



# IRELAND

## FINANCIAL SECTOR ASSESSMENT PROGRAM

### TECHNICAL NOTE ON OVERSIGHT OF MARKET-BASED FINANCE: INVESTMENT FUNDS AND SPECIAL PURPOSE ENTITIES

July 2022

This paper on Ireland was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on June 28, 2022.

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June 29, 2022

# TECHNICAL NOTE

## OVERSIGHT OF MARKET-BASED FINANCE: INVESTMENT FUNDS AND SPECIAL PURPOSE ENTITIES

Prepared By  
**Monetary and Capital Markets  
Department**

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Ireland. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at

<http://www.imf.org/external/np/fsap/fssa.aspx>

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## Glossary

AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
AIFMD	Alternative Investment Fund Managers Directive
AP	Authorized Participant
AUM	Assets Under Management
CIS	Collective Investment Scheme
CNAV	Constant Net Asset Value
CSSF	Commission de Surveillance du Secteur Financier
DETE	Department of Enterprise, Trade and Employment
DoF	Department of Finance
ECB	European Central Bank
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pensions Authority
ESMA	European Securities and Markets Authority
ESCB	European System of Central Banks
ESRB	European Systemic Risk Board
ETF	Exchange Traded Fund
EU	European Union
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSP	Fund Service Provider
GDP	Gross Domestic Product
IF	Investment Fund
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
LMT	Liquidity Management Tool
LVNAV	Low Volatility Net Asset Value
MBF	Market-Based Finance
MM	Market Maker
MMF	Money Market Fund
NAV	Net Asset Value
ODCE	Office of the Director for Corporate Enforcement
QIAIF	Qualified Investor Alternative Investment Fund
RIAF	Retail Investor Alternative Investment Fund
RMP	Risk Mitigation Program
SHS	Securities Holdings Statistics
SMSD	Securities and Markets Supervision Division
SPE	Special Purpose Entity

## EXECUTIVE SUMMARY

**This technical note considers the regulation and supervision of the market-based finance (MBF) sector in Ireland.** The Irish MBF sector is dominated by investment funds (IFs), including money market funds (MMFs), while special purpose entities (SPEs) continue to represent a sizeable proportion of assets. Reflecting Ireland's position more broadly as an open and internationally oriented economy, the MBF sector generally holds non-Irish assets on behalf of non-Irish investors, although domestic interlinkages exist primarily through property funds. This combination makes the sector important from a financial stability perspective both within Ireland and globally, and underlines the importance of robust regulatory oversight and a strategic approach to managing the interaction of domestic and international financial stability objectives.

**Ireland has made good progress in implementing MBF-relevant recommendations from the 2014 and 2016 FSAPs, but some gaps remain.** The implementation of the EU Money Market Fund Regulation (MMFR) has introduced detailed rules on MMFs across the EU Member States including on liquidity, diversification, and stress testing. This has been complemented by the European Securities and Markets Authority's (ESMA) stress testing guidelines for Undertakings for Collective Investment in Transferable Securities (UCITS) and Alternative Investment Fund (AIFs). The Central Bank of Ireland (Central Bank) has also strengthened its approach to collection, monitoring and analysis of data on MBF.

**As the integrated regulator for the financial services sector, the Central Bank would benefit from greater formal legal independence, stronger enforcement powers and more flexibility on individual compensation to attract and retain scarce talent.** Legislative amendments are needed to ensure that members of the Central Bank's Commission may be dismissed by the Minister for Finance only on one or more specified grounds of serious misconduct. The Central Bank's ability to adopt a credibly dissuasive enforcement regime is hampered by the challenges it faces in pursuing sanctions against individuals. The development of the new Individual Accountability Framework (IAF) that is already under preparation should be prioritized by the Irish authorities. While the Central Bank's resources have increased in line with the growth of the financial sector and are sufficient at present, steps should be taken to ensure competitiveness on resourcing and sufficient flexibility to recruit and retain appropriate talent.

**There is scope for the Central Bank to leverage its expertise and experience to promote further EU convergence on MBF oversight.** The Central Bank is well placed to maintain its leading role in the efforts to achieve consistent application of EU legislation on IFs. The authorities should also build on Ireland's status as a hub for MMFs to promote reforms that would materially strengthen resilience of these vehicles, including by decoupling gates and fees from liquidity thresholds and increasing liquidity buffers.

**Closing data gaps would further enhance the Central Bank's robust regulation and supervision of the MBF sector.** This includes data on delegation of portfolio management, IF credit lines,

underlying investors of IFs and leverage in the UCITS sector. This would build on the steps the Central Bank has taken in recent years to broaden the set of data it collects and use it more effectively for the purposes of ongoing supervision and mitigation of systemic risk.

**The Central Bank should intensify its work to assess and mitigate financial stability risks of MBF.** Regulatory action is desirable to broaden the set of liquidity management tools used by Irish IFs and encourage the adoption of tools which result in subscribing or redeeming investors bearing the associated transaction costs, such as swing pricing and anti-dilution levies. The Central Bank should also engage closely with ETF providers to ensure their arrangements with authorized participants and market makers are robust and promote the smooth functioning of the sector, including in times of market stress.

**Finalization of work already under way on IF pricing errors should be prioritized, while oversight of SPEs deserves regulatory and supervisory attention.** The introduction of a comprehensive framework for pricing errors will lay the foundations for greater investor protection and more consistent industry practices. Oversight of SPEs has improved from the perspective of statistical analysis, but more efforts are needed to strengthen governance practices. Gaps in the framework for winding-up of IFs should also be filled, including by clarifying the steps to be taken when unit-holders of an IF cannot be contacted.

**Table 1. Ireland: Main Recommendations on Oversight of Market-Based Finance**

#	Recommendations	Addressee	Timing*	Priority**
1.	Amend the Central Bank Act or other appropriate legislation such that the Minister for Finance may dismiss Central Bank Commission members only on one or more specified grounds of serious misconduct (¶120).	DoF, Oireachtas	ST	M
2.	Enshrine in legislation a written procedure for the submission by the Central Bank and approval by the Minister for Finance of the supervisory levy (¶122).	DoF, Oireachtas	ST	M
3.	Apply sufficient flexibility on remuneration to recruit and retain appropriate talent (¶123).	Central Bank	ST	M
4.	Amend relevant legislation to provide for greater individual accountability and enhance powers of the Central Bank to take direct enforcement action against individuals. Finalize related internal framework to operationalize execution of the upgraded accountability regime (¶102).	DoF, Oireachtas, Central Bank	MT	H
5.	Continue to promote closer convergence at the EU level on remaining areas of divergence on UCITS eligible assets (¶170).	Central Bank	C	M
6.	Intensify planning on how to manage potentially challenging financial stability scenarios involving cross-border complexity and requiring international cooperation (¶111).	Central Bank	C	M
7.	Prioritize guidance to funds sector on use of full range of liquidity management tools, including encouraging adoption of tools which result in subscribing or redeeming investors bearing the associated transaction costs (¶151).	Central Bank	ST	M
8.	Expand data coverage of investment fund sector including on delegation arrangements, credit lines, and UCITS leverage (¶60, 65, 107).	Central Bank	MT	M
9.	Finalize comprehensive framework for treatment of pricing errors (¶155).	Central Bank	ST	M
10.	Engage with ETF providers to ensure their arrangements with authorized participants and market makers are robust and promote the smooth functioning of the sector, including in times of market stress (¶192).	Central Bank	ST	M

**Table 1. Ireland: Main Recommendations on Oversight of Market-Based Finance** (Concluded)

<b>11.</b>	Work with ESMA, ESRB and EU Commission, as part of the Commission's review of the EU MMF Regulation, to promote MMF resilience (¶174).	DoF, Central Bank	ST	H
<b>12.</b>	Strengthen oversight of SPE governance and introduce rules on directors' time commitments (¶175).	DoF, Central Bank, DETE	MT	L
<b>13.</b>	Address any legislative impediments to the Central Bank becoming a signatory to the IOSCO Enhanced MMoU (¶1113)	DoF, Central Bank	MT	M
<b>14.</b>	Fill gaps in the legislative framework for winding-up of IFs, including by clarifying steps to be taken when unit-holders of an IF that has been wound up cannot be contacted (¶178).	DoF, Central Bank	MT	L
<b>15.</b>	Continue efforts to improve visibility on underlying IF investors (¶105).	Central Bank	C	M

\* C = Continuous; I = Immediate (within one year); ST = Short Term (within 1-3 years); MT = Medium Term (within 3-5 years).

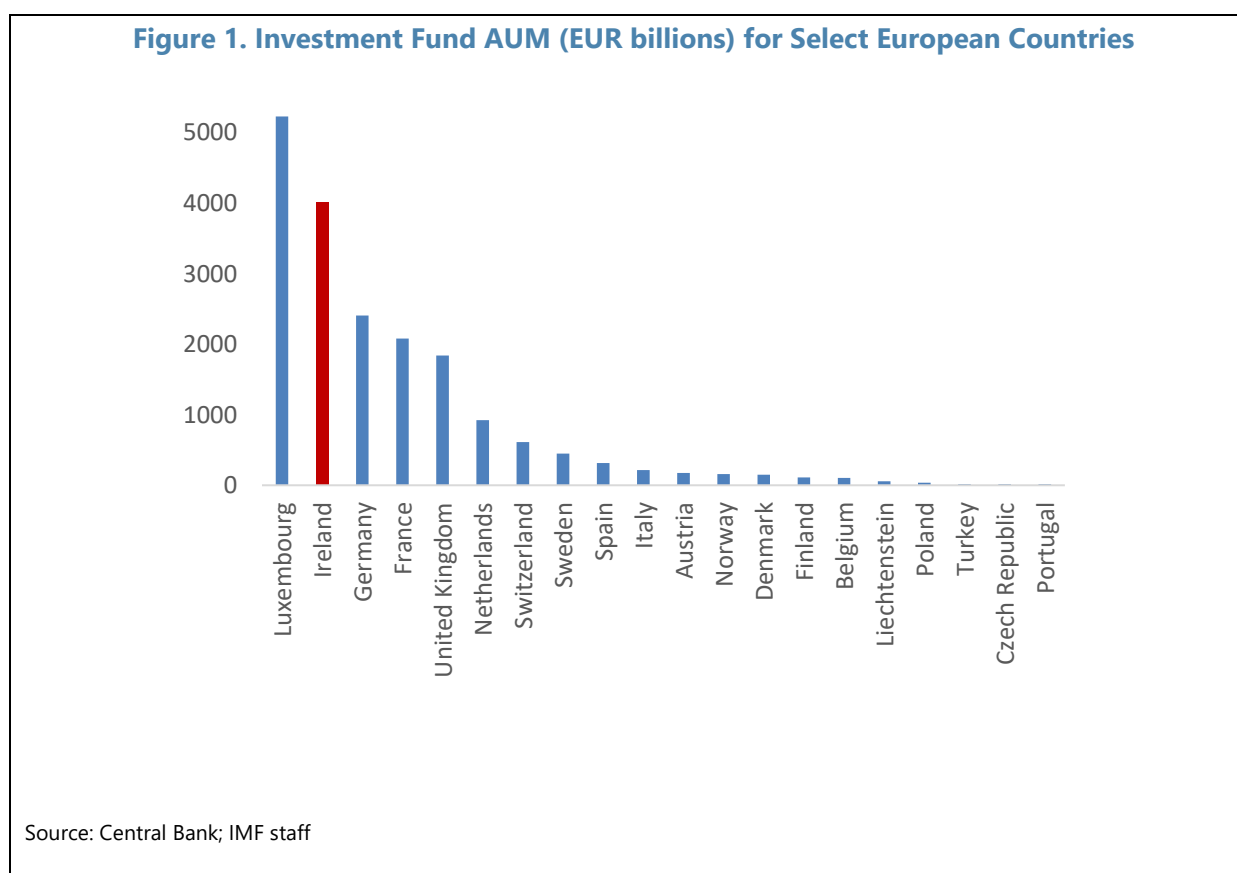
\*\* H = High; M = Medium; L = Low.



