



Shifting Tides: Developing Regulatory Strategy in a Dynamic Environment

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There has been a significant volume of commentary on the challenges that financial services industry stakeholders have experienced in trying to meet the demands of the evolving global regulatory agenda. While the majority has focused on the experiences of financial institutions adapting their business and operating models accordingly, there has been less analysis from the perspective of regulators who, having developed regulatory strategy in the post-financial crisis environment must endeavour to strike a balance between economic growth and greater systemic stability. This article, however, takes one such perspective.

Considering the Central Bank of Ireland's Strategic Plan 2016-2018,¹ this article examines the Central Bank's regulatory priorities concerning the asset management and investment funds industry in particular, and assesses progress to date and possible future developments.

As acknowledged by the Central Bank repeatedly in its Strategic Plan, the priorities are devised in a dynamic environment of change for central banking and financial systems in Ireland and Europe. Accordingly, the possibility that elements of the plan may be overtaken by events that may not have been foreseen at the commencement of the three-year planning cycle is recognised by the commitment to carry out an annual review of the plan.

A stark example of one such event was the June 2016 referendum on the UK's withdrawal from the European Union. This article will consider the likely (and in some cases already evident) impact of the Brexit vote on the Strategic Plan. It will also consider the manner in which market and/or global regulatory developments in areas such as cybersecurity, investment fund pricing, corporate governance and anti-money laundering have been translated into regulatory initiatives in Ireland.

Strategic Planning and Enforcement

The Strategic Plan is published every three years and sets out the future priorities, activities and desired outcomes under each of the regulator's main areas of statutory responsibility. These responsibilities cover: price stability; financial stability; consumer protection; supervision and enforcement; regulatory policy development; payment, settlement and currency systems operations and oversight; economic advice and financial statistics; and recovery and resolution of distressed financial services firms. The Strategic Plan is not limited to the asset management industry and

1. Plan from <https://www.centralbank.ie/publications/Documents/Strategic%20Plan%202016%20-%202018.pdf>, last downloaded on 24 October 2016.

considers all entities subject to Central Bank supervision, including the banking, insurance and securities sectors.

One of the principal methods by which the Central Bank carries out its responsibility of supervision and enforcement is through its annual programme of themed inspections, which is published at the beginning of each year.² In announcing its programme of themed inspections for 2016, the Central Bank indicated that entities deemed to be low impact under its risk-based supervision framework, including collective investment schemes and their service providers, would be subject to increased inspections in future.³ In light of this, the Central Bank has devoted a team to low-impact funds. This new approach followed a number of peer reviews conducted between 2013 and 2015, which suggested that there was possibly an undue weight of focus on high-impact firms. Of the 12 themed inspections outlined in the 2016 programme, eight were of relevance to the asset management industry.

The Impact of Brexit on Strategic Planning

The UK has been central to the growth and development of the investment fund industry in Ireland, with 2,128 Irish-domiciled collective investment schemes registered for sale in the UK and over 160 UK-based fund managers of Irish domiciled funds, more than from any other country.

As UK asset managers evaluate their options to maintain EU access in the wake of Brexit, Ireland has consistently appeared on the short list of potential jurisdictions, with industry surveys highlighting its talent pool, common-law legal system, proximity and use of the English language as key advantages over competitors.⁴

One priority for UK asset managers after Brexit will be to ensure that they can continue to manage Irish-domiciled funds on a delegated basis. UK managers are currently able to use a fast-track clearance on the basis that they fall within scope of a number of EU directives (MiFID,⁵ UCITS,⁶ AIFMD,⁷ credit institutions,⁸ etc.).

This process is likely to fall away in the event of a “hard Brexit” that is, the UK giving up full access to the single market for goods and services and full access to the customs union in return for gaining full control over its own trade deals, its own law-making, and its own immigration policy, but it should be possible for UK institutions to continue to act in respect of Irish funds on the basis that the UK has a

2. From <https://www.centralbank.ie/regulation/processes/consumer-protection-code/compliance-monitoring/Pages/themed-inspection.aspx> , last accessed on 24 October 2016

3. Framework, viz PRISM — the Probability, Risk and Impact System.

4. See “Ireland Edges Ahead of Lux in Brexit Battle, Ignites Europe, 8 August 2016 at www.igniteseurope.com. A subscription service, last accessed on 10 November 2016

5. Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments.

