If only we could copyright the colour green

FUND MANAGEMENT HEAD ROBIN CRESWELL JOINS A PANEL OF IRISH FUNDS EXPERTS TO DISCUSS AIFS, IRELAND'S CP86 GOVERNANCE PROJECT, AND THE POTENTIAL FOR THE EMERALD ISLE TO BE A 'GREEN' HUB.

PANEL

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***Funds Europe* – How are Irish fund structures and the regulatory requirements that sit behind them evolving to allow asset managers to provide investors with the diversification of asset classes and strategies they need?**

Robin Creswell, Payden & Rygel – We're seeing two separate trends: one is a trend towards AIFs [alternative investment funds] and AIFMs [alternative investment fund managers], which of course is well established, and one is a potential for more flexibility inside the Ucits tructure.

Payden & Rygel submitted a fund to the Central Bank some time ago to create a multi-asset/multi-credit fund inside our Ucits. But the more we got into the application process, the more pushback we had for that fund because we wanted to have greater exposure to CLOs [collateralised loan obligations], securitised loans and similar instruments beyond what we had in our existing funds.

We drew a blank with the Ucits structure and we had been reluctant to go to the AIF route for two reasons. Number one, Payden didn't want to set itself up as an AIFM and, going back some way, the third-party AIFM option was not as well established as it is now.

Secondly, we work exclusively for institutions, and what we'd found until quite recently is that institutions, if they were coming into a fund – at least the institutions that we deal with – didn't really want to look at AIFs and, more specifically, often in their deeds of establishment specified they could only invest in funds that were Ucits. So, even though they were institutions and professional investors, and they didn't need the protection of a Ucits, their boards would look at the Ucits structure and say, 'That's a gold seal of approval, we're only going to invest in Ucits.'

That's now changed, so the thing we're seeing on the AIF side is AIFMs are well established. It's now very straightforward to delegate to an AIFM and we found institutions prepared to put up $150 million of seed money to start our multi-asset credit AIF which we launched in February of this year, so that's the one trend.

Interestingly, just in the last few weeks what we were hearing from others interacting with the Central Bank is, first of all an appetite to really engage with managers to do two things: to really understand from practitioners how they intend to use these instruments; and secondly, the Central Bank appears prepared to allow more flexibility around the use of instruments such as CLOs, still consistent with the Ucits directive, where the manager has provided satisfactory evidence of underlying systems, processes, expertise and risk management tools.

It's interesting how, on the one hand, we have found ourselves drawn out of necessity towards the AIF and now, on the other hand, we're seeing some room to explore greater flexibility

potentially available in a Ucits, and I think both of those are very healthy developments for the funds industry.

Kieran Fox, Irish Funds – In addition, there have been several notable developments. There has obviously been the new Investment Limited Partnership (ILP) legal structure, which became effective at the beginning of last year. We have seen traction with this over the last 12 months in terms of several new funds being authorised, and my understanding is there are a number in the authorisation pipeline with the Central Bank.

In addition, at the end of March the Central Bank approved in principle the first Irish Qualifying Investor AIF (QIAIF) with an indirect exposure – albeit small – to cryptoassets. This is significant as it is the first time an Irish investment fund has been authorised to hold crypto exposure. Again, it is my understanding that there are an additional number of applications currently with the Central Bank pending authorisation for approval to hold indirect crypto exposure.

Now that the first one has been approved, I would expect there will be more that the Central Bank will authorise. It is something that we are discussing with the Central Bank and we are in the process of publishing a whitepaper exploring what might be possible and the future developments that could be explored in this area.

Bill Prew, JTC – Our particular focus has been on the Investment Limited Partnerships Act amendment, which came into effect in December 2020 and modernised existing partnership legislation which is expected to make Ireland a more attractive domicile for closed-ended private equity, real estate and other real asset funds.

Alongside this, the Central Bank of Ireland now allows non-banks to act as a depositary to these types of funds, and Indos (a subsidiary of JTC) was one of the first firms to obtain what's known as a specialised depositary licence.

There were around 13 live ILPs with around eight being authorised since the amendments to the ILP were introduced. It's been a relatively slow pick-up, but the legislation was introduced during the middle of Covid and it will take time to develop.

Ireland has clearly got a way to catch up versus Luxembourg but there's no reason why Ireland shouldn't play a more prominent role in the closed-ended funds market going forward.

James McEvoy, Alter Domus – We focus very much on private markets – private equity, real estate, private debt, etc – and it's in that area where we saw the need for some evolution. Over the past year and a bit, there has been significant movement and the introduction of the ILP has been key.