## MARKET-BASED FINANCE<sup>1</sup>

### A. Background

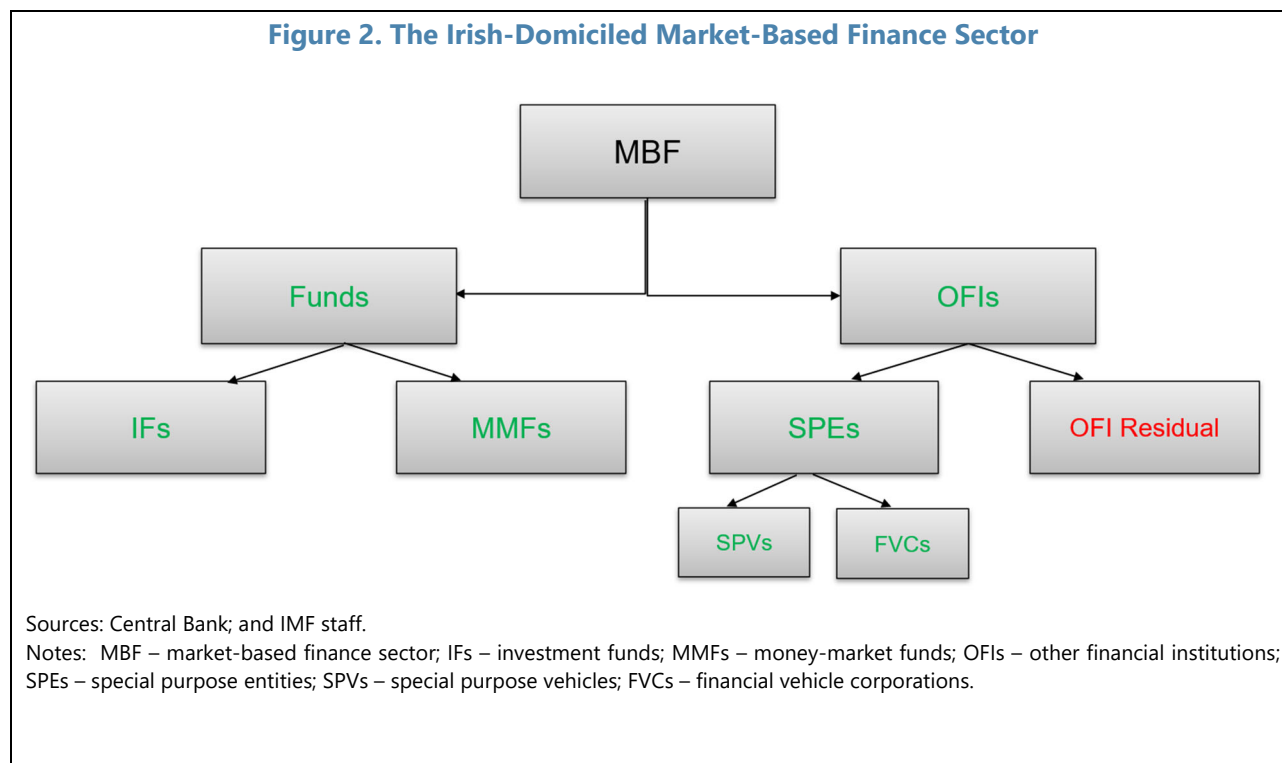
**16. Ireland has one of the largest market-based finance (MBF)<sup>2</sup> sectors in the world, predominantly due to its status as a center for fund management.** It has the third largest fund management sector in the world, with total assets under management (AUM) of EUR 4tn at Q1 2021, and the second largest in Europe (behind Luxembourg). AUM of Irish-domiciled investment funds (IFs) correspond to approximately ten times Ireland's GDP. Ireland is also a prominent global hub for money market funds (MMFs), with AUM of EUR 607 billion at Q1 2021.



<sup>1</sup> The author of this technical note is Richard Stobo.

<sup>2</sup> This technical note (TN) covers the largest components within the MBF sector in Ireland, namely IFs and SPEs. Reflecting the relative significance and complexity of the IF universe, and the materially higher level of regulatory and supervisory oversight to which it is subject, the TN focuses on IFs. The TN does not cover other aspects of the securities sector such as market intermediaries, secondary markets and clearing and settlement.

**Figure 2. The Irish-Domiciled Market-Based Finance Sector**



**17. The mission reviewed oversight of the MBF sector, with a focus on the regulatory and supervisory approach to IFs and fund service providers (FSPs).** Particular emphasis was placed on requirements with most direct relevance for financial stability. This included authorization, ongoing supervision, valuation, liquidity, leverage and segregation and safekeeping of fund assets, building on the relevant IOSCO Principles (for example, Principles 6, 24, 25, 26, 27, 28)<sup>3</sup>; other relevant recent IOSCO standards;<sup>4</sup> and analysis of vulnerabilities that could stem from the interconnectedness with other areas of the financial sector. The mission also assessed the arrangements made in Ireland for monitoring systemic risk arising from MBF activities.

<sup>3</sup> These cover, inter alia, the capacity of the regulator to identify, monitor, mitigate and manage systemic risk; the need for the regulatory system to set standards for the eligibility, governance, organization and operational conduct of investment fund managers; and the importance of appropriate oversight by regulators of hedge funds and/or their managers.

<sup>4</sup> For example: Principles for the Valuation of Collective Investment Schemes (May 2013); Good Practice for Fees and Expenses of Collective Investment Schemes (August 2016); Good Practices for the Termination of Investment Funds (November 2017); and Recommendations for Liquidity Risk Management for Collective Investment Schemes (2018).

## REGULATORY AND MARKET STRUCTURE

### A. Regulatory structure

**18. The Central Bank is an integrated regulator with responsibility for almost all of the financial services sector in Ireland.** The Central Bank's mission is to serve the public interest by maintaining monetary and financial stability while ensuring that the financial system operates in the best interests of consumers and the wider economy. It is a public body, the functions, responsibilities and powers of which are clearly defined and enshrined in the Central Bank of Ireland Act of 1942 (the Act). In addition to its regulatory and supervisory responsibilities across authorization (licensing), supervision, enforcement and regulatory policy development, the Central Bank is the macroprudential authority for Ireland. Accordingly, it monitors risks to financial stability and implements policies to mitigate the impact of those risks on both the financial system and the real economy. It is also the national resolution authority under the European Single Resolution Mechanism framework.

**19. The Central Bank is headed by a Commission, which is responsible for ensuring that the statutory functions of the Central Bank are properly discharged.** The Commission consists of the Governor and two Deputy Governors of the Central Bank, the Secretary General of the Department of Finance and at least six, but no more than eight other members appointed by the Minister for Finance (the Minister). There are currently six appointed members. The relevant legislation specifies the circumstances in which the Governor may be removed from office, but there is wide discretion for the Minister to dismiss other members of the Commission. There is no evidence that this power has impinged on the day-to-day operational independence of the Central Bank. However, amending the legislation to limit the Minister's discretion in this regard would further strengthen the Central Bank's independence de jure as well as de facto.<sup>5</sup>

**20. Recommendation 1:** The Act or other appropriate legislation should be amended such that the Minister may dismiss Central Bank Commission members only on one or more specified grounds of serious misconduct. One way in which this could be achieved would involve amending Section 25(3)(a) and deleting Section 25(3)(b) of the Act.

**21. Although Central Bank's resources have increased in line with the growth of the financial sector and are sufficient at present, the talent market conditions may affect the Central Bank's ability to retain members of staff in particular specialist areas.** The Central Bank has a stable and continuous source of funding sufficient to meet its operational and regulatory needs. It recovers much of its regulatory costs through the industry funding levy, the calculation of which is carried out according to a robust and well-established process within the Central Bank. The legislation provides for the approval of the Minister for setting this levy. If it appears that the amount raised by the levy will be insufficient for the Central Bank to perform its regulatory

<sup>5</sup> A similar recommendation was made in the 2014 and 2016 Ireland FSAPs.

functions, the Central Bank may direct other funds to meet the shortfall.<sup>6</sup> Since 2015, as part of a strategy to move towards full recovery of costs from industry, the Central Bank has steadily increased the proportion of costs attributable to industry. Since the Global Financial Crisis, the Central Bank has aligned with the public sector pay agreements and applied a global grading salary structure.

**22. Recommendation 2:** Enshrine in legislation a written procedure for the submission by the Central Bank and approval by the Minister of the supervisory levy. The legislation would: i) set out expectations on the timing for the process; ii) formalize the Central Bank's stakeholder engagement process; and iii) ensure transparency of decision-making, including on any divergence between the Central Bank's proposal and the regulations ultimately approved by the Minister.

**23. Recommendation 3:** The Central Bank should apply sufficient flexibility on remuneration to recruit and retain appropriate talent.

**24. The regulatory framework in Ireland, including the Central Bank's role and powers, should be understood against the background of the EU institutional and regulatory framework.** EU market oversight is primarily the task of national competent authorities (NCAs), which carry out most supervision and enforcement. The European Supervisory Authorities (ESAs)—the European Securities and Markets Authority (ESMA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Banking Authority (EBA)—foster harmonized practices. ESMA has played an increasingly important role in the regulation and supervision of capital markets in the EU in recent years and is responsible for direct supervision of credit rating agencies, trade repositories, securitization repositories and third country central counterparties.

**25. The ESAs are guided by a unified set of EU capital market rules, the so-called single rulebook.** This rulebook comprises three levels of measures. Level 1 measures comprise EU directives and regulations adopted by the European Parliament and the Council of the EU: regulations are directly applicable; directives must be transposed into national law. Level 2 measures take the form of implementing regulations or directives issued by the European Commission under delegated authority, or regulatory or implementing technical standards drafted by the ESAs. Level 3 measures are nonbinding guidelines issued by the ESAs to ensure consistent national application of the Level 1 and Level 2 measures. The Central Bank participates extensively in the work of ESMA and is represented on its Board of Supervisors by the Director General, Financial Conduct.

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<sup>6</sup> This is also subject to Ministerial approval, but the Minister must consult with the Governor and have regard to the Central Bank's functions and powers under Article 130 of the Treaty on the Functioning of the European Union and the ESCB Statute.

## B. Market Structure

### Box 1. Investment Fund Types in Ireland

**As an EU member state, Ireland complies with EU Undertaking for Collective Investment in Transferable Securities (UCITS) Directive and Alternative Investment Fund Managers Directive (AIFMD).** This means that Irish investment funds fall into one of two categories: UCITS or alternative investment funds (AIFs). The UCITS Directive requires a UCITS fund to be authorized, whereas the AIFMD applies to the fund management company (rather than the fund) and leaves broad discretion to EU Member States on rules applying specifically to AIFs (e.g., on portfolio composition, diversification etc.). The Central Bank authorizes and supervises AIFs under a suite of domestic legislation and rules.

Type of fund	Sub-category	Legal form
UCITS	N/A	Unit trust
		Investment company
		Common contractual fund
		Irish collective asset-management vehicle
AIF	Retail Investor AIF (RIAIF) <sup>1</sup>	Unit trust
		Investment company
	Qualifying Investor AIF (QIAIF) <sup>2</sup>	Investment limited partnership
		Common contractual fund
		Irish collective asset-management vehicle

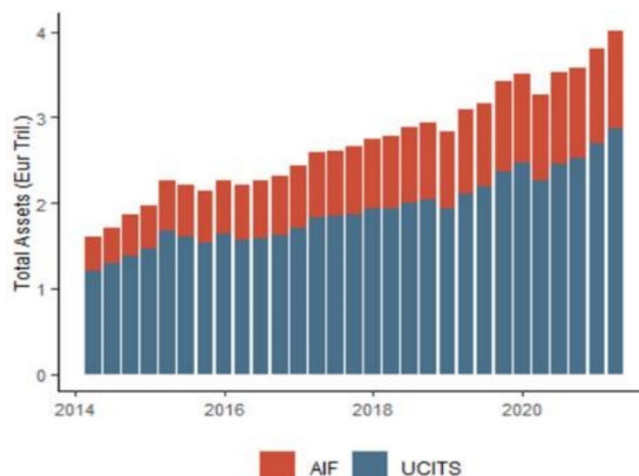
<sup>1</sup> A RIAIF is an AIF authorized by the Central Bank which may be marketed to retail investors.

<sup>2</sup> A QIAIF is an AIF authorized by the Central Bank which may be marketed to Qualifying Investors who meet the criteria set out in the AIF Rulebook (generally, sophisticated and institutional investors).

**26. UCITS represent 76 percent of investment fund assets in Ireland, with AIFs making up the remaining 24 percent.** The most prevalent IF types are bond and equity funds.

