Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

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Funds Regulatory & Supervisory Update

29 September 2023

September 2023

Introduction

Thank you to the organisers for the invitation to be here today. Thank you also to the previous speakers and panellists who have made for an enjoyable and informative event so far.

Over the course of the next 15 minutes I hope to provide an outline of the regulatory agenda at present – from the international programme of work underway at the Financial Stability Board, to matters more domestic including the Central Bank's renewed emphasis on thematic supervision for the funds sector.

Before doing so, I want to spend a few moments looking at the state of play in terms of European capital markets. As you know, work on the Capital Markets Union has continued apace at a European level. These efforts are intended to diversify sources of finance for companies and tackle the barriers to the flow of capital. This is of importance because well-developed, broad, capital markets can help to efficiently allocate capital, thereby supporting economic growth. But, in addition, it has long been recognised that Europe is overly dependent on bank financing and that this contributed to the challenges arising out of the global financial crisis.

In the euro area, the combined total assets of investment funds, money market funds (MMFs), insurance corporations, pension funds and financial vehicle corporations have doubled since the global financial crisis from €15 trillion to €31 trillion. The non-bank sector has become increasingly important in financing the euro area real economy in recent years. As a share of credit granted by all financial institutions, credit granted by non-banks to euro area non-financial corporates has almost doubled since 2008, from 15% to 26% at the end of last year. The growing role of non-banks offers the benefit of diversifying sources of finance and can thereby help to ensure funding to the real economy, including in areas such as the transition to a net-zero, more sustainable, economy.

Back to "Contents"

Ireland has a key role to play in supporting European capital markets – historically as a large domicile of European investment funds and as a centre of excellence in terms of fund servicing globally. But increasingly Ireland is playing the role of European headquarters for asset management firms, particularly since Brexit.

In the past, Ireland as a funds domicile has traditionally attracted the more liquid type investment strategies, and is a world leading in terms of Exchange Traded Funds and Money Market Funds. Increasingly however there have been steps taken to encourage more private funds to establish in Ireland. That includes funds focused on private equity, private credit, real-estate and infrastructure investments. Those steps include the updating of the Irish Investment Limited Partnership legislation. While the number of fund lunches has been slow, we have seen the development of a new eco-system of alternative fund focused service providers establishing here. That includes new fund administrators and depositaries specifically targeting this segment of the market. Those firms may prove important in the future, as some industry forecasts for global alternative assets (including hedge funds) estimate that AUM will reach $23.3tn by the end of 2027 – up from $13.7tn at the end of 2021 (growth of 70.7%).[1]

Importantly, we have also seen a drive towards giving retail investors greater access to these alternate investment strategies and assets, particularly in terms of long term, less liquid, investments. If calibrated corrected, and sold to retail investors appropriately, there are many benefits to retail investors having access to such investments through diversified, pooled, collective investment funds. There are two key regulatory updates in that regard which I will now outline.

Firstly, my colleagues in the Markets Policy Division of the Central Bank are in the process of developing a standalone ELTIF chapter for inclusion in the AIF Rulebook. The ELTIF will be a standalone product

[1] Source: Preqin

Back to "Contents"

which will be authorised under domestic funds legislation and with that bring all of the benefits otherwise applicable to an Authorised AIF in Ireland. I think this is a hugely positive development.

Secondly, there is currently ongoing work underway with ELTIFs at an EU level with the development of the draft regulatory technical standards under the revised ETLIF Regulation. Broadly, the main issue at play is the level of standardisation to have in key characteristics of ELTIFs, including the minimum holding periods, redemption frequency and so on. My personal view is that the amendments to the level 1 ELTIF Regulation removed some of the restrictive requirements that had been previously in place. We should not undo that now at the level 2, and instead I hope that we will provide the right mix of tools and options for mangers to draw on when designing their products to ensure that the investment strategy, portfolio composition, maturity and liquidity profiles are appropriate at the product design phase.

International Agenda

Let me now turn to the broader international agenda. When this event took place last year, the volatility in UK debt markets was still to unfold and Russian's invasion of Ukraine was very much at the forefront of regulatory thinking. In some respects, a year on, it would be easy to think not that much has changed. However, the global economy is in a significantly different place than it was last September.

The economy continues to adjust to the monetary policy response to inflation, with downside risks to global growth, trade and financial markets. We have entered the later stages of the monetary policy cycle, with interest rates having risen significantly across major economies. In June we saw the Fed pause interest rate increases. While in their most recent meeting we have seen the ECB continue to raise interest rates. While there is significant uncertainty about the future path of interest rates, the likelihood of entering a loosening cycle in the near term seems remote. We also have the potential that even lower than expected global growth could materialise, as the

Back to "Contents"

effects of higher interest rates transmit through to economic activity and into inflation.

