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Client Asset Requirements for Fund Service Providers

Introduction

On 2 August 2013, the Central Bank of Ireland ("**Central Bank**") published Consultation Paper CP 71 ("**CP 71**") on proposed Client Asset Regulations and Guidance for investment firms and fund service providers ("**FSPs**"). Having considered the responses received to CP 71, the Central Bank took the decision to introduce two separate set of regulations one for investment firms and another for FSPs. This briefing deals with the regulations which apply to FSPs and is relevant to fund administrators and depositaries/custodians authorised under the Investment Intermediaries Act 1995 (as amended), (the **"IIA**"). The definition of a FSP also includes a UCITS Manager authorised under the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011[1] and an alternative investment manager authorised under the European Union (Alternative Investment Fund) Regulations 2013. Accordingly this briefing may also be relevant to UCITS management companies ("**UCITS ManCo**") and alternative investment fund managers ("**AIFMs**").

On 30 March 2015, the Central Bank published a set of regulations; Investor Money Regulations 2015 for Fund Service Providers[2], (the "**Investor Money Regulations**" or the "**Regulations**") which aim to strengthen the safeguards around investor money.

[1] S.I No. 352 of 2011
2 S.I. No. 105 of 2015

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The Central Bank has published guidance ("**Guidance on Investor Money Regulations for Fund Service Providers**") to assist FSPs to comply with the Investor Money Regulations. The Investor Money Regulations will come into operation on 1 April 2016.

On the publication of the Regulations, Director of Markets Supervision, Gareth Murphy, said "*The publication of these Regulations marks a significant development with regard to the safeguarding of client assets and investor money in Ireland. The development of these Regulations is the outcome of a lengthy period of industry consultation with investment firms and funds service providers. The Central Bank will closely monitor the implementation of these Regulations so as to ensure that our aim of enhancing investor protection and safeguarding client assets is achieved.*"

Who do the Regulations apply to?

The Investor Money Regulations apply to FSPs when holding investor money. The definition of a FSP includes (i) a person who is authorised under the IIA to carry out (a) the administration of collective investment schemes or fund accounting services or acting as a transfer agent or registration agent for such schemes, or (b) custodial operations involving the safekeeping and administration of investment instruments, (ii) UCITS ManCos, (iii) AIFMs and (iv) credit institutions which act as a depositary for investment funds or provides fund administration services to such funds. Accordingly, the Investor Money Regulations will apply to fund administrators and to depositaries/custodians authorised under the IIA, to UCITS ManCos, and AIFMs and certain credit institutions when they hold investor money.

When does a FSP hold investor money?

The Investor Money Regulations are issued pursuant to section 48 of the Central Bank (Supervision and Enforcement) Act 2013 and apply to FSPs when holding investor money.

The Investor Money Regulations provide that a FSP will be deemed to hold investor money where:

(i) It has been lodged into a collection account of a credit institution located and authorised in the EEA, a signatory state to the Basel Capital Convergence Agreement of July 1988 or in Jersey, Guernsey, the Isle of Man, Australia or New Zealand;
(ii) It is held in the name of the FSP or any nominee of the FSP; and
(iii) The FSP has the capacity to effect transactions on that collection account.

The term collection account is defined as meaning an "*account opened with a third party by a fund service provider to hold money to deliver from an investor to an investment fund or from an investment fund to an investor*". Accordingly, the term "collection account" is designed to capture an account operated by a FSP where monies are transferred from the investor to the FSP for onward transmission to the investment fund (the "**Fund**") and likewise where monies flow back from the Fund to the Collection Account for onward transmission to the underlying client. In other words the

Investor Money Regulations will apply to monies in a collection account where that account is held in the name of the FSP or any nominee of the FSP.

The Guidance on Investor Money Regulations for Fund Service Providers specifically provide that if the collection account is an asset of the Fund (i.e. where the Fund has opened a collection account in its name with a credit institution) the Investor Money Regulations will not apply.

Six Core Principles of the Investor Money Regulations

The Guidance on Investor Money Regulations for FSPs explicitly provides that the Investor Money Regulations are applicable to a FSP that is authorised in the State and is holding investor money irrespective of whether the investor money is in respect of Irish or non-Irish Funds.

The Investor Money Regulations are set out under six headings which the Central Bank regards as the six core investor money principles of an investor money regime:

1. Segregation

A FSP should physically hold, or arrange for the holding of investor money separate from the FSP's own assets and maintain accounting segregation between the FSP's own assets and investor money.

2. Designation and Registration

A FSP should ensure that investor money is clearly identified in its internal records and in the records of third parties. The investor money must be identifiable from the FSP's own assets.

Under the Investor Money Regulations a FSP should obtain an Investor Money Facilities Letter where it deposits investor monies with a third party. This letter will governs the relationship with the FSP and the third party.

3. Reconciliation

A FSP should keep accurate books and records to enable it at any time and without delay to provide an accurate record of investor money held by the FSP for each investor and the total held in the collection account. Regulation 5(1) of the Investor Money Regulations requires a FSP to reconcile collection accounts on a daily basis.

4. Daily Calculation

Each working day, a FSP should ensure that the aggregate balance of all collection accounts as at the close of business on the previous working day is equal to the amount it should be holding on behalf of investors.

5. Risk Management

A FSP should ensure that it applies systems and controls that are appropriate to identify risks in relation to investor money and should put in place mitigants to counteract these risks.

6. Client Asset Examination

A FSP should engage an external auditor to report at least on an annual basis on the FSP's safeguarding of investor money.

Conclusion

The Regulations will ensure that FSPs will have stronger systems and controls in place to protect the ownership rights of investors. In addition FSPs will have a process in place which, in the event of insolvency, will facilitate the expeditious return of investor money. It is hoped that the revised regime will prevent a repeat of cases such as MF Global, Lehman Brothers and Custom House Capital in Ireland where individual investors lost significant amounts of money.

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