**27. Both the portfolio assets of investment funds and their investor base are predominantly international, with limited links to the Irish economy.** The main exception are property funds which, while a very small share of the MBF sector as a whole, cumulatively hold over 40 percent of invested commercial real estate (CRE) assets. Although data on ultimate holders of investment fund shares can be difficult to obtain, information provided by the Central Bank indicates that the vast majority of IF investors are institutional in nature.

Figure 3. Total Assets of Irish Investment Funds



Source: Central Bank of Ireland and IMF staff

**28. Key regulated entities in the funds sector, known as fund service providers (FSPs), are fund management companies, investment managers, depositaries and administrators.** Fund management companies are either UCITS management companies, AIFMs or can be dual authorized under UCITS and AIFMD legislation. Ireland has large and well-developed depositary and administration sectors, commensurate with its long-standing status as an investment fund domicile. The vast majority (around 90 percent) of fund management companies in Ireland delegate a component of their portfolio management activity, often across several entities in different global jurisdictions.

### C. Key Developments Since 2016 FSAP

**29. Several important changes have taken place in the Irish regulatory framework for fund management since the 2016 FSAP, reflecting developments at the level of the European Union (EU).** The implementation of the EU Money Market Fund Regulation (MMFR) has introduced detailed rules on MMFs across the EU Member States including on liquidity, diversification, and stress testing. Other relevant EU initiatives includes the Sustainable Finance Disclosure Regulation and the legislation on Cross-Border Distribution of Funds. The UK's withdrawal from the EU (Brexit), meanwhile, has led many regulated entities either to relocate to Ireland or to increase significantly the scale of operations already based there. The risks of disruption to cross-border activities from Brexit were mitigated by the agreement of a Multilateral Memorandum of Understanding (MMoU) between the European Securities and Markets Authority (ESMA) and the UK Financial Conduct

Authority (FCA). ESMA has also been instrumental in expanding the regulatory framework for IFs more broadly, including through stress testing guidelines for UCITS and AIFs.

**30. Ireland has made good progress in implementing MBF-relevant recommendations from the 2014 Report on the Observance of Standards and Codes (ROSC) and 2016 FSAP, but some gaps remain.** Ireland still lacks a comprehensive regulatory framework for treatment of IF pricing errors, while governance of SPEs continues to be an area of concern (Box 3).

## D. Systemic Risk Monitoring

**31. Monitoring and mitigation of systemic risk is an integral part of the Central Bank's mandate.** The Central Bank Act, 1942 sets out the "stability of the financial system overall" as an objective of the Central Bank. As a member of the European System of Central Banks (ESCB), the Central Bank has a mandate on a European level to "contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system." This is complemented by the Central Bank's membership of the ESRB, which is responsible for "the macro-prudential oversight of the financial system within the Union in order to contribute to the prevention or mitigation of systemic risks to financial stability in the Union that arise from developments within the financial system." The Central Bank is also represented at a senior level on the Board of Supervisors of ESMA, the EBA and EIOPA, all of which have financial stability as part of their mandates.

**32. The Central Bank has set up a dedicated internal group to support the identification, monitoring, mitigation and management of systemic risks in securities markets generally and non-bank financial intermediation (NBFi) specifically.** The NBFi Steering Group (NBFISG) provides senior level strategic direction setting and coordination and seeks to ensure there is appropriate alignment in the implementation of the financial stability, conduct, prudential and statistical mandates across the Central Bank in relation to non-bank financial intermediation. This group leverages expertise from across the organization including economists, statisticians, financial stability experts, policy experts and supervisors. It acts as a coordination vehicle for monitoring and addressing potential vulnerabilities in normal times as well as in periods of market stress such as the COVID-19 shock. This should be seen against the background of the Central Bank's multi-year work to improve data coverage and quality for the MBF sector, which includes the integration of regulatory and statistical data with commercial data sources.

**33. The Central Bank carries out ongoing monitoring and analysis of the MBF sector to understand potential vulnerabilities.** This includes work on liquidity mismatch, leverage and interconnectedness. Such analysis may be structured through deeper dives into cohorts of key importance from the perspective of financial stability, such as property funds and MMFs. Additionally, the Central Bank has launched work to develop its own stress testing capabilities, including through international collaboration (e.g., as part of the ECB working group on system-wide stress testing).

**34. As Ireland’s macro-prudential authority, the Central Bank is responsible for monitoring risks to financial stability and the implementation of policies to mitigate the impact of those risks on both the financial system and the real economy.** The Central Bank conducts macro-prudential<sup>7</sup> analysis and research on issues of relevance to the stability of the Irish financial system. Primary responsibility for this analysis within the Central Bank rests with the Financial Stability Division (FSD). Development of macro-prudential policy at the European<sup>8</sup> and national<sup>9</sup> levels has resulted in the expansion of FSD and a significant increase in analytical capacity, including in relation to MBF.<sup>10</sup> FSD conducts its analysis on a system-wide level and draws on the expertise and knowledge of the Supervisory Divisions who have exposure at the individual firm/market level, as well as other divisions within the Central Bank, such as the Economics and Statistics Directorate. This means that FSD’s financial stability analysis involves examining the stability of the overall financial system, its component parts, and the relationships between the financial system and the real economy.

**35. The Central Bank established the Financial Stability Committee (FSC) to direct and consider the results of macro-prudential analysis and specific financial stability issues.** The FSC is composed of the Deputy Governors, Director General, Directors and senior staff from relevant Directorates, including economics and statistics, supervision and operations, and is chaired by the Governor. A key focus of the FSC is to identify actions that can be taken to mitigate risks to financial stability. In some instances, the identified mitigants may be executed through the micro-prudential functions of the Central Bank.

**36. The Central Bank publishes its Financial Stability Review (FSR) bi-annually.** The review evaluates the main risks facing the financial system and assesses the resilience of the financial system to those risks. The FSR<sup>11</sup> communicates the Central Bank’s policy actions to safeguard financial stability and ensure that the resilience of the financial system is proportionate to the risks it faces. In 2021 the Central Bank launched a new annual monitor, known as the MBF Monitor, which reviews vulnerability across the MBF sector focusing on IFs and SPEs.

**37. The Central Bank’s Securities and Markets Supervision Division (SMSD) undertakes an annual risk assessment exercise, the Market Scan.** The Market Scan assesses current market trends, historic conduct events and peer priorities across domestic and international markets to help determine and steer the supervisory priorities for the coming supervisory cycle. Identified risks are scored for probability and impact and are placed on a heat map for a visual representation of the risks. Senior management scrutinizes these risks and an appropriate risk treatment plan is

<sup>7</sup> Recommendations on the macroprudential framework in Ireland, including for MBF, are set out in the technical note on Macroprudential Policy Framework and Tools.

<sup>8</sup> Capital Requirements Directives IV and V.

<sup>9</sup> Central Bank (Supervision and Enforcement) Act 2013.

<sup>10</sup> <https://www.centralbank.ie/financial-system/financial-stability/financial-stability-research>.

<sup>11</sup> The June 2021 edition of the FSR can be found here: <https://www.centralbank.ie/docs/default-source/publications/financial-stability-review/financial-stability/financial-stability-review-2021-i.pdf?sfvrsn=8>.



developed. The Market Scan exercise also feeds into the Securities Markets Risk Outlook Report,<sup>12</sup> which informs securities markets participants of where the Central Bank sees the key conduct risks to securities markets and sets out actions firms should take in order to identify, mitigate and manage those risks.

## E. Regulation

**38. Ireland’s legislative and regulatory framework for fund management is based on the UCITS Directive<sup>13</sup> and AIFMD.<sup>14</sup>** The UCITS Directive, which aims to facilitate cross-border investment fund offerings to retail investors, lays down rules on the authorization and supervision of UCITS funds and the companies that manage them, as well as UCITS depositaries. The UCITS regime has become a global brand signifying safety and quality control. AIFMD establishes a harmonized framework for the managers of so-called alternative investment funds. Among others, these include real estate funds, infrastructure funds, hedge funds, and private equity funds. AIFMD focuses on managers’ compliance and operational frameworks and lays down regulatory and investor reporting obligations, including on leverage. The key provisions are set out in primary legislation through which the relevant EU legislation is transposed and includes additional requirements for fund managers and funds that are specific to Ireland. Irish legislation is complemented by an extensive set of additional material issued by the Central Bank including guidance, Q&As and “Dear CEO” letters. The Central Bank authorizes and supervises AIFs via domestic legislation.

### Segregation and Custody of Assets

**39. The IOSCO Standards for the Custody of Collective Investment Schemes’ Assets<sup>15</sup> provide that the regulatory regime should make appropriate provision for the custodial arrangements of the IF.** The Standards further provide that this may include requiring the appointment of a single custodian for each IF in order to have certainty over who is ultimately responsible for the custody of all IF assets within a given IF. The UCITS Directive and AIFMD are more prescriptive and require the appointment of a single depositary<sup>16</sup> for each UCITS fund and AIF. As a general rule, a depositary must have its registered office or a branch in the same country where the fund is domiciled. This is aimed at ensuring that the depositary can properly exercise its safekeeping and oversight duties. However, a non-EEA AIF’s depositary may be established in the AIFM home state. The competent authority of the UCITS’ home state must approve the depositary

<sup>12</sup> <https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/securities-markets/risk-outlook-reports/securities-markets-risk-outlook-report-2021.pdf>.

<sup>13</sup> DIRECTIVE 2009/65/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)

<sup>14</sup> DIRECTIVE 2011/61/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010

<sup>15</sup> <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD512.pdf>

<sup>16</sup> This requirement was introduced in the EU by the UCITS V Directive.

to act for a fund domiciled in that EEA state. Under the UCITS Directive and AIFMD the fund manager and the depositary must enter into a detailed written agreement that regulates the flow of information necessary for them to perform their roles.

**40. Rules on segregation and custody of assets, which include requirements on independent custody, are broadly similar for UCITS and AIFs.** The regulatory system requires adequate segregation of IF assets from the assets of the IF operator and its managers or other entities. UCITS<sup>17</sup> and AIF<sup>18</sup> Regulations require that the assets of a UCITS/AIF be entrusted to a depositary for safe-keeping. UCITS and AIF depositaries are required to be independent.

### ***Safe-Keeping***

**41. The rules on safe-keeping for UCITS and AIFs distinguish between assets that can be held in custody (generally, financial instruments) and other assets.** The depositary must hold in custody all financial instruments that may be registered in a financial instruments account opened in the depositary's books and all financial instruments that can be physically delivered to the depositary. For that purpose, the depositary must ensure that all financial instruments are registered in the depositary's books within segregated accounts in accordance with the principles set out in Article 16 of Directive 2006/73/EC such that they can be clearly identified as belonging to the relevant UCITS/AIF at all times. For other assets, the depositary has a duty to verify the ownership of the UCITS/AIF of such assets and ensure an updated record is kept.

**42. The IOSCO Standards require that the assets of an IF be entrusted to a third party custodian that is functionally independent.** AIFMs and UCITS management companies are prohibited from acting as a depositary, and there are restrictions on common management of the UCITS management company/AIFM and the depositary.

**43. Delegation of custody is permitted under the UCITS Directive and AIFMD, subject to certain conditions.** Under both pieces of legislation, the depositary must exercise all due skill, care and diligence in the selection and appointment of the third party, and carry out periodic reviews and ongoing monitoring thereafter. The UCITS framework is more restrictive, placing an obligation on the depositary to demonstrate an objective reason for the delegation and show that it is not done with the intention of circumventing regulatory requirements. The third party is required to segregate the assets of the depositary's clients from its own assets such that the assets can, at any time, be clearly identified as belonging to clients of a particular depositary. Further protection is afforded to UCITS unit-holders by a requirement on the third party to take all necessary steps to ensure that in the event that it becomes insolvent, assets of a UCITS held by it in custody are unavailable for distribution among, or realization for the benefit of, its creditors.

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<sup>17</sup> Irish UCITS Regulations 34(4).

<sup>18</sup> Regulation 22 of EU (Alternative Investment Fund Managers) Regulations, 2013 (AIFMD Regulations) [S.I. No. 257 of 2013].