In light of that, regulators remain concerned about the risk of sharp market price corrections. Those risks are heightened amid even tighter financing conditions with elevated volatility and fragile liquidity, particularly in debt markets… The risk of disorderly corrections in the real estate sector have accelerated with rising mortgage rates affecting debt serviceability and we appear to be seeing the materialising crisis in the real estate sector in China. All of which points to regulators remaining concerned around what these macroeconomic conditions will mean for global financial markets. In particular, the 'known risks' around high leverage and challenging liquidity conditions remain a core focus of regulators.

When this group met last September, who would have predicted the first failure of a global systemically important bank since the 2008 global financial crisis (GFC), as well as a few medium sized bank failures. Those events have pushed banking regulation back onto the regulatory agenda.

Nevertheless, notwithstanding renewed work on banking regulation, there is increasing focus on potential systemic risk from the non-bank sector. Recently the Financial Stability Board set out its assessment of the global economy ahead of the G20 meeting in India. The emphasis placed on the non-Bank sector, and the funds and asset management industry in particular, are a sign of things to come.

The emphasis over the last 12 months has been on liquidity, with both the FSB and IOSCO consulting on updates to the international regulatory framework. The FSB consultation seeks to introduce a broad framework for a bucketing approach to liquidity. The IOSCO consultation sets out an expectation that "*responsible entities should **consider and use** at least one appropriate anti-dilution LMT for each open-ended fund under management to mitigate investor dilution and potential first-mover advantage arising from structural liquidity mismatch in OEFs*"

Back to "Contents"

As the FSB has signalled in their recent G20 letter, a major focus of their policy work next year will be to address financial stability risks associated with non-bank leverage. Details of that are still being worked out but there is a lot of ambition from policy makers internationally to make the output from that work impactful.

Unsurprisingly, these issues of liquidity and leverage remain a focus in Europe and at the Central Bank of Ireland. In particular, there is continued work underway looking at liability driven investment funds (LDI) funds with a view to preventing a repeat of the issues we saw last year, one of the first times that leverage played such a significant role in a market event.

Supervision – Thematic Focused

Let me finish by turning to matters more domestic and specifically provide an update on our programme of thematic or sectoral supervision. 2023 has seen us place greater emphasis on using a sectoral or thematic approach to supervising the Funds Sector. This sectoral approach to supervision facilitates the identification and assessment of sectoral risks, while also engaging effectively with industry to promote higher standards. This programme of work includes initiatives which originate at a European level and are coordinated by ESMA – so called Common Supervisory Actions or CSAs. It also includes local initiatives which we have decided to focus on.

In terms of the European CSAs – there are currently two active CSAs. The first relates to **Asset Valuation** and the second relates to **Sustainability and Disclosure Risk**.

The first in relation to asset valuation has largely been completed. Firms that were subject to inspection have received Risk Mitigation Programmes (RMP) where that was required. ESMA published its

Back to "Contents"

pan-EU findings in May 2023, and the Central Bank expects to issue an industry letter by the end of the year.

In terms of the second CSA on Sustainability and Disclosure Risk, this is just getting underway. This will take place over two phases. The first phase is due to conclude by January 2024 and is focusing on greenwashing risks. The second phase will conclude by September 2024 and is focused on sustainability and disclosure issues generally. The relevant questionnaire was issued to in scope firms on 15 August 2023 with a due date of 12 September 2023. All firms have now responded and supervisors are currently in the process of reviewing the responses.

In terms of local supervisory initiatives, there are a number that I would highlight. The first relates to a thematic review which commenced earlier this year and focused on Exchange Traded Funds (ETFs). The primary objective of this thematic review is to gain a better understanding of the roles played by Authorised Participants and Market Makers (APs/MMs) in the ETF ecosystem, in order to assess the functioning of the Irish ETF sector. The review comprised of a Quantitative Questionnaire issued to all ETF providers and a Qualitative Questionnaire issued to a select number of ETF management companies. The Questionnaire responses are currently being analysed and we anticipate concluding this review later this year.

There are also a number of areas where we are carrying out a number of mini thematic reviews. Those areas include (i) looking at the role of non-discretionary investment advisors, (ii) examining conflicts of interest for third party management companies and (iii) investigating the use of the Fixed Operating Expense Model in some investment funds. There are clearly a wide range of issues under consideration. The use of such mini-thematic reviews will likely be a feature of the regulatory toolkit going forward; as a result, industry can expect to see more frequent targeted questionnaires focussed on specific areas of risk. Clearly not every piece of thematic work warrants an industry letter, depending on the nature and purpose of individual reviews.

Back to "Contents"

However, we are currently considering how best to communicate the outcome from those reviews, perhaps in the form of an annual bulletin capturing a range of reviews at once.

Conclusion

Let me conclude there. While I have covered a large number of different topics, including the international regulatory agenda, the current macro-economic landscape, alterative investment funds in Ireland and an overview of our thematic supervisory work underway – I am conscious that there are many other items we could have dealt with. For example, I know there will be many interested in the forthcoming SEAR framework or our work on sustainable finance disclosures. Hopefully we will get to unpack some of those issues over the course of the rest of the day.

Thank you.

Back to "Contents"

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