Opening Statement regarding the "ESA Package"

Oireachtas Joint Committee on Finance, Public Expenditure & Reform and Taoiseach

28 November 2017

Mr. Chairman, Deputies and Senators - thank you for the invitation to participate in today's meeting to consider the European Commission's "ESA Package"[1] published on 20 September 2017. These proposals are very important given the potential impact on consumers, the regulator's role and powers as well as on industry providers and funds industry activity which supports employment and economic activity. While there are aspects to the ESA proposals we welcome, there are a number of areas which are of significant concern. Before we get further into details of the proposals, I'd like to give a brief overview of our association and the Irish funds industry.

Irish Funds and the industry we represent

The Irish Funds Industry Association CLG (Irish Funds) is the representative body for the international investment fund community in Ireland[2]. Our 125 member firms[3] provide services in relation to funds domiciled both in Ireland and overseas[4]. The investors in these funds come from 70 countries around the world, the investment managers of the funds originate from 50 different countries and the underlying investments held are also truly global in nature[5].

The funds industry in Ireland provides a range of services[6] which enable investors (both individuals and institutions) to pool their resources together collectively (via funds), in a highly regulated environment, to invest in order to generate returns and

[1] COM(2017)536/948972

[2] Founded in 1991, Irish Funds represents fund managers, depositories, administrators, transfer agents, professional advisory firms and other specialist firms involved in the international fund services industry in Ireland.

[3] Irish Funds has 125 member firms. For more details please click here.

[4] As at 30 September 2017, domiciled assets administered in Ireland amounted to €2.3 trillion and non-domiciled assets administered in Ireland amounted to €2.0 trillion.

[5] Regulated investment funds hold a wide range of assets and securities including those issued by governments, municipalities and corporations both in publicly listed form and those which are not listed, thereby providing significant capital into economies.

[6] Investment management, risk management, depository, fund administration, advisory, oversight and governance

manage risk. This activity supports saving for retirement, aged-care provision, education and other important goals.

Ireland has developed into a centre of excellence for fund products[7] and services which are;

- Authorised and supervised locally, and
- Anchored in a number of European Directives[8] which facilitate EU market access through financial services passports, the ability to delegate certain activities, equivalence rules and other requirements.

This interplay between the local National Competent Authorities ("NCA") in each country - in our case the Central Bank of Ireland - and the European Supervisory Authorities (ESAs) - in our case ESMA – works well and both entities have significant powers as well as pre-existing governance and co-operation structures.

The long-standing regulatory and commercial eco-system which exists in Ireland for regulated funds has been a stand out success for more than 25 years and has contributed to the global success of UCITS. Our industry employs over 14,000 people living in at least 15 counties throughout Ireland and provides a compelling proof statement of our country's ability to develop and scale specialist international financial services activities. We do this by applying global capabilities to an EU policy and regulatory framework and providing the resulting solutions to both EU and non-EU investors. This point of applying global skills is one which I will return to later.

Our industry is a significant supporter of the Government's IFS2020 Strategy and we continue to work hard to help deliver on its objectives. In this regard I have separately

[7] As at June 2017, total world-wide investment fund assets amounted to €42.3 trillion. Investment fund assets domiciled in Ireland amounted to €2.1 trillion, representing 5.3% of global investment fund assets and 14.6% of European fund assets[7], making Ireland the third-largest home for regulated funds globally and the second largest in Europe.

[8] These include but are not restricted to the directives and regulations relating to Undertakings for Collective Investments in Transferable Securities (UCITS), the Alternative Investment Fund Managers Directive (AIFMD) and the Markets in Financial Instruments Directive (MiFID).

approached the individual members of the Committee to discuss industry's long-standing request for legislative amendments to Ireland's investment limited partnership legislation which was agreed by the Government in July. These proposals need to come to this Committee for pre-legislative scrutiny as a matter of priority given the opportunity for additional employment in the sector which we are currently squandering. Our clients want to do more business here but our offering is simply not competitive in this respect. I hope you'll excuse my short detour but as a key priority for our industry it would be remiss of me to attend here and not mention it.

Capital Markets Union ("CMU") and Brexit – Background and context to ESA proposals

In approaching the detail of the ESA Package we would note two significant matters which provide both a backdrop and context for the proposals themselves, namely CMU and Brexit.

The CMU initiative, which we are strong supporters of, is cited throughout the proposals as being a primary catalyst for the measures. The CMU Green Paper and Action Plan emphasise the importance of the Single Market and a single rulebook which is effectively and consistently enforced, and are also based on principles such as fostering stronger connections with global capital markets, helping to attract investment from all over the world and increasing EU competitiveness. When CMU was launched by the Commission in September 2015 it was clearly explained as not being a regulatory driven initiative. We believe the current ESA Package is in sharp contrast to this approach and that ESMA already has most of the tools available to support the delivery of the CMU objectives.