**44. Rules on liability for loss of assets are broadly similar for depositaries of UCITS and AIFs, but with one important nuance.** The UCITS and AIFMD Regulations provide that the depositary is liable to the UCITS/AIF and the unit-holders for any loss suffered by them as a result of “the depositary’s negligent or intentional failure to properly fulfil its obligations”. Unlike the UCITS Directive, the AIFMD also allows the depositary to transfer its liability to a third party via a written contract which must establish the objective reason for the transfer. The Central Bank is not notified of the use of this option by depositaries.

### Valuation of Assets

**45. In general, IFs are expected to calculate their NAV as frequently as they allow subscriptions and redemptions.** UCITS are required to make prices public each time they sell, issue, repurchase or redeem, and at least twice a month. In practice almost all Irish UCITS offer daily dealing and publish prices accordingly. AIFM Regulation 20(4) provides that the valuation procedures used require that the assets are valued, and the NAV per unit or share is calculated, at least once a year. AIFM Regulation 20(5) provides that if the AIF is open-ended, such valuations and calculations must also be carried out at a frequency which is both appropriate to the assets held by the AIF and its issuance and redemption frequency. AIFM Regulation 20(6) provides that if the AIF is of the closed-ended type, such valuations and calculations must also be carried out in case of an increase or decrease of the capital by the relevant AIF.

**46. Valuation policies must be included in the prospectus (for UCITS and RIAIFs) or the constitutional document (AIFs) of the IF.** For UCITS, a responsible person must establish and ensure adherence to the policy. Provisions for valuation of assets, where market prices are not available, are contained in the UCITS Regulations, AIFM Regulations and in Guidance for UCITS published on the Central Bank website.<sup>19</sup> The guidance for UCITS (a similar approach applies to RIAIFs) clarifies permitted approaches for unlisted securities and securities which are listed or traded on a regulated market where the market price is unrepresentative or not available. These include the use of matrix pricing and probable realization value (in the absence of a representative market price), as well as clarifications on which individual or entity may carry out the valuation of such instruments.

**47. If asset valuations are checked by an independent auditor at the time the annual report is finalized.** Rules in place in Ireland, applicable to UCITS and AIFs, provide that the accounting information (including a balance sheet or statement of assets and liabilities which show the valuation of IF assets at the end of the financial year) must be audited by one or more persons empowered to audit accounts in accordance with the Irish Companies Acts. An IF must publish an annual report for each financial year, which must include a full reproduction of the auditor’s report to unit-holders, including any qualifications. In addition, for AIFs, AIFM Regulation 20(14) provides that where the valuation function is not performed by an independent external valuer, the Central

<sup>19</sup> <https://www.centralbank.ie/regulation/industry-market-sectors/funds/ucits/guidance/ucits-asset-valuation>

Bank can require the AIFM to have its valuation procedures or valuations (or both) verified by an external valuer or, where appropriate, by an auditor.

### **Accounting Standards**

**48. All Irish domiciled IFs that are not listed (or are listed but do not prepare consolidated accounts) have the option to choose between EU adopted IFRS and local GAAP.** In recent years GAAP has broadly converged with IFRS. The Irish UCITS Regulations<sup>20</sup> provide that the management company must establish, implement and maintain accounting policies and procedures in accordance with the accounting rules of the UCITS home Member State. This aims to ensure that the calculation of the NAV of each UCITS is accurately effected on the basis of the accounting, and that subscription and redemption orders can be properly executed at that NAV. Article 57 of the AIFMD Level 2 Regulations provides that AIFMs must establish, implement and maintain accounting policies and procedures and valuation rules that enable the AIFM to deliver in a timely manner to the Central Bank financial accounts which reflect a true and fair view of its financial position and which comply with all applicable accounting standards and rules.

### **Pricing and Redemption of IF Units/Shares**

#### **Liquidity Management Tools**

**49. Irish IFs have a range of liquidity management tools available to them.** The tools (Box 2) are either expressly provided for in Ireland's legislative framework (transposing the UCITS Directive and AIFMD) or the Central Bank's domestic regulatory requirements (via the UCITS Regulations or AIF Rulebook). UCITS may provide for short-term borrowing, redemption gates, redemption in kind, anti-dilution levies, swing pricing and redemption fees. The same tools are available to AIFs, as well as side pockets subject to certain conditions. While the relevant authorization application forms specifically contemplate LMTs, the Central Bank does not actively encourage IFs to have a particular set of tools available to it at authorization.

<b>Box 2. Liquidity Management Tools in Ireland</b>		
	<b>Type of fund</b>	
<b>Tool</b>	<b>UCITS</b>	<b>AIF</b>
Gates	Yes	Yes
Side pockets	No	Yes
Anti-dilution levy	Yes	Yes
Redemption fees	Yes	Yes
Redemption in kind	Yes	Yes

<sup>20</sup> Schedule 5(37).

**Box 2. Liquidity Management Tools in Ireland (Concluded)**

Suspension	Yes	Yes
Swing pricing	Yes	Yes
Side letters	No	Yes
Short-term borrowing	Yes	Yes

Sources: ESMA, Central Bank of Ireland

**50. Policymakers at the international level continue to assess liquidity risks arising from IFs and seek ways to strengthen the regulatory framework.** Experience during the COVID-19 market turmoil of 2020 underlined the role of IFs in transmitting and amplifying shocks. Both the Financial Stability Board (FSB) and IOSCO are considering additional measures that could prevent or mitigate these effects. Academic research and experience from countries with large IF sectors show that swing pricing<sup>21</sup> is beneficial in reducing the first mover advantage and discouraging potentially destabilizing runs on IFs. While definitive statistics are not available, it appears that swing pricing may have been adopted less widely by Irish IFs than their peers in the UK and Luxembourg.<sup>22</sup> Feedback obtained during the mission indicates that intervention by the Central Bank may be needed to change current market practice. Of note is the work underway by the European Commission in its review of the UCITS Directive and AIFMD. These proposals seek to make available a wide range of LMTs in addition to establishing a framework within which they might be used. These amendments will be reflected in Irish implementing legislation. The Central Bank will also be actively engaged at ESMA level in developing technical standards to support these proposals.

**51. Recommendation 7:** The Central Bank should prioritize the publication of its planned discussion paper on IF liquidity risk management, taking due account of progress of the FSB and IOSCO work, as well as initiatives underway as part of the review of the UCITS Directive and AIFMD. The initiative should be used to continue to encourage more widespread adoption in IFs' offering documents of a full range of liquidity management tools among IFs domiciled in Ireland, including by greater Central Bank challenge of IFs at the authorization stage if and when the regulatory framework has been updated. Particular emphasis should be placed on tools which result in subscribing or redeeming investors bearing the associated transaction costs, such as swing pricing and anti-dilution levies.

<sup>21</sup> IFs use swing pricing to ensure that an investor with a large redemption pays for the market impact of the redemption on the portfolio, so that the holdings of investors who remain in the fund, and the performance of the fund, will not be diluted.

<sup>22</sup> For example, recent work by the Bank of England (BOE) found that swing pricing is the most widely available liquidity management tool in the UK; specifically, 202 funds or 83 percent of single-price funds covered by a BOE survey indicated having in place the option to use swing pricing incorporating a dilution adjustment (see section 3.1: <https://www.bankofengland.co.uk/report/2021/liquidity-management-in-uk-open-ended-funds>).

**52. Both AIFs and UCITS may temporarily suspend the repurchase or redemption of their shares.** Such suspensions must be communicated to the Central Bank without delay. The UCITS Directive and the AIFMD also give the Central Bank the power to impose a suspension.

#### *Pricing errors*

**53. IOSCO's Principles for the Valuation of Collective Investment Schemes state that IFs should have policies and procedures in place that seek to detect, prevent and correct pricing errors.** The Principles also state that pricing errors that result in a material harm to CIS investors should be addressed promptly, and investors fully compensated. The EU UCITS Directive and AIFMD include general references to the treatment of pricing errors. The UCITS Directive only notes that UCITS home member state rules apply to the errors in the NAV calculation and related investor compensation. AIFMD implementing measures require an AIFM to ensure that remedial procedures are in place in the event of an incorrect calculation of the NAV.

**54. There is currently no specific regulatory framework for pricing errors in Ireland, although a consultation process is under way.** Market practice is currently based largely on guidance developed by the industry association, Irish Funds, which has not been approved by the Central Bank. Although this has been helpful in promoting consistency, different approaches remain on issues such as materiality thresholds and the circumstances in which unit-holders should be compensated.<sup>23</sup> To address this, the Central Bank is currently consulting on a regulatory framework to establish rules and guidance in relation to the treatment, correction and redress of errors in investment funds. The proposals were set out in Consultation Paper 130<sup>24</sup>, published in September 2019.<sup>25</sup>

**55. Recommendation 9:** The Central Bank should move expeditiously to the next stage of its policy development process and put in place a comprehensive framework for the treatment of pricing errors, including on the categorization of errors and how they should be resolved.

#### **Leverage**

**56. Rules on leverage differ significantly between UCITS and AIFs.** The UCITS Directive limits a UCITS fund's global exposure from derivative instruments to 100 percent of the total net value of the UCITS portfolio. Global exposure is calculated using either the commitment approach or the Value-at-Risk (VaR) method.<sup>26</sup> Borrowing is not taken into account when determining the global exposure of a UCITS, but UCITS are permitted to borrow, on a temporary basis, up to 10 percent of

<sup>23</sup> Under the Irish Funds guidance, material pricing errors are defined as those which have a NAV impact of 0.5 percent or more. The guidance also provides for de minimis limits whereby no compensation is due unless the amount payable exceeds a certain value.

<sup>24</sup> <https://www.centralbank.ie/docs/default-source/publications/consultation-papers/cp130/cp130-treatment-correction-and-redress-of-errors-in-investment-funds.pdf?sfvrsn=5>

<sup>25</sup> The 2014 IOSCO ROSC included a recommendation to the CBI to publish rules relating to pricing errors.

<sup>26</sup> UCITS that use a VaR method for the calculation may have a global exposure in excess of the 100 percent limit.

their NAV for non-investment purposes. The AIFMD defines leverage as “any method by which the AIFM increases the exposure of an AIF whether through borrowing of cash or securities, or leverage embedded in derivative positions or by any other means.” The Directive requires AIFMs to set leverage limits in respect of each AIF they manage, but does not set maximum limits on leverage.<sup>27</sup> Leverage must be calculated using two methods: the gross method and the commitment method.<sup>28</sup> The overall leverage of an AIF is expressed as a ratio between the exposure of the AIF and its NAV.

### **Reporting of leverage**

**57. Prospective investors in a UCITS can obtain an understanding of the expected levels of leverage to be employed by a UCITS from different aspects of the prospectus.** This includes: information necessary for investors to be able to make an informed judgement of the investment proposed to them and, in particular, the risks attached thereto; an explanation of the UCITS’ risk profile; and the categories of assets in which the UCITS may invest, including whether this encompasses financial derivative instruments (FDIs). Similarly, UCITS are required to prepare a short document known as a “key investor information document” (KIID). The KIID must provide information on essential elements of the UCITS, including the risk/reward profile of the investment. In addition, the annual report of a UCITS must include a general description of the use of FDIs and of the efficient portfolio management (EPM) techniques and instruments that have been employed during the reporting period.

**58. Prospective investors in an AIF must be given access to certain specified information before they invest.** This includes information on the investment strategy and objectives of the AIF, a description of the type of assets, the techniques employed and the circumstances in which the AIF may use leverage. The Irish framework also requires that additional information be included in the AIF’s annual report – supplementing the provisions of Articles 103–107 of the AIFMD Level 2 Regulation – on open derivative positions at the reporting date, as well as a description of the use of securities lending or repo arrangements.

**59. Rules on reporting of leverage to the Central Bank differ significantly between UCITS and AIFs.** The annual FDI Return that UCITS must submit provides information on the use of derivatives, leverage and relevant calculation methodologies. Although the Central Bank expanded the list of information to be included in this return beyond the minimum foreseen by the UCITS

<sup>27</sup> However, Article 25 AIFMD provides that an AIF is considered to be “substantially leveraged” when the exposure of the AIF calculated according to the commitment method exceeds three times its net asset value. AIFMs that manage AIFs employing leverage on a substantial basis have to make available additional information to their competent authorities, including the overall level of leverage employed by each AIF and the extent to which the AIF’s assets have been reused under leveraging arrangements. In December 2020, ESMA published [guidelines](#) (with which the CBI complies) on application of Article 25 AIFMD.

