"Protecting investors in a time of great change" – Colm Kincaid, Director of Securities and Markets Supervision

01 December 2020 **Speech**

Address to the EY Funds Forum Event, 1 December 2020

Good morning everyone.

As we gather together for this event today, we are surrounded by an environment of change. We are battling a pandemic and, with Brexit, we are preparing for a once in a generation change to the European political order. I would also say that the pace at which change itself takes place is accelerating, fuelled by technology.

Never before has it been so important for securities markets to continue to perform their proper function to support economic activity and the well being of EU citizens. Nor has the need ever been greater to be vigilant to protect investors' best interests, as they seek to navigate these uncertain times. Moreover, this is a challenge for all investors, from the most sophisticated institutional market participant to the first-time retail investor.

I want to spend the next few minutes therefore sharing with you some thoughts from the perspective of the Central Bank of Ireland on the funds industry's role to protect investors in this time of great change.

What principles should guide us?

When we supervise conduct on wholesale securities markets, including in the field of funds, we look to see a market that satisfies the following five principles:

1. It has a high level of protection for investors and market participants.
2. It is transparent as to the features of products and their market price.
3. The market must be well governed (and comprise firms that are well governed).
4. The market must be trusted, by both those using the market to raise funds and those seeking to invest.
5. The market must be resilient enough to continue to operate its core functions in stressed conditions and to innovate appropriately as markets evolve.

We expect firms to have regard to these principles when conducting business activity and I suggest it is also a good set of principles by which to navigate the changes that surround us.

Turning then to some of these major changes.

Towards a greener financial system

The evolving climate crisis and the universal need to mitigate its effects requires that financial products and services themselves become more environmentally sustainable.[1] By financing initiatives and trends aimed at stemming the climate crisis, sustainable finance can play a key role in ensuring that securities markets aid the transition to greener economic activities.

To ensure this transition is successful, it is imperative that investors' best interests are protected and the reputation of the emerging concept of green finance is not damaged. This includes taking special care to avoid the risk of greenwashing (be that intentional or through a failure of proper diligence). It is also important that, where the sustainability aspect of the product or service is unclear or dependent on future developments, this is explained clearly in the product documentation.

EU regulatory changes are in train to support this outcome. They include the Sustainable Finance Disclosure Regulation (SFDR) and firms need to continue to move forward at pace in their implementation plans ahead of the relevant requirements coming into force on 10 March 2021. While we do aim to facilitate a practical approach to certification that reflects that the related Regulatory Technical Standards will come later, the duty sits with firms to ensure a meaningful review of the documentation they submit to the Central Bank for approval. We will communicate the specific arrangements for this exercise in the coming days, including the relevant dates for submissions.

Combatting Financial Crime

At a time of increasing complexity and change, firms also need to ensure that the Irish funds industry is not a gateway for money laundering or terrorist financing, including bearing in mind the fund sector's Medium High rating in the Anti-Money Laundering National Risk Assessment. This rating recognises the risks arising from the relative complexity of fund legal structures and

highlights the need for the sector (and each firm in the sector) to be vigilant. It is an area where standards need to be raised, in particular to ensure firms apply controls and processes that are specific and appropriate to their individual firm. This is not a risk that can be managed by generic policies or processes owned by other entities within the group.

Brexit

As we head into Christmas we also head towards the departure of the UK from the EU.

The decision by the UK to leave the EU will change the structure, composition and operations of securities market participants in both jurisdictions. The risks arising from this are numerous and cover all aspects of the securities market landscape, including funds. Firms have done a lot to prepare for Brexit and it has been a supervisory focus of the Central Bank of Ireland for some time. Nevertheless, firms need to remain vigilant in this final stage of the UK's exit, as well as looking to the medium and longer term risks it presents to their business and the investors that business serves.

COVID-19

Of course, 2020 has been dominated by the COVID-19 pandemic.