Around that time, we also got some further guidance from the Central Bank on certain rules around closed-ended funds, and they were really important to better facilitate private funds and how they operate. That new guidance also applies to Icavs (Irish collective asset-management vehicles) or any other Irish fund structure.

So, that guidance, together with the new ILP, have set us off for the market to evolve in a much more meaningful way, and we very much see it as a growth market.

***Funds Europe* – Over the past six years, the Irish funds industry has had to adjust to increased levels of fund governance requirements from the Central Bank of Ireland (an initiative known as CP86). Has this been a painful process?**

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Creswell – My first impression early in the process of CP86 was of this overwhelming volume and frequency of requests from the Central Bank and we, along with everybody else, received numerous 'Dear Chairman' letters – we had one for liquidity, value for money, closet tracking, governance and so on, and they were not trivial enquiries. But if you went through those 'Dear Chairman' letters, the CBI actually communicated very clearly what they wanted. Initially it was quite overwhelming but then we paused, read the detail and went, 'This actually all makes sense,' and we got busy, we got the resources and I think most of the industry got behind that.

What's most interesting is we haven't seen mass sanctions, we haven't seen mass enforcement, there hasn't been mass remediation. I know that some

people had remediation letters, and those were all resolved. I think almost exclusively they resolved very swiftly and very constructively.

The CBI has been a leader in the industry, it has kind of reset the bar, it's told us very clearly what the expectations are and after the initial shock and awe, we all come out of this as winners. Let's not forget we're all fiduciaries, we're holding assets of other people's money, and the industry has come out of this very much stronger.

We've had to invest, we've had to hire more people, we've had to invest in processes, but I do think the Irish structure is one that everybody can have a very high level of confidence about. So, even though I'm a practitioner and it's cost us money, it's been a very business-positive process.

McEvoy – Some perhaps were more challenged than others and it is reflective of a broader European trend. In many ways it's been helpful because CP86 ultimately resulted in quite clear guidance that has been applied across the sector now.

We also now have the European Commission's published proposals on AIFMD II [the second Alternative Investment Fund Managers Directive] which are under discussion, including around AIFM substance. A lot of that heavy lifting is done here in Ireland thanks to CP86, so it looks like there shouldn't be much to do for AIFMs here in the market in that regard.

For some we have seen a move to a third-party AIFM model, as the bar for establishing and running a proprietary AIFM has certainly raised. We've seen consolidation amongst AIFMs – and obviously AIFMs now in the market should assume they will continue to face some challenge and scrutiny.

Prew – It's not stopping here and Ireland will be introducing the Senior Executive Accountability Regime, or SEAR, over the next 18 months. This is the Irish equivalent of the Senior Managers Certification Regime (SMCR) in the UK, and a key focus of SEAR is on governance and accountability.

Fox – The landscape in Ireland has changed over recent years. There has been a sharp increase in the number of Ucits management companies and AIFMs over the last three or four years. This is due in large part to the UK's departure from the European Union and the effect of the CP86-related increase in management company substance. There has been a migration from self-managed investment companies (Smics) into either in-house proprietary management companies or on to third-party management company platforms. As a result, the number of Smics has reduced significantly. There are obviously still some, but I think they are likely to continue to reduce in number.

To quantify some of the change, I would highlight a finding from an Economic Impact report carried out on the industry at the end of 2020, which showed asset/fund management headcount numbers increase by approximately 60% over two years to stand at 3,600.

Of course, there are particular areas where there has been a greater focus in terms of increased headcount or substance – such as fund risk, investment management, operational risk, regulatory compliance – and although over the period under which the change was taking place it was challenging and sometimes difficult, now that we're towards the end of this period of change and increased substance, we have reached a threshold where I think we're in a much stronger place.

"AT THE END OF MARCH THE CENTRAL BANK APPROVED IN PRINCIPLE THE FIRST IRISH QUALIFYING INVESTOR AIF (QIAIF) WITH AN INDIRECT EXPOSURE – ALBEIT SMALL – TO CRYPTOASSETS."

Kieran Fox, Irish Funds

***Funds Europe* – More broadly, what is the regulatory 'temperature' in Ireland now? What do asset servicers, management companies (ManCos) and wider fund organisations need to consider and prioritise?**

Creswell – What's being tested by the Central Bank, in effect, at present is the veracity of the ManCo structure. Are the ManCos really in control? Are they really getting the risk management data and running their own numbers? Are they independently reviewing risk

processes, governance and so on? I can speak for our structure where we know that's happening, so my expectation is that the thing that has really changed, and what we expect to see prioritised is really a firming up around all the components of the ManCo that allow the ManCo to do their job.

