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New Central Bank Investment Firms Regulations

The Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Investment Firms) Regulations 2017 (the "**CBI IF Regulations**") were signed by the Central Bank Deputy Governor on February 28, 2017 and were subsequently published in Iris Oifigiul on March 7, 2017. The new CBI IF Regulations apply to MiFID investment firms, to IIA investment business firms and to IIA fund administrators and follow on from a consultation paper CP97 which the Central Bank issued in early November 2015.

As that CP explained, the Central Bank previously set down a variety of requirements for MiFID firms and for IIA firms in a number of different documents. The intention behind these new Regulations is to consolidate all of those requirements into a single document which can be updated to reflect changes which may be introduced in the future. That, in itself, is a welcome development but firms within its scope need to realise that this is more than a housekeeping requirement. By these obligations now being set within a statutory instrument, non-compliance may constitute a "prescribed contravention" under Part IIIC of the Central Bank Act, 1942 giving rise to Central Bank enforcement action.

The Central Bank has subsequently, on March 13, 2017, issued guidance on a number of related topics – Relationship with the Central Bank (with particular focus on the types of records to be maintained); Fund Administrator Outsourcing; and Own Funds, Risk Assessment and Capital Planning for Fund Administrators – and has also issued a first set of Q&A relating to these new Regulations in which the focus is predominantly on Fund Administrator Outsourcing

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related questions. It has also issued a *Dear CEO* type letter on "Outsourcing of Fund Administration Activities" on March 7, 2017.

Part 1: Application and Scope

As noted above, the CBI IF Regulations apply to:

(i) MiFID investment firms (which are subject to the requirements in Part 2);

(ii) IIA investment business firms who are not fund administrators (which are subject to the requirements of Parts 2 and 3); and

(iii) fund administrators (which are subject to the requirements of Parts 2 to 5).

Much of what appears within the CBI IF Regulations is not new, being taken from, for example, the former Chapter 5 of the AIF Rulebook [Fund Administrator Requirements] so there should be a high level of familiarity with the requirements already.

Part 2: General Supervisory Requirements

Part 2 applies to each category of entity. The requirements contained within Part 2 include:

(i) General Requirements

Regulations 4, 5, 6 and 7 deal broadly with a firm's interactions with the Central Bank, requiring it to consult with the Central Bank in various instances such as when engaging in a new area of business or field of activity etc. Firms are also obliged to notify the Central Bank in writing as soon as the firm becomes aware of any of a number of occurrences including a breach by the firm of the CBI IF Regulations or of a breach of supervisory and regulatory requirements or of a breach of any other enactment or legal instrument which may reasonably be considered to be of prudential concern to the Central Bank or which may impact on the reputation or good standing of the firm. There is no materiality threshold.

Firms must also notify the Central Bank prior to any direct or indirect acquisition or disposal of shares or interests in any other undertaking or business (other than for the purpose of trading activities). Rules are imposed in relation to the provision of internal audit reports and in relation to a change in auditors.

(ii) Reporting Requirements

A variety of reporting requirements are imposed by Regulation 8, with specific reference to the use of the Central Bank's Online Reporting System and where the specific data items and reports required are set out in the Reporting Requirements Schedule (Parts 1-7 of the Schedule to the CBI IF Regulations). This is welcome and should be quite user friendly.

Part 3: Additional Supervisory Requirements for IIA Investment Business Firms

Part III deals with a variety of additional supervisory requirements imposed on IIA investment business firms. The organisational requirements will not apply to MiFID firms given that the European Communities (Markets in Financial Instruments) Regulations 2007 (the "MiFID Regulations") set down the organisational requirements of such firms in detail.

Part 3, therefore, focuses on its application to IIA investment business firms and to fund administrators and imposes obligations under the following headings:

(i) Organisational Requirements

Obligations imposed include the obligation to have in place, at all times, policies, resources and systems to identify, monitor, report and manage risks to which the firm is or may be exposed to in respect of its activities. The requirement makes specific reference to management resources to, financial resources, to control systems and accounting procedures and to robust governance arrangements as well as business continuity, with additional provisions dealing with accounting policies and procedures and business continuity policies.

Firms are also required to ensure that a suitably qualified person is appointed to oversee the compliance function of the firm (referred to the "Compliance Officer") and Regulation 10 sets out the responsibilities of the Compliance Officer and the tasks of the compliance function.

(ii) Client Borrowing

Regulation 11 makes it clear that a firm must not provide credit to a client except where that is in accordance with the firm's credit policy <u>and</u> it is for the purpose of (a) settling a securities transaction on a regulated market in the event of default or late payment by the client, or (b) paying an amount to cover a margin call made on a client. Rules around the entering into of collateral margined transactions also apply.