<sup>28</sup> A more detailed description of the calculation methodologies for UCITS and AIFs can be found in the Technical Note – Fund Management, Regulation, Supervision, and Systemic Risk Monitoring prepared in the context of the 2017 Luxembourg FSAP (see Box 3 on page 25): <https://www.imf.org/-/media/Files/Publications/CR/2017/cr17257.ashx>

Directive<sup>29</sup>, leverage-related reporting for AIFs is more extensive. AIFMs must regularly provide the competent authorities of their home Member State with information on the main instruments in which they are trading and on the principal exposures and most important concentrations of the AIFs that they manage to enable the competent authorities to monitor systemic risk effectively. In addition, AIFMs managing AIFs which employ leverage on a substantial basis are required to report leverage-related information on a quarterly basis. This information must include the overall leverage employed by each AIF, a break-down between leverage arising from borrowing of cash or securities and leverage embedded in financial derivatives and the extent to which the AIF assets have been reused under leveraging arrangements. This information must also include the identity of the five largest sources of borrowed cash or securities for each AIF and the amounts of leverage received from each source.

**60. Recommendation 8:** EU legislative requirements on IF leverage have not moved in tandem across fund types, with the result that regulators now receive more regular and extensive reporting for AIFs than for UCITS. This can be explained partly by the more restrictive rules on leverage of individual UCITS, which contrast with the relative flexibility afforded to AIFs. However, the UCITS sector is materially larger than the AIF sector (both at the EU level and within Ireland), and UCITS making use of VaR methodologies can employ significant levels of leverage. The Central Bank should, therefore, build on the steps already taken through the MMIF reporting framework so that it has a more comprehensive and up-to-date picture of leverage within the UCITS sector. While there may be relevant developments at the EU level in the coming period, it would be preferable for the Central Bank to take the initiative rather than waiting for possible changes to the EU framework.

### Operational/Conduct of Business Requirements

**61. Ireland applies extensive rules on operational and conduct of business requirements to IFs and their managers.** The precise rules depend on the particular activity involved and stem from three pieces of EU legislation: the Markets in Financial Instruments Directive (MiFID), UCITS Directive and AIFMD. AIFMs and UCITS management companies can combine permissions so that a single entity, which is dual authorized, can manage both UCITS and AIFs. In such circumstances, the entity must comply with both regimes as they pertain to the various classes of assets under management. While a MiFID authorization cannot be combined with another type of authorization, AIFMs and UCITS management companies can obtain so-called “top-up” MiFID permissions<sup>30</sup> to engage in individual portfolio management and receipt and transmission of orders for individual (non-fund) clients). In these cases, the entities must comply with the MiFID conduct of business standards when providing MiFID services.

<sup>29</sup> The CBI gathers information allowing it to estimate leverage through gross notional derivative exposures via the quarterly Money Market and Investment Funds (MMIF) statistical reporting.

<sup>30</sup> Additional clarity at EU level on the scope of permissible “top-up” MiFID activities, and the rules that apply to those activities, would be helpful. The CBI highlighted these issues in its response to the European Commission’s consultation on the AIFMD Review (see Annex 1): <https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/funds/industry-communications/public-consultation-on-the-review-of-the-alternative-investment-fund-managers-directive---29-january-2021.pdf?sfvrsn=4>.



## Delegation

**62. The primary model used by IFs domiciled in Ireland involves an extensive use of delegation arrangements.** The majority of Irish fund management companies, with responsibility for the management of 7,180 IFs (approximately 90%), delegate a component of their portfolio/investment management. In some cases portfolio management is delegated to more than one entity, in more than one jurisdiction. Countries to which portfolio management is delegated include Brazil, the U.S., Malaysia, and South Africa, although the UK is by far the main destination for delegation of this kind. No Irish fund management companies currently delegate risk management. In all cases, the Central Bank requires delegating entities to retain full responsibility for the activity, to be discharged in line with the FMC Guidance (described in the section on Governance below).

**63. Delegation is permitted by the UCITS Directive and the AIFMD, subject to certain conditions.** The arrangements must be disclosed to the Central Bank, and must not prevent the effectiveness of the Central Bank’s supervision. The delegating entity must be in a position to monitor the activities of the third party on an ongoing basis. Where the delegation involves portfolio/investment management, the mandate can only be given to entities authorized or registered for the purpose of asset management and that are subject to prudential supervision by their home authorities.<sup>31</sup> Under both Directives, delegation of portfolio/investment management to a non-EU/EEA entity is subject to cooperation arrangements being in place between the Central Bank and the supervisory authorities in the domicile of the third party.

**64. Fund management companies may not delegate their activities to the extent that they become “letter-box entities” as defined in EU legislation.** The rules around this test have been the subject of much regulatory debate in recent years. While the UCITS Directive contains only a general principle, the AIFMD and its implementing rules set out a much more detailed framework against which to assess whether an entity has become a letter-box.<sup>32</sup> This includes a description of circumstances that would lead to the entity being considered a letter-box (such as where it no longer retains the necessary expertise and resources to supervise the delegated tasks effectively, or it delegates the performance of investment management functions to an extent that exceeds by a substantial margin the investment management functions performed by the AIFM itself). As part of its efforts to promote supervisory convergence in the context of Brexit, ESMA issued an opinion<sup>33</sup> stating that the UCITS Directive should be interpreted in a manner consistent with the AIFMD framework when identifying letter-box entities. More recently, the European Commission’s proposed amendments to the AIFMD,<sup>34</sup> while highlighting the benefits of delegation, noted that “additional measures would be necessary in order to implement the requirements of the [AIFMD] ensuring that

<sup>31</sup> Where this condition cannot be met for AIFMs, delegation is subject to prior approval of the CBI.

<sup>32</sup> See Article 82 of the AIFMD Level 2 Regulation

<sup>33</sup> [https://www.esma.europa.eu/sites/default/files/library/esma34-45-344\\_opinion\\_to\\_support\\_supervisory\\_convergence\\_in\\_the\\_area\\_of\\_investment\\_management\\_in\\_the\\_context\\_of\\_the\\_united\\_kingdom\\_withdrawing\\_from\\_the\\_european\\_union.pdf](https://www.esma.europa.eu/sites/default/files/library/esma34-45-344_opinion_to_support_supervisory_convergence_in_the_area_of_investment_management_in_the_context_of_the_united_kingdom_withdrawing_from_the_european_union.pdf)

<sup>34</sup> [https://ec.europa.eu/info/publications/211125-capital-markets-union-package\\_en](https://ec.europa.eu/info/publications/211125-capital-markets-union-package_en)

AIFMs deploy the necessary human resources to perform retained tasks where some of their functions are delegated to third parties.”

**65. Recommendation 8:** Delegation is a common practice in the Irish funds industry, and procedures for monitoring third parties to which activities have been delegated are well-established. The Central Bank gathers information bilaterally from firms as part of the initial authorization process, as well as during its ongoing supervision thereafter. However, the extent of delegation used by Irish fund management companies calls for more extensive and systematic data collection on these arrangements by the Central Bank, either at national level or in line with revised EU rules. In addition to facilitating ongoing supervision, this would help the Central Bank assess the impact on its regulated population of any tightening of requirements on delegation arising from the AIFMD Review, particularly in respect of non-EU delegation.

## Governance

**66. The Central Bank took important steps to streamline and strengthen organizational and governance requirements through the implementation of the Fund Management Companies (FMC) Guidance.** This guidance, finalized in December 2016, was a deliberate effort to raise the bar with respect to delegation and delegate oversight, organizational effectiveness, Directors’ time commitments, managerial functions and operational effectiveness. It also seeks to ensure that UCITS management companies and AIFMs do not fall within the definition of a “letter-box entity”.<sup>35</sup>

**67. The FMC Guidance has been successful in raising standards within Irish IF managers and their service providers.** It was particularly useful for the Central Bank in the context of the new/additional authorizations sought by many entities in Ireland as a result of Brexit, as it provided a clear framework against which to assess applicants’ business models and resource plans. There is anecdotal evidence to suggest (and Central Bank staff acknowledge) that the efforts made with regard to the cohort of Brexit relocations, while successful in raising standards, have resulted in a situation in which some of the entities present in Ireland prior to Brexit are now lagging behind to some extent. It will be important for the Central Bank to continue its efforts to bring all market participants to the same level, including through the follow-up of the “Dear CEO” letter that the Central Bank issued in December 2020 on the “Thematic review of fund management companies’ governance, management and effectiveness”.<sup>36</sup>

## Composition of IF Portfolios

**68. Detailed eligibility requirements apply in relation to assets in which UCITS may invest, while non-retail AIFs are permitted extensive discretion on the composition of their**

<sup>35</sup> See previous section on Delegation.

<sup>36</sup> <https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/funds/industry-communications/dear-chair-letter---thematic-review-of-fund-management-companies-governance-management-and-effectiveness---20-october-2020.pdf>

**portfolios.** The Irish UCITS Regulations incorporate the ESMA guidelines concerning eligible assets for investment by UCITS,<sup>37</sup> which mean that they must invest in liquid assets. Permitted investments include listed liquid transferable securities and money market instruments, exchange-traded derivatives and bank deposits which are repayable on demand or have the right to be withdrawn and mature in no more than 12 months. A UCITS is permitted to borrow up to 10 percent of its assets for temporary purposes. The absence of rules in the AIFMD on portfolio composition for AIFs reflects the fact that these funds are primarily targeted at professional investors that are capable of performing their own due diligence. However, individual EU member states have the possibility to impose more stringent rules in this area. The Central Bank has taken advantage of this option to draw a distinction between rules for RIAIFs and QIAIFs. RIAIFs, as they are designed for retail investors, have portfolio rules which are largely similar to UCITS. QIAIFs, on the other hand, are targeted at professional investors and are not, with some limited exceptions, subject to regulatory restrictions on investments, borrowing or leverage. However, QIAIFs must respect any limitations on portfolio assets set out in their prospectus.

**69. ESMA plays an important role in ensuring consistent interpretation and application of the rules on eligible assets for UCITS.** In addition to the aforementioned guidelines, ESMA periodically updates its Q&A. Evidence gathered during the mission indicates that there remain areas of divergence across EU Member States in the application of the rules on eligible assets. While it is challenging to achieve full consistency on every aspect of the framework across the EU Member States, it would be beneficial to investor protection and regulatory coherence to address the remaining areas of divergence. These include eligibility of bank loans, delta one securities<sup>38</sup> and digital assets. At the time of writing, the Director General, Financial Conduct at the Central Bank chairs the ESMA forum charged with (inter alia) promoting convergent application of the UCITS framework.

**70. Recommendation 5:** The Central Bank should seek to continue to play a leading role in the ESMA discussions on UCITS eligible assets with a view to developing common approaches to bank loans, delta-one securities and digital assets.

## Money Market Funds

**71. The EU Money Market Funds Regulation (MMFR) sets out prescriptive rules on eligible assets, liquidity and stress testing.** MMFs can be set up as one of three types: i) public debt constant net asset value MMFs; ii) low volatility net asset value MMFs (LVNAV MMF); and iii) variable net asset value MMFs (VNAV MMF). The MMFR introduces a further distinction between short-term MMFs<sup>39</sup> and standard MMFs.<sup>40</sup> Short-term MMFs must ensure their portfolio has a weighted average

<sup>37</sup> These guidelines were originally developed by ESMA's predecessor, the Committee of European Securities Regulators.

<sup>38</sup> Derivatives which aim to provide one-to-one exposure to the performance of the underlying asset.

<sup>39</sup> All three types of MMF may take the form of a short-term MMF.

<sup>40</sup> Standard MMFs can only take the form of a VNAV MMF.

maturity (WAM)<sup>41</sup> of no more than 60 days and a weighted average life (WAL)<sup>42</sup> of no more than 120 days, while WAM and WAL thresholds for standard MMFs are 6 months and 12 months, respectively. MMFs are required to conduct regular (at least bi-annual) stress tests of their portfolios based on common parameters developed by ESMA and updated annually. Where the stress tests reveal any vulnerability of the MMF, the fund manager must draw up an extensive report with the results of the stress testing and a proposed action plan. The report and action plan are required to be submitted to the regulator of the fund (i.e., the Central Bank for Irish MMFs) and to ESMA.