6. 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).

7. Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers.

8. Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

model of prudential regulation comparable to EU requirements. In this regard, it is worth noting that Prime Minister May has indicated her intention to pass a “Great Repeal Bill” prior to Brexit, thereby enshrining current EU law into UK domestic law. Accordingly, UK investment managers of Irish domiciled funds should be able to find themselves in an analogous position to the many investment managers from various jurisdictions including the USA, Hong Kong, Singapore, Brazil, South Africa, Dubai and others that have been approved by the Central Bank to manage Irish-domiciled funds.

Brexit also presents a clear impetus for UK management companies to consider the establishment of a base in the EU in order to continue to have the current level of access to the EU market (and, in particular, the authority to allow sales teams to operate within the EU). This may be done by establishing an Irish entity with a relevant EU licence, whether as a UCITS management company, AIFM or MiFID firm.

All this has the potential to affect the Strategic Plan published in November 2015 — a time when the prospect of a positive vote in the UK’s referendum on its withdrawal from the EU appeared an unlikely scenario. The Central Bank identified a number of critical factors or “strategic enablers” that must be managed to achieve the aims of the Strategic Plan. These included the areas of people and knowledge and information and resources. In the wake of the Brexit vote, the Central Bank has had to react swiftly to external events and no doubt reconsider elements of its Strategic Plan. One immediate step taken was to split its Markets Supervision Directorate into two units as it deals with a surge of inquiries from London-based investment funds and firms following the Brexit referendum — an Asset-Management Directorate and a Securities and Markets Directorate.⁹ To ensure sufficient capacity, it has also been reported to be seeking to attract staff with experience of working in the UK Financial Conduct Authority (FCA).¹⁰

In a speech delivered in October 2016, Gerry Cross, the director of Policy and Risk at the Central Bank, acknowledges some of the challenges for Ireland and the Central Bank when speaking about the implications of Brexit for the Central Bank’s regulatory and supervisory mandate.¹¹ Cross notes the potential for a material increase in the number of applications for authorisation in Ireland due to the possible loss of passporting rights of UK-authorized entities.

As part of his update, Cross also confirms that the Central Bank will not offer fast-track authorisation to a firm already licensed by the UK authorities, noting that “to carry out our ongoing oversight effectively, it is important to have carried out a good quality authorisation process so that we have an understanding of the business and the risks and how they are managed”. He also notes that the Central Bank will need to be satisfied that it is authorising a business or line of business that will be run from Ireland and which it can effectively supervise.

Any outsourcing by the relevant firm should be in accordance with practice that has been allowed by the Central Bank to date, and in agreement with international practices and standards.

9. See “Irish Regulator Creates Fund Unit in the Wake of Brexit Vote”, Ignites Europe, 20 September 2016, last accessed online on 10 November 2016.

10. See “Ireland Moves to Attract UK Regulatory Staff”, Ignites Europe, 6 September 2016, last accessed online on 10 November 2016.

11. Central Bank Speech “Brexit and Financial Services” Director of Policy and Risk Gerry Cross speaking at Deloitte Ireland Brexit Briefing 3 October 2016, available at <http://www.centralbank.ie/press-area/speeches/Pages/DirectorofPolicyRiskGerryCrossspeakingatDeloitteIrelandBrexitBriefing.aspx>, last accessed on 30 November 2016.

Importantly, however, Cross goes on to note that an entity that has been authorised and is currently supervised in the UK should be “in a good position to understand what is expected in processes such as these and should be in a position to quickly get a complete application together”. He also confirms that the Central Bank is open to meeting and engaging with firms in advance of a completed application, which can be particularly helpful in more complex cases. In terms of capacity, he confirms that the Central Bank is committed to being in a position to discharge the work in processing what could be a large influx of applications within a short period of time and to carry out the related oversight activities that will be required. In this regard, he notes that workforce planning for 2017, which is currently being finalised, reflects the additional resources required to deal with applications that may be made to the Central Bank and that the Central Bank will staff-up as necessary.