Additionally, Members of the Committee will also be aware of the potential for significant disruption to our industry (and the European savings industry generally) in light of the UK's decision to leave the EU. ESMA issued several Opinions[9] relating to Brexit and supervisory convergence in July 2017 and created a Supervisory Coordination Network. The CBI participates in this network which augments the existing powers of the ESAs and whose stated objective is "….to promote consistency of decision-making by NCAs"[10]. It was therefore surprising that within 10 weeks of the publication of those opinions (and without public consultation in respect of some key elements) that we had EC proposals which revisited much of the same ground again.

While there are aspects of the proposals which we welcome and support, overall we believe the proposals as drafted have a real potential to add to the disruption and confusion already faced in light of Brexit and potentially inhibit rather than support CMU.

ESA Package

The ESA Package is a significant and far-reaching set of proposals which seeks to alter the powers, governance and funding of the ESAs. We will confine our statements to those aspects of the proposals which relate to the European Securities and Markets Authority ("ESMA"), the ESA being primarily responsible for our industry.

As mentioned already we support the ambition of the European Commission to move forward with the CMU initiative and recognise that enhancing the role of the ESAs in certain ways could have positive benefits, including helping to bring down barriers to

[9] ESMA34-45-344, ESMA35-43-762 and ESMA70-154-270 all issued on 13 July 2017
[10] ESMA42-110-433: ESMA Opinion to support supervisory convergence in the area of investment management in the context of the United Kingdom withdrawing from the European Union – para 7.

cross-border fund distribution, ensuring consistency in the application of EU rules, and consolidating data management and reporting.

In considering both the proposal and accompanying impact assessment we focused on three primary questions:

- What is the likely impact on consumers/clients and providers of services?
- How do the proposals improve the functioning of the Internal Market?
- What is the evidence which supports the changes proposed?

There are some areas where the proposals are well thought out and clearly articulated - in other significant areas this is less clear and we are not in agreement with the conclusions reached. Linking back to the three questions we posed, we believe that ESMA already has significant powers which it can and should use before being granted additional ones, especially in the absence of consultation or evidence of problems in key areas like delegation or outsourcing. To do so would be to risk negative impacts on consumer choice, competition and efficiency and would also potentially compromise what is a successful and well-functioning regulatory and commercial ecosystem for cross border funds, remembering that we are part of a global market for capital.

Additional powers proposed for ESMA

We are aware that concerns have been raised by a number of member states, including Ireland, regarding the granting of additional powers. The question whether some of the measures may also impinge on the principle of subsidiarity[11] is another point which we have noted. On a combined reading of the proposal and accompanying impact assessment[12] it is unclear that they satisfy the preconditions for intervention by Union institutions.

The specific aspects of the proposals in relation to powers where we have concerns are:

- Delegation and outsourcing, and
- Direct authorisation and supervision of certain products by ESMA.

Delegation and outsourcing[13]

The efficient delivery of a wide range of regulated fund products (representing a diverse set of investment opportunities and underlying providers) has been enabled through the use of both delegation and outsourcing. These dual aspects of delegation and outsourcing enable investment managers (whose operating models, investment expertise and geographic bases of operation are not homogenous) to submit to EU regulation/authorisation and product rules in order to deliver their capabilities to customers. They have been key contributors to the success of UCITS[14], and more recently AIFs[15]. Delegation has worked extremely well historically and has been central in making UCITS in particular, not just a European, but a truly global, success story[16]. It is a reliable, well-functioning and tested model, which is central to ensuring EU investors can access world leading investment expertise.

[11] http://www.europarl.europa.eu/ftu/pdf/en/FTU_1.2.2.pdf
[12] SWD (2017) 308 final
[13] COM(2017) 536 final: See Article 31a (page 115) for the specific text
[14] There were €9.3 trillion of UCITS assets at the end of July 2017. Source EFAMA (www.efama.org)
[15] Alternative Investment Funds: There were €5.8 trillion of AIF assets at end July 2017. Source EFAMA (www.efama.org)
[16] European domiciled fund assets represent 34% of world-wide assets, far outstripping the region's comparable population and GDP share. Net sales across both UCITS and AIFs for the first 7 months of 2017 exceeded €600bn.

The proposal envisages an enhanced role for ESMA in authorising delegation and outsourcing arrangements between EU-based and third country entities. Specifically, all third country outsourcing, delegation, and risk transfer arrangements authorised by EU Member States would need to be assessed/approved by ESMA where an EU passport is being utilised. The existing EU legislative framework already has robust standards in place for delegation and outsourcing, including to third countries[17].

Therefore, we believe the proposals would lead to a more bureaucratic, costly and inefficient process regarding delegation, outsourcing and risk transfers, and would lengthen the time to market of European fund products. There is lack of evidence of any market failure here so one must ask, what is the problem which the Commission is looking to fix? Additionally, there is less regulatory certainty under what is proposed and it sends a negative message across the globe regarding the openness of the European industry at a time when the Commission's CMU initiative, which we support, is seeking to attract global capital.

