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Submitted via email to fundspolicy@centralbank.ie

9th December 2019

IAIM's response to Consultation Paper 130 – Treatment, Correction and Redress of Errors in Investment Funds

Dear Sir/Madam,

The Irish Association of Investment Managers (IAIM) represents the major investment managers operating in Ireland. Our members manage significant assets on behalf of Irish and international clients including pension funds, UCITS and AIF managers. The services our members provide are critical to individual and institutional savers and investors alike, allowing them to achieve their financial goals and meet their responsibilities. Individually and as an association, we are committed to ensuring proper and responsible management of assets for the benefit of all clients.

Investment management represents a fundamental and high-value part of Ireland's financial services offering – and a part that is changing rapidly, driven by technology and other market forces. It is highly regulated and the ability to provide a well-regulated environment for investment management is a substantial and proven part of Ireland's international financial services offering.

We appreciate the opportunity to respond to this consultation. We welcome the introduction of the regulatory framework contained in the Consultation Paper insofar as it seeks to enhance investor protection and issues guidance. However, it is important that any significant changes to widely adopted industry practices do not inhibit the competitive environment established in Ireland. In this regard, we would encourage the Central Bank to maintain flexibility, namely on the issues of quantitative thresholds and the standard of liability the framework introduces.

We would be happy to elaborate further on any of the points raised in this letter.

Yours Faithfully

Regina Breheny
CEO IAIM

CP 130 – Treatment, Correction and Redress of Errors in Investment Funds

We are of the view that the proposals as currently drafted entail many hidden legal complexities which need careful consideration before implementation is countenanced. European co-ordination is of paramount importance in this regard.
Our major concerns are detailed below.

Scope

- **Application of requirements to non-Irish managers, funds and depositaries**

  We do not believe it is appropriate to introduce national requirements that will impact on non-Irish domiciled Fund Management Companies, UCITS/AIFs, or depositaries. This matter is best dealt with at a European level so that there is a harmonised approach across the single market. As it is currently drafted, we believe that the Consultation Paper cuts across the segregation of responsibility between home and host Member States under the UCITS Directive. In particular Article 19(3) includes as one of the areas within the competency of the UCITS home MS "the calculation of the issue or redemption price and errors in the calculation of the net asset value and related investor compensation". An Irish UCITS ManCo managing an Irish UCITS would apply Irish rules. An Irish UCITS ManCo managing a Luxembourg UCITS would apply Luxembourg rules. A Luxembourg UCITS ManCo managing an Irish UCITS would apply Irish rules.

  The Central Bank appears to be front-running coordinated EU legislation on this issue. Given that this is an area that impacts business domiciled domestically and marketed on a cross-border basis across Europe, we believe that the matter is best dealt with at a European level by the European Securities and Markets Authority (ESMA) so that there is a harmonised approach across the single market.

  At a practical level, in light of the number of funds domiciled in different jurisdictions across the EU, with different methodologies and frameworks related to the treatment, correction and redress of errors, the proposed enshrining within national legislation of such rules, in a rules-based manner, is inappropriate.

- **Liability of the Management Company**

  There are issues of liability, whether the ManCo is to be strictly liable for the acts/omissions of its delegates and, if so, whether that is to a higher standard than its own liability or otherwise. There are also issues regarding the timing of compensation (i.e. where there are disputes over whether it is payable or not and/or by whom), redress to investors, which investors and to what extent. How this regime sits with standard liability clauses for negligence, breach of contract etc and SLAs also needs to be teased out.

Article 13 provides that if the law of the ManCo's home MS allows delegation to third parties then a variety of pre-conditions must be complied with. Article 13(2) states "the liability of the management company shall not be affected by the delegation of any functions to third parties". The UCITS Directive does not impose a specific liability standard. Historically the liability standard between the ManCo and the Fund is set out in the management agreement. If the liability of the ManCo will not be affected by delegation, then it cannot exclude its liability for an act or omission of its delegate. This does not mean however that the ManCo is liable for losses caused by the acts or omissions of delegates. Further clarification will be necessary.

Materiality

- Materiality will often be indicated by a range of potential circumstances with the eventual treatment of a particular error depending upon a full consideration of the information involved. The proposed regulatory framework does not take into account the differences in size and complexity of fund management companies and the level of risks they employ. Flexibility and proportionality should be allowed e.g the threshold for AIFs should be set depending on the dealing frequency of the fund, its portfolio composition, investor profile and its investment strategy, such as the inclusion of emerging markets, less liquid investments, and hard to value investments. Furthermore, in existing agreements, quantitative and qualitative materiality thresholds that differ from those proposed may have been set and agreed on by the parties. If one such agreement is indeed in place, this should take precedence over the proposed regulatory framework.

- We suggest that qualitative materiality factors should be principles based and determined by the Depository where industry experience lies. We agree that "materiality will depend on the circumstances and nature of the error and should be assessed on a case by case basis".

- We agree with the emphasis placed by the CBI on materiality as distinct from determining a breach of investment restrictions to be advertent or inadvertent. However, any conflict with the UCITS legislation in this approach will need to be resolved. As noted by the CBI, Regulation 77 of SI 352/2011 requires a UCITS to prioritise correction of inadvertent breaches that arise on foot of investment flows or other issues outside its control. It is appropriate that the Fund ManCo (i) identifies and assesses the materiality of such breaches and (ii) ensures that such breaches are corrected appropriately, promptly and in the interests of the investors. However, a breach outside of the control of the ManCo or its delegates – for example exposure or concentration limits breached as a result of market moves – should not give rise to an obligation to pay redress to investors. A breach requiring redress should only arise where it is the result of either a manifest action or inaction by the ManCo or its delegates. The Depository has the fiduciary responsibility to determine that this is the case.

Reporting/Notification

- We believe the ManCo should report errors to the depositary and that the depository should be the sole party responsible for reporting material errors to the Central Bank. It is crucial that a depositary, which represents the interest of investors, performs this valuable fiduciary oversight role and adopts an unbiased and thorough approach towards monitoring and reporting errors.

- We agree that investors should be notified where the error is above the materiality threshold and when redress is required.

- We believe that Fund ManCos should ensure that the management bodies of their client funds are made aware of all material errors whether redress is required or not.

- We do not agree that Fund ManCos should be obliged to notify investors in their client funds of all material errors irrespective of whether redress is required or not. The nature timing and format of investor communications will vary depending on the nature of the underlying investor base and the legal, regulatory and operational requirements of the Fund vehicle.

Redress

- The requirement for redress should depend on the materiality of the error, the causality, as well as the applicable standard of liability. We do not think payment to the fund and/or investors is appropriate where there has been no quantifiable harm to investors.

- We believe that De Minimus limits should apply but should be set at a level appropriate to the type of investor e.g the scale of an institution investment is significantly different to that of a retail investor.

- We do not believe that redress should be required in any circumstances where an inadvertent investment breach has been identified. Redress should only be required where the Depository has determined the ManCo or its delegate to be in advertent breach of investment restrictions either by an action or failure to act appropriately to resolve an inadvertent breach.