Cross expressed similar thoughts and sentiments in a more recent article on “Responding to the post-Brexit environment”.¹² In that article, Cross acknowledges that a key component of a successful and attractive jurisdiction for the location of financial services activities is a strong and independent regulator, with international credibility and that delivering this is by far the most valuable contribution the Central Bank can make to the attractiveness of the jurisdiction as a location for financial services firms.

The Central Bank has indicated that firms seeking authorisation in Ireland will find the Central Bank to be “engaged, efficient, open and rigorous”.¹³

We believe that these comments, added to those in Cross’s speech referred to above, reflect the clear intent of the Central Bank to engage with the increasing workload that may flow from Brexit (whatever form it takes) and to incorporate such changes into the Central Bank’s strategic planning. In this regard, we believe that there is an opportunity for industry here in Ireland to assist the Central Bank in achieving this aim. For example, one practical step would be for industry to assist the authorisation process by clearly and comprehensively mapping the approval and supervision process applied by the FCA against equivalent Central Bank requirements. If this is shared with the Central Bank, it could assist the approval process by allowing the Central Bank to focus on those areas where its processes diverge from those of the FCA, while leveraging the overlap between the regulatory regimes. It will be important for the Irish industry to explore other ways in which the Central Bank may be in a position to fast-track certain aspects of the authorisation procedure while continuing to meet its mandate to ensure prudential soundness, ensure financial stability and protect consumers and work is ongoing on this process.

12. See “Responding to the post-Brexit environment” 23 December 2016 available at <http://www.centralbank.ie/press-area/speeches/Pages/RespondingtothepostBrexitenvironmentGerryCross.aspx>, last accessed on 4 January 2017.

13. See “Firms seeking authorisation in Ireland will find the Central Bank to be engaged, efficient, open and rigorous – Deputy Governor Cyril Roux” 1 December 2016 available at <http://www.centralbank.ie/press-area/press-releases/Pages/FirmsseekingauthorisationinIrelandwillfindtheCentralBanktobeengagedefficientopenandrigorousCyrilRoux.aspx>, last accessed on 4 January 2017 and “Responding to the post-Brexit environment” 23 December 2016 available at <http://www.centralbank.ie/press-area/speeches/Pages/RespondingtothepostBrexitenvironmentGerryCross.aspx>, last accessed on 4 January 2017.

Regulating Cyber Risk

One area addressed in the programme of thematic inspections for 2016 that clearly illustrates the challenge of regulating in an ever-changing environment relates to information technology risk or cybersecurity.¹⁴

Cybersecurity risks and threats have been present since the dawn of the information technology age. However, in recent years, reported cyberattacks and cybersecurity breaches are becoming more significant and more sophisticated in terms of their impact, attracting mainstream media headlines with allegations of state-sponsored hacking programmes against other sovereign states and financial institutions. Unsurprisingly in this context there has been increased attention at international level on the issue, with the International Organisation of Securities Commissions (IOSCO) and the Committee on Payments and Market Infrastructures issuing guidance on cyber resilience for financial market infrastructures in June 2016.¹⁵ This trend has played out at a domestic level, with the Central Bank increasing its focus on this area every year and two separate rounds of guidance issued to industry participants.

In February 2015, the Central Bank identified cybersecurity and operational risk, together with the inspection of controls and procedures around system security and access, as an area of focus in its programme of themed inspections.¹⁶ Throughout the course of 2015, it also conducted a number of reviews of the cybersecurity policies and procedures of a variety of financial institutions. This led to the publication of a letter to industry stakeholders in September 2015, setting out examples of best practice arising from its thematic review.¹⁷

In 2016, IT risk, focusing on the resilience of firms' IT systems, was included in the programme. This process led, in turn, to formal Cross-Industry Guidance in Respect of Information Technology and Cybersecurity Risks, published in September 2016. The guidance addresses the role of the board and senior management in the oversight of IT and cybersecurity risks, but also addresses IT-specific governance and risk management, including risk management frameworks, disaster recovery, business continuity planning, change management and outsourcing of IT systems and services.