**72. International policymakers are considering reforms to MMFs in light of the experience of March-April 2020.** The FSB’s Holistic Review of the March Market Turmoil describes the impact of the market stress on the financial sector, including MMFs.<sup>43</sup> The FSB followed this up with a report setting out policy options to enhance MMF resilience,<sup>44</sup> which are intended to inform jurisdiction-specific reforms and any necessary adjustments to the policy recommendations for MMFs issued by IOSCO in 2012.<sup>45</sup> The IMF also issued a Departmental Paper on *Investment Funds and Financial Stability*<sup>46</sup> that sets out ways of mitigating risks arising from investment funds (including MMFs). At regional and national level, other initiatives are under way: in the U.S., the President’s Working Group on Financial Markets published a report on potential reform options for MMFs in December 2020<sup>47</sup>, while preparatory work has begun in the EU to review the MMFR.

**73. Although the MMFR strengthened the regulatory framework for MMFs in the EU in general and Ireland specifically, more needs to be done to enhance the resilience of these vehicles.** This is particularly important in the context of Ireland given the size of the domestic MMF sector. Reforms that could materially strengthen MMF resilience include:

- a. Decouple gates and fees from liquidity thresholds.
- b. Increase minimum liquidity thresholds in normal times while allowing for temporary deviations of liquidity buffers when MMFs are confronted with severe shocks.
- c. Enhancing the quality and diversification of liquidity assets held by MMFs, including the mandatory holding public debt in private debt MMFs.

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<sup>41</sup> WAM is a measure of the average length of time to maturity of all of the underlying securities in the fund weighted to reflect the relative holdings in each instrument. WAM is used to measure the sensitivity of a MMF to changing money market interest rates.

<sup>42</sup> WAL is the weighted average of the remaining life (maturity) of each security held in a fund, meaning the time until the principal is repaid in full (disregarding interest and not discounting). WAL is used to measure the credit risk of the MMF.

<sup>43</sup> See Box 4.1 on page 19: <https://www.fsb.org/wp-content/uploads/P171120-2.pdf>

<sup>44</sup> <https://www.fsb.org/wp-content/uploads/P111021-2.pdf>

<sup>45</sup> <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD392.pdf>

<sup>46</sup> <https://www.imf.org/-/media/Files/Publications/DP/2021/English/IFFSPCEA.ashx>

<sup>47</sup> <https://home.treasury.gov/system/files/136/PWG-MMF-report-final-Dec-2020.pdf>

- d. Enhancements to reporting to regulatory authorities and stress testing.
- e. Introduce a mandatory requirement for MMFs to have available a minimum of one liquidity management tool, such as anti-dilution levies, redemption fees or swing pricing.
- f. Impose a minimum-balance-at-risk requirement, wherein a portion of each unit-holder's recent balances at the MMF is available for redemption only with a time delay to ensure that redeeming investors remain partially invested in the fund over a certain time period.
- g. Allow MMFs the option to offer redemption in-kind to institutional investors if liquid assets fall significantly below regulatory thresholds.
- h. Introduce industry-wide gates, triggered by supervisory intervention or pre-defined criteria.

**74. Recommendation 11:** Working closely with ESMA, the ESRB and the European Commission, as part of the Commission's review of the EU MMF Regulation, the Irish authorities should take an active role by promoting reforms – including those set out above<sup>48</sup> – that would materially strengthen resilience of MMFs. Ireland is well placed to play a leading part in this debate given its expertise on MMFs and the global significance of the MMF sector in Ireland. Precedent can be found in the development of ESMA's Opinion on Key principles for a European framework on loan origination by funds,<sup>49</sup> where the Central Bank played a key role in drawing up an initial proposal that could ultimately form the basis for a common EU approach.

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<sup>48</sup> Reforms a. to e. in the list set out in paragraph 73 reflect the content of the Recommendations issued by the [ESRB](#) and [ESMA](#) on January 25, 2022 and February 14, 2022 respectively. It is recognized that the European Commission, in formulating its views on the review of the MMFR, is likely to focus on the combined input of the ESRB and ESMA. However, it is recommended that the Central Bank seek opportunities to broaden the discussion of reforms to include options f. to h. in paragraph 73.

<sup>49</sup> [https://www.esma.europa.eu/sites/default/files/library/2016-596\\_opinion\\_on\\_loan\\_origination.pdf](https://www.esma.europa.eu/sites/default/files/library/2016-596_opinion_on_loan_origination.pdf)

### Box 3. Oversight of Special Purpose Entities

SPEs are companies created for a limited and specific purpose. The purposes include to: i) hold a pool of assets to act as security (collateral) for loans; ii) pass the financial risks associated with holding a pool of assets to other entities or investor(s); iii) avail of favorable tax circumstances; and iv) create liquidity for an entity i.e. give it easier access to cash. SPEs are neither authorized nor prudentially regulated by the Central Bank. However, the activity of an individual SPE might be subject to regulation. For example, if an SPE is required to issue a prospectus, it must comply with the Prospectus Directive. In addition, most SPEs submit statistical returns to the Central Bank in relation to their balance sheets, profits and losses, activities and links to other entities.

Ireland has emerged as a global hub for this activity, with SPEs holding approximately EUR 900bn of the EUR 5tn non-bank financial sector at the end of Q4 2020. The SPE sector can be split between Securitization SPEs (SSPEs), also known as Financial Vehicle Corporations (FVCs), and other SPEs. Within FVCs in Ireland, the largest component (EUR 150bn) are those holding Collateralized Loan Obligations (CLOs). Nearly all European CLO vehicles are now located in Ireland. Some IFs use other SPEs to avail of more favorable treatment under double-taxation treaties. In this case, the Central Bank looks through the SPE (which is a wholly-owned subsidiary of the IF) when assessing compliance by the IF with relevant requirements e.g., eligible assets and diversification. The SPEs are linked to the IFs through loans or profit-participating notes.

For SSPEs, risk retention requirements are in place via different pieces of EU sectoral legislation requiring originators, sponsors or original lenders of a securitization to retain a 5% 'material net economic interest' in the transaction that they issue. SPEs have sometimes been used to fulfil these requirements in transactions where the SPE has been designated as the originator.

In the Ireland FSAP 2016, it was noted that there may be weaknesses in the governance of SPEs, with anecdotal evidence of instances where individuals were appointed to tens or even hundreds of SPE boards. The FSAP recommended that the Irish authorities examine whether the governance structure (particularly board level appointments) associated with certain types of Irish-domiciled SPE might pose future reputational risks. In the intervening period, no action has been taken to address this recommendation and the Central Bank no longer holds data on directorships of these entities due to GDPR requirements. It has been suggested that imposing requirements in this area – such as a cap on directorships, or a fitness and probity regime – would be a matter for the Office of the Director for Corporate Enforcement (ODCE), the body charged with overseeing compliance with company law in Ireland. However, the ODCE does not currently treat SPEs differently from any other company and does not have the licensing powers to impose fitness and probity requirements on directors.

**75. Recommendation 12:** The Irish authorities should strengthen oversight of SPE governance and introduce rules on directors' time commitments, making legislative changes where necessary to ensure the relevant body has the appropriate powers.

## Winding-up of an IF

**76. The regulatory system makes provision for the winding up of IFs.** The UCITS Regulations require that the prospectus of a UCITS include details of the circumstances in which winding-up of the UCITS can be decided on and the winding-up procedure, in particular as regards the rights of unit-holders. The dissolution of AIFs is provided for in different pieces of primary legislation, depending on the legal form of the AIF.

**77. Gaps exist in the Irish legislative framework for winding-up of IFs.** The Central Bank does not have the power to appoint an administrator of an IF, although this is arguably of less relevance to IFs, given that the assets are already in the control of the depositary. A further gap relates to the steps to be taken when an IF is wound up and the unit-holders cannot be contacted as monies of those unit-holders must continue to be held by the IF and so cannot be liquidated. The Central Bank has engaged with the Department of Finance on this issue in recent years, including through a proposal that the Dormant Accounts Act be made accessible to IFs for the purposes of lodging money of uncontactable investors and thereby permitting the investment fund to be liquidated. Separately, it seemed that intervention by the Department of Rural and Community Development in 2019 might lead to progress. However, the legislative situation remains unclear.

**78. Recommendation 14:** The DoF and the Central Bank should work together to fill gaps in the legislative framework for winding-up of IFs, including by clarifying steps to be taken when unit-holders of an IF that has been wound up cannot be contacted.

## F. Authorization

**79. The Central Bank is responsible for authorization of IFs and fund service providers (FSPs).** IFs and FSPs are covered by separate teams within the Securities and Markets Supervision Division (SMSD) but there is close cooperation between the relevant staff, and the issues examined as part of the risk-based review process are broadly similar. Service standards adopted by the Central Bank aim to provide certainty to applicants on the authorization process (though not the outcome).

### FSPs

**80. The FSP Authorizations Team organizes a pre-engagement meeting with every applicant, following which there is an iterative process between Central Bank staff and the firm until the authorization is granted.** Fund management companies are the most common type of applicant. Firms first submit a Key Facts Document (KFD), which is a lighter version of a formal application, covering matters such as strategy, capital, outsourcing plans, compliance and risk frameworks, and qualifying unit-holders. Depending on whether specific issues are identified by Central Bank staff, a revised KFD may be requested. The formal application must contain both a standalone business plan and details on staffing, including which individuals will hold the pre-

approval controlled function (PCF) roles.<sup>50</sup> Individuals applying to hold a PCF role, who are subject to a fitness and probity assessment, may be interviewed. A check-point meeting is held internally at an early stage of the process once the Central Bank has received the firm's response to the first set of Central Bank comments. The Central Bank may refuse to grant authorization where the required standards are not met. Alternatively, the Central Bank may impose conditions on the firm's authorization.

## Funds

**81. The approach of the Funds Authorization Team distinguishes between UCITS and RIAIFs on the one hand and QIAIFs on the other.** UCITS applications are triaged through meetings with the entire team to determine whether enhanced scrutiny is required, such as when the investment policy of the IF will include particular types of security (e.g., CFDs or binary options) or there is an unusual fee structure. QIAIF applications are not typically subject to review taking into account the more sophisticated nature of their target investors and that the relevant FSPs will have been authorized in advance. However, certain types of QIAIF, including property funds and loan origination funds, are subject to a pre-approval process.

Fund type	Fund authorizations			
	2018	2019	2020	Total
UCITS	560	421	410	1391
AIF – Unit Trusts	49	19	32	100
AIF – Designated Investment Companies	74	56	51	181
AIF – ILP	0	0	0	0
AIF – Common Contractual Funds	31	13	15	59
AIF - ICAV	403	294	209	906
<b>Total</b>	<b>1117</b>	<b>803</b>	<b>717</b>	<b>2637</b>

## G. Supervision

**82. Supervision of IFs and FSPs is informed by the Central Bank's risk-based framework, Probability Risk and Impact System (PRISM).** Under this framework the most significant firms (i.e., those with the ability to have the greatest impact on financial stability and the consumer) receive a high level of supervision under structured engagement plans, leading to early interventions to mitigate potential risks. Firms are categorized on a four-point scale according to their impact: high, medium-high, medium-low and low. Staff responsible for authorization complete a handover note for the relevant supervision team that helps inform the PRISM assessment. The outcome of PRISM is

<sup>50</sup> <https://www.centralbank.ie/docs/default-source/regulation/how-we-regulate/fitness-probity/regulated-financial-service-providers/list-of-46-preapproval-controlled-functions.pdf?sfvrsn=6>



a bespoke engagement model for each firm. Metrics used to determine the impact of a given firm have been revised in recent years to ensure they take fuller account of different aspects of a firm's operations.

**83. The PRISM Framework makes provision for supervision teams to draw on expertise from across the Central Bank by means of Risk Governance Panels (RGPs).** RGPs aim to capitalize on the wide variety of internal experience and expertise. A panel meeting offers the opportunity for constructive discussion of the key risks and issues facing regulated firm and the appropriateness of the supervision team's supervisory strategy. The RGP is also a forum, where appropriate, for discussion of the potential systemic impact of observed risks. RGPs are advisory; decision-making authority remains with the Heads of the Supervisory Divisions and the relevant Director(s).

**84. During the Brexit and subsequent COVID-induced market volatility, SMSD developed a process to monitor the redemption activity levels of investment funds domiciled in Ireland.** Analysis was conducted daily on redemption activity across all asset classes (i.e., equity, bond, hedge etc.) and fund types to determine whether any material issues were present. This analysis was presented daily on a call with subject matter experts from across the Central Bank to discuss the analysis and recommendations for any actions arising. The Central Bank expects to continue gathering much of this additional data in future, albeit on a less frequent basis, and plans to introduce automated filing which will make the data more readily available for analysis.