We also expect to see more on ESG [environmental, social and governance]. We are familiar with mutual fund businesses in the US where we've seen the SEC [Securities and Exchange Commission] examining US companies around their ESG policies and procedures, so the theme last year for 2021 was a very invasive, very aggressive examination of fund managers for ESG, and very publicly – it's all in the press – they came and named-and-shamed some very big well-known companies and levied very high fines.

I wouldn't say my focus has moved beyond the ManCo, because there's still a lot of work being done, but I'm very confident that that train has left the station and will arrive securely.

For us, the discussion now with the Central Bank is the work that Central Bank needs to be doing around ESG. We would expect to see a Dear Chairman letter some time this year that begins to look at the ESG underpinnings of Ucits and AIFs. What we haven't had is a thematic review, and we should probably expect one in the next 18 months. I think it would be very healthy.

We've dealt with category 6, category 8, category 9; the Taxonomy is out and our entire industry is reacting appropriately. But there's a lot of work to be done by the Central Bank in terms of clarifying what its ESG position is.

We're already doing that work, categorising our funds, and there's been some criticism by some service providers to the industry that measure Ucits performance – external service providers – who have said, 'Actually, a lot of Category 8, or Category 9 funds don't do what they say on the tin.' But that's not being driven by the regulator; it's the third-party evaluations being done. Everything around ESG is currently a priority, it's going to remain a priority going forward.

McEvoy – Locally, there are a number of new regulatory initiatives underway, some of which are quite substantial.

There is the cross-industry guidance on outsourcing and cross-industry guidance on operational resilience, each of which requires firms to ensure they have a robust strategy with processes and controls in place in these areas. The upcoming Individual Accountability Framework is also a fundamental development. It focuses on incentivising positive individual behaviour and providing regulatory means to enforce on individuals.

All of these either are already or will need really active management and assessment to make sure the firms are compliant across ManCos and administrators, etc. So, it is ever-evolving.

Another topical area is AIFMD II and delegation. With the proposals as they stand, local regulators will need to report to Esma [the European Securities and Markets Authority] where managers are delegating more than retaining in respect of portfolio management and risk management. One would think the volume of reporting, particularly with regard to portfolio management, is going to be very high, and it does indicate that the proportionality of delegation will remain under continued assessment at a European level.

Fox – Esma obviously set the tone and the direction for a lot of what we see from a regulatory perspective that gets rolled out across member states. We know over recent years Esma focused on substance and including a paper looking at substance requirements for ManCos that were relocating due to Brexit. CP86 has put the industry on a very solid footing here. Having the ability to demonstrate to other regulators that we have real and meaningful substance with decision-making being taken within structures here is powerful and important.

The Central Bank has indicated that

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Bill Prew, JTC

they will complete their common supervisory approach (CSA) on fund valuations and Ucits costs and fees. There will also be a focus on the oversight of delegates and operational resilience. The Central Bank are also taking a close interest in sustainable finance-related disclosures.

***Funds Europe* – If a fund domicile wishes to position itself as a 'green hub' or 'sustainable centre of excellence' (which is the case in Ireland), what are the steps that need to be taken?**

Creswell – I was quite interested in this idea of a green hub. I think Ireland – which is the Emerald Isle, after all – can really set itself apart by taking leadership on definitions, categorisation, and acceptable processes within ESG.

One of the things that we're having to invest in is engagement, and we think engagement is an absolutely key function of ESG. What we think is very risky is if national regulators start to denominate asset classes as anti-ESG, so you can't invest in carbon because it's anti-ESG, you can't invest in armaments because it's anti-ESG.

I sit on the board of an ecclesiastical endowment, and there are two things that came up for us: number one is we are located in the heart of the UK military headquarters, so thousands of jobs depend on armaments development, so even though we're an ecclesiastical endowment we're saying, 'We don't want to deprive people of their jobs.'

Secondly, in the last few weeks we've had proof that we need an armaments industry for defence, this idea of defence has been forgotten; that's why we make armaments.

On the carbon side, we can't transition to a carbon-free environment without the revenues from carbon, so as an investor these companies have a key role to play for all kinds of reasons including experience of large infrastructure projects which could be utilised for renewable energy, and we don't want our institutional clients being prevented from investing because they've got an ESG label against them.

What we want is clear rules of engagement around how we determine a bad actor. We want that to remain with our judgement, which we determine through engagement. Also, just developing acceptable processes, acceptable definitions, accrediting benchmarks that are acceptable ESG benchmarks, and developing some common ground in the Irish structure.

In summary, the capital markets are there for funds like us to invest in and direct money to the future and what we need is understanding around ESG that will allow us to efficiently allocate capital to deliver the social requirement, the social needs rather than something that's maybe more prescriptive. Prescriptive solutions tend to end up with bad allocations of capital.