I want to start my remarks here by acknowledging the hard work by people across the funds sector in extraordinary circumstances. On the whole, these efforts meant that, so far, the sector has been successful in meeting the business continuity and market challenges that presented themselves. Nevertheless, vulnerabilities did emerge in how well firms were prepared to deal with the issues they faced.[2]

What is most striking to us is the extent to which the vulnerabilities that emerged fall squarely within the priority areas we have been engaged with the sector on for some time now, namely:

- The need for better implementation of our framework for fund management companies' governance, management and effectiveness (the 'CP86 theme') – and here in particular the need for the Irish regulated entity to be properly resourced;
- The need to manage liquidity risk more proactively (the 'liquidity theme'); and
- The need to have better quality data (the 'data quality theme').

Firms need to take specific action on each of these themes if they are to be in a position to weather the next period of market stress. For our part at the Central Bank, we have specific supervisory actions in play on each these fronts, and we will have recourse to all the tools at our disposal to ensure a satisfactory outcome.

We must also acknowledge the role that extraordinary government and central banking support played in mitigating the market impact of COVID. Had this support not been there in 2020 the position for funds (as for other market participants) would have been very different. But this support carries a public cost that has to be factored into our reckoning for the longer term.

So, as well as enhancing near term preparedness, we also need to consider reform to the regulatory framework. This requires a detailed and holistic consideration of the issues and strong international coordination to support both the objectives of Capital Markets Union and a safe and vibrant global securities market. The Central Bank of Ireland will be an active voice in this reform agenda, not least on the need for a more comprehensive macroprudential framework for market based finance.[3]

The framework for fund management companies' governance, management and effectiveness

Amongst the phrases we have heard repeatedly in 2020 is the statement that 'there is no silver bullet'. However, when it comes to investment funds meeting the challenges of the near, medium and longer term, I wonder if there is in fact a 'silver bullet' in the form of the proper implementation of the CP86 framework. If firms can make the necessary progress here, and do so at pace, it will enhance their capacity to deal with the challenges I have referred to, however those challenges present themselves.

But the situation on the ground is not as it should be.

Time and again the root cause of the issues we encounter as supervisors is a failure to properly implement this framework. You will also have seen the serious deficiencies we identified in our recent thematic review.[4] Here, you will recall, we found that two years after the framework coming fully into force, many firms could evidence the introduction of only limited changes. As well as prescribing a series of specific risk mitigation programmes within individual firms, we have required all firms to prepare an action plan by end Q1 2021 to remedy this situation. This includes planning to put more resources into the firm to meet the requirements of the framework.

As we indicated in our industry letter, we plan a further industry wide review in 2022 to benchmark how much progress industry has made. Much will depend on what we find.

Concluding remarks

We are in a period of great change and regulated firms have a responsibility to help investors navigate that change. Whether it be battling climate change or the impacts of COVID 19, or dealing with the change to the landscape from Brexit, the key to firms discharging this responsibility is to be well-resourced, well organised and well run. The regulatory framework provides a map for

firms to achieve this, but firms have got to start applying it in a way that is more prudent and risk oriented and less focused on delineating the minimum requirements of the law. I hope, and expect, that when we next speak about change at this event next year, a better implementation of the CP86 framework is one of the changes we are referring to.

Thank you for your attention, and my thanks once again to the organisers of today's event for the opportunity to speak to you.

My thanks to Alice Ryan, Rosemary Hanna and Helen Hegarty for their assistance with these remarks.

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[1] For more detail, see "Sustainable Finance: the changing regulatory landscape" - Gerry Cross, Director of Financial Regulation: Policy & Risk

[2] For further analysis of the COVID impacts see the Central Bank's Financial Stability Review (and Box H in particular)

[3] Making the case for macroprudential tools for the market-based finance sector: lessons from COVID-19 - Governor Makhlouf

[4] Central Bank publishes outcome of thematic review of fund management companies, 20 October 2020