(iii) Books, Records, Financial Payroll and Management Information

A 6 year retention period is imposed for a variety of records of an investment business firm including (there is a long list which we do not go into here) an obligation to retain a complete written record of all investment advice, including oral advice, given to clients as well as "all records requiring to demonstrate compliance with these Regulations". These are quite stringent requirements and it is important that firms be aware of them and have (and apply) an appropriate record retention policy.

(iv) Telephone Recordings

Where a firm records telephone conversations, it is required by Regulation 13 to retain them for a period of at least 6 months and, where the firm has reasonable cause to believe that the telephone recording is or might be relevant to a complaint, disciplinary action or investigation, it is required to retain the telephone recording until it ceases to be of relevance. That means in practice that, not only do you have to retain the recording for the initial 6 months but you may also need to carry out an analysis to determine whether or not you have such "reasonable cause" thereafter.

Part 4: Fund Administrator Requirements

Part 4 of the Regulations sets out requirements relating to fund administrators, including organisational requirements, outsourcing requirements, requirements relating to the check and release of the final NAV, management of outsourcing risks (there are numerous rules regarding outsourcing) and certain miscellaneous requirements. These need to be read in conjunction with the Central Bank's latest guidance and Q&A document.

These requirements include:

(i) Directors

A fund administrator, who is not a sole trader (unlikely to be too many sole trader fund administrators), is required to ensure that it has a minimum of two directors who are present in the State for the whole of 110 working days in a year. The previous requirement was for a minimum of two Irish resident directors. There has been plenty of debate about director residency or location requirements in recent times so do not propose commenting on this other than to note that, coincidentally, the European Commission, albeit in a different context, issued a report to the European Council and the European Parliament on February 27 this year *[Accelerating the capital markets union: addressing national barriers to capital flows]* where, referring to the position of residency requirements on the managers of financial market players, it indicated that even though such requirements might not pose specific problems for large banks or insurance companies, their suitability is doubtful and they can negatively impact smaller financial service providers as well as the personal freedom of the individuals concerned.

The Commission said that *"Member States put forward various reasons for these requirements, such as easing supervision, ensuring effective management and preventing fraud. However these discriminatory restrictions to fundamental single market freedoms do not appear to be justified by an overriding reason in the public interest, do not seem suitable and are, in any event, disproportionate. Indeed modern communication methods could in most cases be seen as sufficient to achieve some of these objectives"*.

Whilst we note that the 110 day obligations are imposed only in respect of two board members, we also note the Commission's suggestion that regulators require that managers commit sufficient time to their mandate, that they are present when needed and that they have the necessary knowledge, skills and experience for the position, rather than imposing a specific residency requirement.

(ii) Client Assets

The rule provides that a fund administrator shall not hold client assets or investor money without the prior written approval of the Central Bank. Again, this simply reflects what was in the prior version of the AIF Rulebook.

(iii) Outsourcing Requirements

Chapter 2 of Part 4 deals with outsourcing at great length, including a prohibition on outsourcing in certain circumstances. None of the provisions should be of any surprise to fund administrator given that these requirements are taken from Annex II of Chapter 5 of the Central Bank's AIF Rulebook. Rules includes a requirement to notify an outsourcing proposal to the Central Bank; rules relating to the check and release of the final NAV; a prohibition on outsourcing of the maintenance of the shareholder register; management of outsourcing risks [including the requirement that a fund administrator retain responsibility for the outsourced administration services]; the requirement to have a documented policy on outsourcing; outsourcing to be subject to a written agreement; and rules around chain outsourcing, as well as an obligation to submit an annual outsourcing return to the Central Bank.

(iv) Miscellaneous

A miscellaneous provision found at the end of Part 4 requires that a fund administrator providing services to an investment fund that is not authorised by the Central Bank must satisfy itself that the prospectus issued by the fund does not state or suggest, directly or indirectly, that the investment is authorised by the Bank. Although this too previously appeared within the former Chapter 5 of the AIF Rulebook, it is a matter which is, ultimately, outside of the control of the fund administrator (given that it is not the entity which issues the prospectus) so it seems a bit unfair to have such an obligation imposed in circumstances where sanctions for non-compliance can be imposed.

Part 5: Own Funds and Capital Adequacy Requirements for Fund Administrators

Part 5 of the CBI IF Regulations deals with own funds and capital adequacy requirements of fund administrators. The financial controllers of fund administrators will need to pay great attention to these rules.

If you have any questions about these new Regulations, please contact:

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