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14. The other areas addressed were outsourcing arrangements; alternative investment fund managers' programme of activities; the risk function; production costs of investment funds; use of financial indices as eligible investments for UCITS investment funds; director time commitments; review of client asset management plans for investment firms; review of suitability assessment of clients; examination of information provided to clients on an ongoing basis; hedging arrangements at share-class level for investment funds; and a review of the practices of firms when dealing with insider information and their compliance with the Market Abuse Regulations (Regulation (EU) No 596/2014).
 15. Guidance on cyber resilience for financial market infrastructures June 2016 Committee on Payments and Market Infrastructures and Board of the International Organization of Securities Commissions ISBN 978-92-9197-288-3 (online).
 16. Central Bank Information Release 26 February 2015 "Central Bank publishes programme of themed inspections in Markets Supervisions, available at [https:// www.centralbank.ie/press-area/press-releases/Pages/ CentralBankpublishesprogrammeofthemedinspectionsin MarketsSupervision.aspx](https://www.centralbank.ie/press-area/press-releases/Pages/CentralBankpublishesprogrammeofthemedinspectionsinMarketsSupervision.aspx), last accessed on 30 November 2016.
 17. Central Bank letter dated 22 September 2015 re Review of the management of operational risk around cybersecurity within the Investment Firm and Fund Services Industry, available at [https://www.centralbank.ie/regulation/ industry-sectors/investment-firms/mifid-firms/Documents/ Industry%20Letter%20-%20Thematic%20Review%20 of%20Cyber-Security%20and%20Operational%20Risk.pdf](https://www.centralbank.ie/regulation/industry-sectors/investment-firms/mifid-firms/Documents/Industry%20Letter%20-%20Thematic%20Review%20of%20Cyber-Security%20and%20Operational%20Risk.pdf), last downloaded on 30 November 2016.

Expressly recognising the rapid developments in this area, the Central Bank's guidance notes that it does not address all aspects of the management of IT and cybersecurity risk, but rather focuses on those areas that the Central Bank deems most pertinent at that time based on the supervisory work carried out to date. However, firms would be wise to have due regard to the importance afforded to cybersecurity as a strategic priority by the Central Bank, as inevitably increased regulatory focus brings with it an increased risk of regulatory sanctions for breach where systems and processes are deemed to fall short of required standards.

Investment Fund Costs

The issue of investment fund costs has moved up the regulatory agenda in recent times, with the European Securities and Markets Authority (ESMA) commencing supervisory work on potential "closet index tracking". National regulators in the UK, Denmark, Norway and Sweden are also looking at issues related to the disclosure of investment fund fees, while investor protection group Better Finance has announced that it will carry out its own closet-tracking probe after ESMA refused to name and shame the funds it suspected as potentially being mis-sold.

This trend was reflected in Ireland with the 2016 programme of thematic inspections confirming that the Central Bank would conduct an analysis of the production costs of investment funds.

As part of its analysis, the Central Bank stated that it would focus on the effectiveness of disclosures regarding costs and fees. While the rules regarding prospectus and UCITS KIID disclosures provide a clear framework, in the Central Bank's view, it is not clear that the application of the rules permits investors to make an informed decision and to differentiate between funds. The Central Bank undertook to conduct a statistical analysis relating total expense ratios with the various characteristics of Irish-domiciled funds. Outliers would be identified to determine whether further follow-up supervisory work may be warranted.

The statistical analysis would use data available to the Central Bank already in the form of funds' regulatory returns.

Corporate Governance

Corporate governance for investment funds and fund managers has been a focus for the Central Bank since its inclusion in the 2014 programme of themed inspections, leading to the publication of the Central Bank's Consultation on Fund Management Company Effectiveness — Delegate Effectiveness in September 2014 (CP86)¹⁸ and to the publication of final guidance on directors' time commitments, organisational effectiveness, delegate oversight, managerial functions, operational issues and procedural matters in December in 2016.¹⁹ The issue of directors' time commitments continued to be a component of the themed inspection programme in 2016, with a particular focus on directorships with extensive sub-fund commitments. While CP86 is a domestic initiative, it is clear that the Central Bank has had regard to global trends in relation to substance and the management of risk. The focus has

18. From <https://www.centralbank.ie/regulation/marketsupdate/Documents/CP86%20Fund%20Management%20Company%20Effectiveness-Delegate%20Oversight.pdf>, last downloaded on 24 October 2016.