In addition to the increased administrative burden and bureaucracy of a centralised review of outsourcing and delegation by ESMA, we would be concerned that a centralised review of delegation/outsourcing arrangements could have a negative impact on the diversity of arrangements which have served both investors and industry well for the past 25 years. The approaches taken to delegation/outsourcing (which operate within the associated EU and local rules) have developed over time via extensive consultation and scrutiny from the Central Bank of Ireland leading to a robust system with investor protection as a core principle. Ensuring the best funds expertise globally is available to investors and delivered via delegation and outsourcing arrangements is key to the success of the European industry. From an Irish

[17] Both the UCITS Directive and AIFMD specifically lay down rules for investment funds and/or management companies to delegate certain functions. Both Directives also set-out rules for cooperation between home Member States and host Member States and provide for cooperation agreements between EU home Member States and third countries.

perspective the European market access which we offer to global asset managers is a fundamental part of our success.

Responsibility for direct authorisation and supervision for ELTIF[18], EUVECA[19] and EUSEF[20]

The other area, with respect to additional powers, where we have concerns relates to a move to direct authorisation and supervision of certain investment funds, a clear move away from the model which is currently in place and which operates with relative ease and efficiency.

The ESA Package proposes shifting responsibility for authorisation and supervision of ELTIFs, EUVECAs and EUSEFs structures from NCAs to ESMA. Though these fund structures originate from EU Regulation, they would be subject to a manager's regulation (via AIFMD) rather than a product regulation. The proposal would set the precedent of a dual regulatory regime (e.g. ESMA for the ELTIF element and CBI for the AIFMD element) with consequent uncertainty as to which regulatory regime should prevail in the case of investor detriment. There is no clarity as to where ESMA's responsibility stops and the NCA's responsibility starts. A dual regulatory regime for these types of investment funds would undoubtedly lead to a more complex, cumbersome and expensive fund authorisation/supervision process. Operationally there would be challenges as ESMA staff would need to appreciate and understand the different legal structures available in each Member State, so as to understand how these interact with investor protection mechanisms within the various national fund structures.

[18] European Long-term Investment Fund
[19] European Venture Capital Fund
[20] European Social Entrepreneurship Fund

The current system of supervision by NCAs is best suited to deal with the different market structures and legal regimes of Member States.

Changes in governance and accountability

We support the desire for the ESAs to be nimble, capable of effective and efficient action and empowered to promote convergence of NCAs on an ongoing basis. This needs to be balanced with the ability of NCAs to actively contribute and influence policy formation, particularly as NCAs are answerable to their national parliaments and investors. The proposal around the new Executive Board requires some scrutiny, especially given the extent of the proposed power concentrated in it. There is a legitimate concern about a lack of representation of the views of Member States.

Furthermore, we are concerned regarding the role a new Executive Board would play in relation to the development of a "strategic supervisory plan" which could supersede or re-prioritise work and areas of focus of NCAs which could limit their discretion to focus on risks most relevant to their local markets. We consider it important that NCAs retain this national discretion or at the very least, the strategic supervisory plan should be agreed by the Board of Supervisors as the central decision-making body of the ESAs.

ESMA Funding[21]

The financial crisis and the resulting policy and regulatory responses at global, regional and national level created a renewed impetus and upscaling in regulatory and supervisory resourcing in NCAs, including the CBI, over a number of years which both consumers and industry have funded.[22] The proposals suggest a re-creating of this centrally in the ESAs with little clear justification and scant detail regarding cost. Initial

[21] Article 49a (page 70)
[22] At the end of 2008 the Central Bank employed 1,022.5 permanent staff and at the end of 2016 this number was 1,593.3. (source: Central Bank Annual Report)

indications are that the proposals will not yield a comparable reduction in (industry) funding of NCAs.

The proposals suggest altering the current funding model (40/60 split between EU budget and other sources) to a balancing contribution from the General Budget of the Union not to exceed 40% of ESMA's revenues. We believe a reduction in EU funding potentially erodes ESMA's accountability to the European Institutions. The current 40/60 split between EU budget and other sources is important to ensure strict budget control of the ESAs.

While I want to use the time available to ensure our concerns with these proposals are understood, it is important to also mention aspects of the proposals which we support.

Provision of information

We support the direct collection of information by ESMA as this reduces burdens on regulated entities by allowing the forwarding of data already provided to the NCA without further adjustment. More fundamentally, this would lay the foundations for a common EU data reporting hub at ESMA feeding off data provided at national level which could be utilised by both the relevant NCA and ESMA. This would support common data standards, encourage comparability and reduce costs for market participants.

Additionally, as part of the CMU initiative, we have previously supported the development a common European portal for cross-border passporting notifications and for ESMA to act as an information repository on the marketing requirements of individual Member States. We reiterate this request as this would assist in reducing the costs and the barriers to entry for fund managers seeking to market their funds on a cross-border basis.

Open Public Consultation on Guidelines and Recommendations

We are supportive of the proposal for ex ante consultation on guidelines and recommendations. Furthermore, to enhance practical use of the guidance provided in ESMA Opinions and Q&As, NCAs should be able to consult with stakeholders alongside the coordination process at ESA level.

In conclusion we are grateful for the opportunity to present to the Committee on this topic and look forward to your questions.

Thank you.