Prew – The whole funds industry ecosystem needs to think about their own ESG credentials and there will be a lot more focus on service provider ESG within the asset management supply chain. Indos and our parent JTC Group have also become carbon-neutral, which is just one thing that managers and other service providers can do to enhance their ESG profile. If fund managers and service providers continue to proactively embrace ESG, then Ireland will continue to be an attractive destination to partner with effectively.

McEvoy – Talent is essential for any business ecosystem. We're fortunate, we have it here in spades, and I think the Irish academic institutions have always been very good at being able to pivot and develop. This is certainly an area where it's very important that graduates are coming through with good knowledge and understanding on ESG and responsible investing in the sector, so firms like ourselves are able to embrace them into the industry and help grow that ecosystem.

Fox – I joke that Ireland should be entitled to have some ownership of the colour green, given the close association with our national identity. But, as we can't copyright the colour, we'll have to settle for soft ownership of it for now!

In Ireland, we have strongly committed support from the government for sustainable finance and last year we published the first National Sustainable Finance Road Map outlining the ambition we have in this area. The Road Map includes some 18 different action plans across four distinct pillars and the important point is that it is a joint plan, between industry, government, and the regulator.

Training and access to talent is also hugely important. Through the government-funded sustainable finance Skillnet, Ireland is looking at national training and leadership capacity in sustainable finance and ESG. In 2020, for example, Ireland rolled out the development of what we think is Europe's first Taxonomy training programme for asset managers. Sustainable finance has been one of the key priorities of Irish Funds over the last number of years and we have produced a significant number of technical information notes and webinars alongside continuous engagement with national and European regulators.

***Funds Europe* – What is the single thing that has made Ireland more attractive in recent times and/or the single thing that it needs to do or its biggest challenge?**

Creswell – I set my first business up in Ireland in 1992 when they were handing out special tax licences in the IFSC [International Financial Services Centre], so the thing that makes Ireland really attractive is there's a complete infrastructure and a business-friendly environment. The rules are pretty clear and they're generally quite well written. The whole transition to the ManCo structure has been good. We only made the transition to ManCo late last year; we had stuck with self-managed, but it's actually been fine.

Everything works and everything's heading the right way and there's a really good environment.

We don't need another flash and a bang and another great invention. What we most need is not to overcook this cake. I know of organisations that chose not to come to Ireland in the last two-and-a-half years because of the uncertainty around what the substance tariff would be, how many jobs they would have to make, and those literally went to other European countries because those tariffs were less. That's a shame because actually there's more certainty under the Irish structure than in some other jurisdictions, there's more business certainty and there's more business robustness.

I think our industry has more work to do; we have to engage through Irish Funds, through the various professions at a micro level for policymakers. It's not just the Central Bank, it's for policymakers to understand there are real costs to getting it wrong, there are real benefits to getting it right, and we need to find the middle ground and not mess it up.

McEvoy – We would have to point to the ILP and some of those additional rule clarifications that came around the same time. On a standalone basis, those changes really paved the way that we're moving forward.

We need stability and we need assurance. Ireland has always provided this, but I think we always need to continue to be mindful that our clients and any stakeholder to the industry needs comfort that there isn't exposure to dramatic shift in terms of legal, regulatory and political environment as we continue to grow what is a very successful and high-employment industry.

Fox – The new ILP structure has been the single most important recent development which has made Ireland more attractive.

Also, being able to have an Irish fund structure that has access to digital asset exposure is a hugely positive development by the Central Bank and something which has a lot of potential to grow. Certainly, over the course of the last 12-18 months, we've seen a noticeable uptick in demand from our members and from institutional investors seeking exposure to that area as an asset class.

While we tend to focus on the things we need to do better, it is also important to acknowledge the positives. Assets in Irish-domiciled funds increased by 22.5% in 2021, we are the fastest growing of the five largest fund domiciles in Europe over recent years and more than 60% of all European ETF assets are located here. But there is no room for complacency. We have to stay laser-focused on making sure that Ireland remains the best place in Europe to do business for the fund and asset management industry, for setting up funds, for having clarity and transparency, for having a robust but a fair and engaged regulatory environment that provides solutions and positive outcomes for savers and investors.

"FURTHER GUIDANCE FROM THE CENTRAL BANK ON CERTAIN RULES AROUND CLOSED-ENDED FUNDS WERE REALLY IMPORTANT TO BETTER FACILITATE PRIVATE FUNDS AND HOW THEY OPERATE."

James McEvoy, Alter Domus

Prew – Ireland has a strong track record in fintech generally and in five years, the industry will look quite different, not just because of funds investing in crypto directly or indirectly. If the Central Bank and others can embrace digitalisation more broadly and leverage the fintech strengths in Ireland, that provides real opportunity. **f**e