19. From [http://www.centralbank.ie/regulation/marketsupdate/Documents/161219_FINAL%20FUND%20MANCOS%20GUIDANCE%20_CD%20\(002\).pdf](http://www.centralbank.ie/regulation/marketsupdate/Documents/161219_FINAL%20FUND%20MANCOS%20GUIDANCE%20_CD%20(002).pdf), last downloaded on 4 January 2017.

been on ensuring that the Central Bank will, at all times, remain in a position to effectively supervise Irish-authorized management companies.

It would be reasonable to speculate that the outcome of the Brexit referendum had an impact on one of the proposals made by the Central Bank prior to the date of the UK referendum. In its proposals published in June 2016, the Central Bank had proposed a location rule, requiring that two-thirds of designated persons or directors of Irish management companies be resident in the EEA. While the rationale advanced for this rule at the time suggested that UK-based persons would continue to be eligible following Brexit (and the potential departure of the UK from the EEA), the vote arguably required the Central Bank to recast this requirement, particularly in light of the relationship between Ireland and the UK.

The final form of the location rule, as published in December 2016, is that half of the designated persons or directors of Irish management companies be resident in the EEA and that half of the managerial functions be performed by at least two designated persons resident in the EEA.²⁰ The Central Bank has sought to provide a degree of comfort to fund management companies with directors and designated persons located in the UK, as they plan for the post-Brexit regulatory environment. While the Central Bank is understandably unable to be definitive about whether UK resident individuals will meet the test for effective supervision until after the final terms of the UK's exit from the EU are known, the Central Bank's feedback statement includes a lengthy list of criteria taken into account by the Central Bank in determining its ability to exert effective supervisory influence over a fund management company and its management. We believe those criteria should apply to UK resident individuals regardless of the final terms of Brexit.

Anti-money Laundering

Although not expressly referred to in either the Strategic Plan or the 2016 programme of themed inspections, countering money laundering and terrorist financing is likely to remain high on the regulatory agenda, particularly following Ireland's FATF mutual evaluation review in 2016.

In a briefing to the industry in December 2015, the Central Bank indicated that the outcome of the review may lead to an increase in legislation and regulatory supervision in this area. As well as addressing possible new measures at a national level in 2017, industry stakeholders must also address the implementation of the EU Fourth Money Laundering Directive by 26 June 2017. Certain provisions regarding the beneficial ownership of corporates and other legal entities have already been transposed into Irish law, with the passing of the European Union (Anti-Money Laundering: Beneficial Ownership of Corporate Entities) Regulations 2016 in November 2016. The new provisions require corporates and other legal entities incorporated in EU member states to obtain and hold adequate, accurate and current information on their beneficial owners and each entity must set up a beneficial ownership register. The requirements were transposed early in Ireland to ensure that the central register required to be created under the EU Fourth Money Laundering Directive can be populated with the relevant information from June 2017. Again, the publication of these regulations to coincide with the FATF mutual evaluation review is illustrative of the potential of external events to impact on regulatory planning.

20. See Central Bank "Feedback Statement on CP86 – Consultation on Fund Management Company Effectiveness – Managerial Functions, Operational Issues and Procedural Matters" available at [http://www.centralbank.ie/regulation/marketsupdate/Documents/161219_CP86%20FEEDBACK%20STATEMENT_THIRD%20CONSULT_FINAL_RHD%20\(002\).pdf](http://www.centralbank.ie/regulation/marketsupdate/Documents/161219_CP86%20FEEDBACK%20STATEMENT_THIRD%20CONSULT_FINAL_RHD%20(002).pdf), last downloaded 4 January 2017.

Future Developments

While the Brexit vote has led to considerable uncertainty, the Central Bank's preparations and planning for a possible "leave" vote in advance of the UK referendum, its extensive experience in working with industry stakeholders to create a prudent but practical regulatory environment sensitive to needs of international fund managers, while honouring its mandate of safeguarding stability and protecting consumers, and its recent organisational restructuring and increased capacity via ongoing recruitment all point to a positive environment for those UK firms seeking to relocate their operations to an EU jurisdiction.

In terms of ongoing and future strategic priorities, a continued focus on cyber risk and security, corporate governance, anti-money laundering and the costs and fees charged by investment funds are likely to appear high on the regulatory agenda for the foreseeable future. The Central Bank's positive track record in being responsive and reassessing its regulatory priorities to react to external events looks set to continue.

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