require more frequent reporting may arise in the context of a specific firm or all firms in cases where a need is identified due to a particular risk or a particular market or economic event or situation.
- (g) Regulation 22 is an existing obligation outlined in Chapter 5 of the AIF Rulebook. The Central Bank will take account of the response received and ensure that the obligations imposed are reasonable, while achieving the Central Bank's aim of ensuring clarity regarding the regulatory status of non-Irish funds.
- (h) The Central Bank will amend the eligible assets calculation in Regulation 97(4) to include these accounts.
- (i) This question appears to relate to Regulation 103 of the MiFID Regulations and accordingly investment firms must ensure that they comply with the obligation in that Regulation.

Next Steps

17. The Central Bank expects to publish the Central Bank Investment Firms Regulations together with the guidance mentioned in paragraph 4 in early 2017.

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

Annex I

Guidance for fund administrators

Check and release of the final NAV³ by an outsourcing service provider

Before submitting a notification to the Central Bank of a proposed outsourcing arrangement, with regard to outsourcing the check and release of an investment fund's final NAV, under the Central Bank Investment Firms Regulations 2016, fund administrators must ensure that they are able to demonstrate that the outsourcing of the check and release of the NAV is necessary, because the following conditions are met:

- (a) the fund is daily dealing;
- (b) the outsourcing service provider who checks and releases the final NAV is an entity within the fund administrator's group and the fund administrator and the outsourcing service provider share the same systems, controls, staff training, procedures and processes for the valuation of each investment fund final NAV;
- (c) the prices for investments used for valuation purposes are not available from markets before 5pm Irish time in order to facilitate a release of the final NAV within normal Irish business hours; and
- (d) the release of the final NAV outside of normal Irish business hours (8am – 6pm) is necessary in order to facilitate investor dealing due to the existence of one of the following circumstances:
 - i. the final NAV is required to be received by the underlying investor in markets with time zones from UTC (GMT) +4:00 to UTC (GMT) +12:00 by market opening T+1;
 - ii. the fund is a US Money Market Fund with trade date settlement;
 - iii. the fund is an ETF which needs to release the final NAV to the primary market and to investors in the secondary market outside of normal Irish business hours (8am-6pm).

While each notification by a fund administrator with regard to the outsourcing of the check and release of the final NAV, under the Central Bank Investment Firms Regulations 2016, will be considered and determined by the Central Bank on its merits, the Central Bank will

³ “final NAV” means a net asset value calculated for an investment fund, provided to investors, published or otherwise released to the market by the fund administrator or its outsourcing service provider.

have strict regard, inter alia, to the criteria above when assessing such outsourcing applications.

Firms that have existing, previously cleared, outsourcing arrangements in respect of the check and release of the final NAV that do not meet with the criteria outlined in this Guidance are not being required to change those arrangements.

Additional sub-funds may be added where the relevant umbrella fund has previously cleared outsourcing arrangements without prior notification to the Central Bank provided that:

- the same circumstances that existed when the initial clearance was granted by the Central Bank continue to apply; and
- any specific conditions that apply in respect of the existing Central Bank clearance will be complied with in respect of the additional sub-fund(s).

T +353 1 224 6000 F +353 1 671 6561 www.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