## FSPs

**85. Supervisory engagement with FSPs takes the form of inspections (on-site and off-site, as well as periodic and ad hoc), thematic reviews and ongoing desk-based analysis.** Where an inspection identifies a breach of a regulatory requirement, the firm is instructed by the Central Bank to remedy the situation. Where necessary, a Risk Mitigation Program (RMP) is issued with action points for rectification of the breach. Issues identified during an inspection may form the basis for subsequent regulatory or enforcement action by the Central Bank (see section on Enforcement below). Desk-based supervision, such as regulatory returns analysis, is also used to monitor ongoing compliance. Reports submitted by FSPs to the Central Bank generate alerts within the Central Bank's IT system when certain key risk indicators are triggered.

**86. The Central Bank employs a trigger-based approach to supervision of FSPs.** In addition to desk-based supervision, the relevant team relies on both formal and informal channels for relevant information. Formally, the FSP team relies on reporting provided by the IF and relevant FSPs. Informal channels include information provided through news websites, investor complaints and inputs from other supervisory divisions within the Central Bank (e.g., the Anti-Money Laundering Division) and other authorities.

**87. Depositaries and auditors play an important role in the oversight of FSPs.** Depositaries must enquire into the conduct of the fund management company in its management of the IF and are required to notify the Central Bank promptly of any material breach of regulations, conditions

imposed by the Central Bank or provisions in the prospectus. Depositaries must also prepare a report, to be sent for inclusion in its annual financial audit, setting out their opinion on (inter alia) whether the fund has been managed in accordance the provisions of the constitutional document and IF legislation. The Central Bank requires auditors to make a report following the completion of the annual financial audit that states whether circumstances have arisen that require the auditor to report a matter to the Central Bank.

**88. The Central Bank’s supervisory approach to depositaries takes account of these entities’ specificities.** Most Irish depositaries are standalone entities authorized under domestic legislation, but with a credit institution parent. The Central Bank engages regularly with the prudential regulator of the parent in these cases (typically the U.S. Federal Reserve). Almost all the other depositaries are branches of EU banks that offer only depositary activities in Ireland. A credit institution with an existing license that is seeking to offer depositary services must apply to the Central Bank, which treats the application in the same way as a new authorization. Given that depositaries act for multiple IFs, the Central Bank often targets supervisory work at the depositary level as a means of identifying possible areas of concern at a range of IFs.

## Funds

**89. The Central Bank’s supervisory approach to IFs is thematic-based and data-driven, reflecting that funds are categorized as low impact in PRISM.** Ongoing monitoring and analysis of regulatory reporting has historically been the main driver for supervisory action. The Funds Supervision Team uses a triage approach to supervisory issues. A triage is the recording of a matter to allow for initial assessment to consider what action, if any, is required. A triage recording also allows for ongoing monitoring of the matter via focused supervisory engagement if deemed necessary. Triage can involve high levels of engagement with IFs and FSPs. Over the past five years, the Funds Supervision Team has opened 3,291 triages, most of which were triggered by a depositary or regulatory alert.

**90. The Central Bank is currently reviewing its supervisory impact model for funds, including the merits of using different quantitative metrics.** The review, which is in response to the significant growth in the size and complexity of the funds sector, is now at a more advanced stage wherein a proto-model has been developed to better capture the actual impact of the failure of a fund or group of funds (capturing the various dimensions of related risk) and to potentially utilize the model as a driver of supervisory engagement.

## ETFs

**91. The Irish ETF sector has seen spectacular growth in recent years (Box 4).** Ireland is now the domicile for 60 percent of European ETFs by assets under management (AUM), while ETFs account for 23 percent of Irish IFs’ AUM. The AUM of ETFs has more than doubled since 2017 and totaled EUR 878bn as at September 30, 2021. There is one dominant player in the Irish market that manages ETFs totaling 61 percent of AUM. The vast majority (97 percent) of ETFs are passively

managed, while 70 percent of ETF AUM is in equity funds. For bond ETFs, the sector is split evenly between government and corporate debt.

#### Box 4. Exchange Traded Funds (ETFs)

The specific characteristics of ETFs give rise to a particular set of risks:

- Pricing discount risk – this refers to a situation where there is a disparity in pricing between the market price of the ETF and its NAV.
- Settlement risk – trading and settlement of ETFs is fragmented, leading to more frequent settlement delays which can have a knock-on effect on market participants.
- Liquidity providers – only authorized participants (APs) have direct access to the ETF for the purposes of subscription and redemption activity, while market makers (MMs) could choose to step away from providing liquidity.
- Direct redemption risk – according to ESMA guidelines, investors have the option of redeeming directly at the level of the ETF provider but there are doubts around the feasibility of this mechanism.<sup>1</sup>

During the COVID-19 market turmoil, the first of these risks materialized in the form of large differences between certain fixed income ETF share prices and the estimated value of their assets (up to 17 percent in the case of one Irish ETF). Analysis conducted by the Central Bank showed that the discounts generally levelled off within a week.

Settlement risk has been mitigated by the migration of all Irish ETFs to ICSDs in Belgium and Luxembourg, although operational shortcomings at MMs may continue to play a role.

The Central Bank's work on liquidity providers has identified concentration risk. With respect to APs, two of the most active APs are responsible for up to 90 percent of AP activity for certain ETFs of the dominant player. Although there was no evidence of MMs stepping away from the market during the COVID market stress period, this remains an area that requires close monitoring.

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<sup>1</sup>The CBI is encouraged to raise this issue for discussion within ESMA.

**92. Recommendation 10:** The relevant Central Bank supervision teams should engage with ETF providers to ensure their arrangements with APs and MMs are robust and promote the smooth functioning of the sector, including in times of market stress. There should also be closer cooperation between supervisors of IFs and the colleagues supervising APs and MMs.

## Thematic Inspections

**93. Thematic inspections are an important part of the Central Bank’s supervisory framework and allow for a targeted approach to review, assessment and mitigation of risks within a given sector and across individual firms.** The Themed Inspections Team in SMSD engages with colleagues across the Division and the Central Bank’s Funds Policy team when considering prospective thematic subjects. Inspections can be desk-based or on-site depending on the nature of the topic, the sample size/scope and the methodology to be used.

**94. Themes for reviews come from a range of sources.** They can be the product of supervisory experience around a topic e.g., performance fees. Other sources include the introduction of a new piece of regulation, media reporting or engagement with other regulators.

**95. ESMA plays an increasingly important role in the choice of thematic inspections through its Common Supervisory Actions (CSAs).** These initiatives, which are part of ESMA’s efforts to build a common supervisory culture among national regulators, consist of ESMA asking each national regulator in the EU to carry out thematic work on a given subject. The first CSA in the area of IFs was launched in January 2020 and covered UCITS liquidity risk management; the results were published in March 2021.<sup>51</sup> The second CSA is currently under way and covers UCITS costs and charges. The CSA is now the primary annual focus point for the Central Bank’s Themed Inspections team. To the extent that the CSA process may involve a less targeted approach to the selection of firms to be covered by thematic work, it will be important for the Central Bank to ensure an appropriate balance through the inspections it launches on its own initiative.

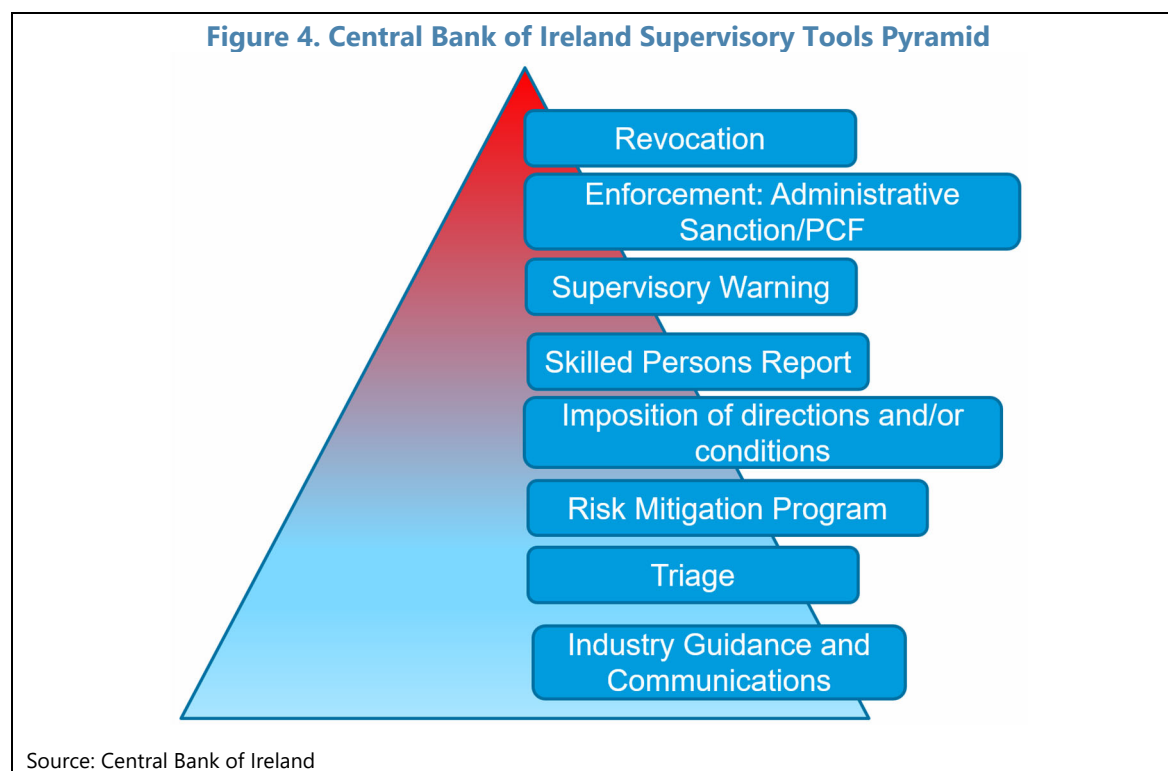
## H. Enforcement

**96. The Central Bank’s enforcement strategy is aimed at promoting principled and ethical behavior in regulated entities and individuals that work in such entities.** The Central Bank seeks to achieve a sufficiently dissuasive enforcement regime by making use of the extensive intervention powers at its disposal. This aim is supported by a wide set of legislative and regulatory powers, including the ability to access any document, require any person to provide information, perform on-site inspections and allow auditors or experts to carry out verifications or investigations.

**97. The Central Bank determines the nature of its interventions taking into account a range of factors such as the seriousness of the breach, its duration and the firm’s willingness to rectify shortcomings.** The Central Bank also refers to its Supervisory Tools Pyramid (Figure 1). These interventions range from issuing industry guidance and communications through to imposition of formal sanctions (including fines) or even revocation of a firm’s authorization. Each type of intervention is not mutually exclusive, and the choice of approach may evolve depending on the behavior of the entity e.g., its openness with the Central Bank. The fluid nature of the decision

<sup>51</sup> [https://www.esma.europa.eu/sites/default/files/library/esma\\_34-43-880-\\_public\\_statement\\_-\\_2020\\_csa\\_ucits\\_liquidity\\_risks\\_management.pdf](https://www.esma.europa.eu/sites/default/files/library/esma_34-43-880-_public_statement_-_2020_csa_ucits_liquidity_risks_management.pdf)

on the eventual intervention is reflected in close cooperation between the supervisory and enforcement areas of the Central Bank.



**98. An established process is in place for matters that are assessed for potential administrative sanctions.** Supervisory staff are encouraged to raise concerns with their counterparts in the Enforcement Directorate at an early stage. To facilitate this, an Enforcement Relationship Manager is assigned to each Division in the Central Bank to respond to queries, help supervisors consider the appropriate supervisory action, and give advice on evidential requirements. Enforcement has a formal Case Governance Framework which provides the governance structure for commencing and managing investigations and ensuring appropriate oversight of the investigations. Case selection is informed by all of the circumstances of a case, including whether the matter aligns with the Central Bank's supervisory strategy and objectives, and the seriousness of the matter. Case selection and governance are key to ensuring that the Central Bank's resources are applied to those cases that best achieve the Central Bank's strategic objectives, motivate compliant behavior and promote a culture of high standards within the financial services industry.

**99. Acceptance of the case by Enforcement triggers several procedural steps.**<sup>52</sup> An investigation letter is sent to the regulated entity, and a call is arranged with the entity to explain the process. The Central Bank can issue statutory requests for information to complement what has

<sup>52</sup> The Outline of the Administrative Sanction Procedure, published by the CBI in 2018, gives further detail: <https://www.centralbank.ie/docs/default-source/regulation/how-we-regulate/enforcement/administrative-sanctions-procedure/legislation-and-guidance/outline-of-the-administrative-sanctions-procedure.pdf?sfvrsn=8>.

already been gathered by the relevant supervisors. Any non-compliance can be taken into account as an aggravating factor in settlement at a later stage or can be pursued in court. Interviews may be organized also as part of the investigation. The case team then makes a recommendation to the Director of Enforcement on the appropriate sanction based on various factors including the seriousness of the breach, its duration and how to achieve the appropriate deterrent effect.<sup>53</sup> The recommendation is escalated within the Central Bank before being sent to the regulated entity. If the entity agrees to settle on the Central Bank's terms, a sanction or sanctions are imposed and a public statement is issued. If the regulated entity does not wish to settle or the matter is not appropriate for settlement, the matter may be referred Inquiry for determination. The Central Bank's Regulatory Decisions Unit supports the Inquiry process and is independent to Enforcement.

**100. The current legislative framework should be strengthened to ensure that the Central Bank can pursue individuals directly for their misconduct. In its 2018 report reviewing bank culture and behavior, the Central Bank identified several areas for strengthening the governance framework.** Specifically, an enhanced Individual Accountability Framework (IAF) was suggested to achieve behavioral, cultural and regulatory objectives. This framework is comprised of four key components:

- **The Senior Executive Accountability Regime (SEAR)** will require firms to set out, clearly and comprehensively, where responsibility and decision-making lie in order to achieve transparency as to who is accountable for what within firms.
- **The enforceable Conduct Standards** set out the behavior expected of firms and their staff, including obligations to conduct themselves with honesty and integrity, to act with due skill, care, and diligence, and in the best interest of consumers.
- **The Central Bank's Fitness & Probity Regime** will be enhanced and will place a greater onus on firms to proactively certify that certain staff are fit and proper and capable of performing their roles with integrity and competence.
- **The Central Bank's Administrative Sanctions Procedure** will be strengthened to ensure that individuals can be pursued directly for their misconduct rather than only where they have participated in a firm's wrongdoing. The reforms will also provide for greater process efficiency, clarity and administrative consistency to all involved, including those who may be the subject of enforcement action. A continued focus by the Central Bank on proportionality and fair procedures is a key theme of its IAF proposals.

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<sup>53</sup> Guidance issued by the CBI in 2019 clarifies the factors taken into account: <https://www.centralbank.ie/docs/default-source/regulation/how-we-regulate/enforcement/administrative-sanctions-procedure/asp-sanctions-guidance.pdf>.

A legislative process has been launched to put in place the IAF.<sup>54</sup> The legislative process is led by the Department of Finance, and the Central Bank has been heavily involved at all stages in the drafting of the provisions. The Central Bank is hopeful that the legislation will be enacted as soon as possible.

**101. The FSAP’s review of recent enforcement data suggests that the Central Bank has tended to favor Risk Mitigation Programs (RMPs) over formal enforcement action as a means of addressing concerns.** In the past five years, administrative sanctions have been issued against four FSPs. By way of comparison, over the same period the Funds Supervision Team has issued 124 RMPs to 29 IFs. The number of formal enforcement actions should be viewed against the background of the aforementioned gaps in the legislative framework and the challenges these can create in pursuing enforcement actions against individuals. The Central Bank is currently required to prove that a regulated firm has committed a breach, then show that individuals (known as “Persons Concerned in Management” cases) participated in the breach, although sanctions have been imposed on a few individuals in recent years.

**102. Recommendation 4:** The Irish authorities should amend relevant legislation to provide for greater individual accountability and enhance the powers of the Central Bank to take direct enforcement action against individuals. The Central Bank should finalize the related internal framework to operationalize execution of the upgraded accountability regime.

## I. Reporting and data

**103. The Central Bank receives an extensive set of reports and data from Irish IFs and FSPs.** Both UCITS and AIFs are required to provide periodic reporting to the Central Bank covering (i) annual/semi-annual financial statements; (ii) annual auditor report; (iii) key investor information document (UCITS only); (iv) annual financial derivative instrument return (UCITS only); (v) annual fund profile; (vi) quarterly balance sheet and profit & loss data for statistical reporting (monthly for MMFs); and (vii) monthly net asset value data. On an ad-hoc basis funds submit a regulatory report of material issues and a depositary report. An internal system monitors a series of key indicators generated from various returns related to annual/interim accounts and capital requirements.

**104. Merging the Securities Holdings Statistics (SHS) with the Central Bank’s internal database has improved understanding of the underlying investor base of IFs.** The SHS, which is collected from all Euro-area depositaries and financial institutions, gives the Central Bank greater visibility on underlying investors of IFs, except for those who hold their securities in the UK and the U.S. The Central Bank has engaged with the funds industry in the context of liquidity management to urge them to make greater efforts in looking through to underlying investors, particularly with a view to identifying which entity holds decision-making power on redemptions. The next iteration of the EU’s Anti-Money Laundering Directive (AMLD6) may seek to address this issue more broadly.<sup>55</sup>

<sup>54</sup> The “General Scheme” (i.e., a draft outline of the main elements) of the Bill was published in July 2021: <https://assets.gov.ie/180083/8175a004-8e41-4e76-b09d-d6ee8ab72506.pdf>.

<sup>55</sup> Transparency of beneficial ownership information can help detect and deter illicit financial flows.

**105. Recommendation 15:** The Central Bank should continue its efforts to improve visibility on underlying investors.

**106. The Central Bank has expanded the scope of data it collects for supervisory and systemic risk purposes, but gaps remain.** Enhanced reporting and monitoring were put in place at the outset of the COVID-19 market turmoil (see paragraph 82). IFs often have credit lines in place with credit institutions to help them manage short-term liquidity pressures. These credit lines are one way in which IFs and banks are interconnected. Having access to information on credit lines, including whether they are shared with other funds, gives a clearer picture of how IFs would be able to cope with unusually high levels of redemptions and/or unexpected illiquidity in their portfolio assets.

**107. Recommendation 8:** The Central Bank should make progress on collecting data on credit lines put in place by IFs, including whether the credit lines are shared and to what extent they have been drawn down. This can be achieved either as part of the next update to the ECB's Investment Fund Statistics Regulation<sup>56</sup> or through changes to domestic rules.

## J. International Cooperation

**108. The Central Bank plays an active role on policy development within European and international fora, while cooperating extensively with peer regulators for the purposes of ongoing supervision and systemic risk monitoring.** Supervision teams make extensive use of the various Memoranda of Understanding (MoU) entered into by the Central Bank directly, through ESMA or as a member of IOSCO. The Central Bank can initiate a request for assistance in the form of an information request or a meeting with relevant supervisory authorities of an FSP/IF of interest. The Central Bank also receives requests for assistance. Cooperation extends to assessments of individuals as part of a fitness and probity review. Engagements are most prominent with the UK Financial Conduct Authority, as well as other EU national regulators such as the CSSF (Luxembourg), the AMF (France) and BaFin (Germany). The Central Bank also engages with national regulators in Asia, North America and the Caribbean.

**109. International engagement is a core part of the Central Bank's work program on non-bank systemic risk.** This is primarily in the context of the relevant policy framework for non-banks, but encapsulates both macro and micro perspectives. The Central Bank is active across selected FSB fora (although opportunities for engagement are limited by the fact that Ireland is not a G20 country), IOSCO, ESMA and the ESRB. The Central Bank co-chaired the work that produced the ESRB's 2020 Recommendation on liquidity risks in investment funds, led the working group on operationalizing the FSB recommendations on liquidity management, and chairs ESMA's Investment Management Standing Committee.

<sup>56</sup> Regulation (EU) No 1073/2013 of the European Central Bank of 18 October 2013 concerning statistics on the assets and liabilities of investment funds.



**110. The Central Bank’s active international engagement at the EU and international level helps further its regulatory and financial stability mandates, but the internationally-focused nature of the sector inherently makes the achievement of the Central Bank’s mandate more complex.** The EU institutional architecture makes it easier for the Central Bank to have insights into financial stability in the other 26 Member States, notably through well-established cooperation and data-sharing mechanisms. However, it remains to be seen to what extent the UK’s departure from the EU will create new challenges,<sup>57</sup> particularly against the background of the strong interconnections between the Irish and UK MBF sectors. More broadly, a situation could arise where a decision taken by the Central Bank may be beneficial from the perspective of domestic financial stability but would have adverse effects in another jurisdiction. The Central Bank rightly expects the entities it supervises to have in place “playbooks” to cover different scenarios, including situations of market stress. It would be desirable for the Central Bank itself to conduct similar thinking on how to manage potentially challenging financial stability scenarios involving cross-border complexity and requiring international cooperation.

**111. Recommendation 6:** The Central Bank should intensify planning on how to manage potentially challenging financial stability scenarios involving cross-border complexity and requiring international cooperation.

**112. The Central Bank is a signatory to the ESMA MMoU on Cooperation Arrangements and Exchange of Information and the IOSCO MMoU Concerning Consultation and Cooperation and the Exchange of Information.** These arrangements provide a sound basis for the Central Bank’s ongoing cooperation with peer regulators. The Central Bank is not yet a full signatory to IOSCO’s Enhanced MMoU, which was introduced in 2016 to reflect advances in technology that have changed the way that the securities and derivatives industry operates and how violations of securities and derivatives laws occur. The main obstacle relates to the ability of the Central Bank to access, and subsequently share with other MMoU signatories, records held by telephone and internet service providers. Legislative change would be needed to give this power to the Central Bank. Alternatively, it may be possible for the Central Bank to obtain such records from another authority, but it is not clear that it has a firm legislative basis for doing so.

**113. Recommendation 13:** Although not being an Enhanced MMoU signatory has not had an adverse impact on the Central Bank’s ability to provide or seek cooperation thus far, it should liaise with the DoF to address any legislative impediments and allow it to become a full signatory in due course.

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<sup>57</sup> This is particularly relevant to the issue of leverage since relevant data for UK AIFs is no longer shared with EU regulators.

## K. Conclusions and Recommendations

**114. Oversight of MBF in Ireland should reflect the globally systemically important nature of the sector.** The Central Bank is well placed to build on what is already a robust regulatory and supervisory regime by making further enhancements in the following areas:

- a. Central Bank independence, powers and resourcing
  - Legislative changes regarding the Minister's power to dismiss Central Bank Commission members are needed to secure the Central Bank's de jure independence.
  - The Central Bank's powers should be enhanced to provide a sound basis for direct enforcement action against individuals.
  - Enshrine in legislation a written procedure for the submission by the Central Bank and approval by the Minister for Finance of the supervisory levy.
  - The Central Bank should apply sufficient flexibility on remuneration to recruit and retain appropriate talent.
- b. Financial stability
  - The Central Bank should prioritize the adoption of guidance on liquidity management tools, including tools such as swing pricing which result in subscribing or redeeming investors bearing the associated transaction costs.
  - The Central Bank should engage with ETF providers on arrangements with APs and MMs.
  - The Central Bank should intensify planning on how to manage potentially challenging financial stability scenarios involving cross-border complexity and requiring international cooperation.
- c. Data
  - Collection of data should be expanded in the areas of delegation, UCITS leverage, and credit lines.
  - The Central Bank should continue its efforts to improve visibility on underlying investors.

d. EU convergence

- The Irish authorities should take an active role in promoting reforms to the EU MMFR that will materially strengthen the MMF sector.
- The Central Bank should push for the adoption of common approaches at EU level to UCITS eligible assets requirements.

e. Regulatory framework

- The Central Bank should proceed expeditiously to finalize its new approach to IF pricing errors.
- The Irish authorities should work together to strengthen governance of SPEs.
- The DoF and the Central Bank should work together to fill gaps in the legislative framework for winding-up of IFs, including by giving the Central Bank the power to appoint an administrator and clarifying steps to be taken when unit-holders of an IF that has been wound up cannot be contacted.