Annex 1

Notification to the Commission under MiFID II (Ireland)

Amendments to the Client Asset Regulations

Investment firms are typically authorised in Ireland under the European Union (Markets in Financial Instruments) Regulations 2017 (the MiFID II Regulations). The MiFID II Regulations implement MiFID II into Irish law.

In January 2018, the second edition of the Investment Firms Regulations entered into force, which integrated the domestic Client Asset Regulations (CAR). The requirements in the CAR are imposed by the Central Bank of Ireland (the Central Bank) to complement and supplement the legislative requirements already set out in the MiFID II Regulations relating to the safeguarding of client assets.

1. Extension of the scope and application of the CAR

In order to extend the scope and application of the CAR to credit institutions, the Central Bank is proposing to amend the definition of "investment firm" as contained in Regulation 47(1) of the CAR, to include credit institutions authorised by the Central Bank as a credit institution and in respect of carrying out MiFID investment business only. In addition, the CAR expands on the duty of single officer, as set out in Regulation 71 of the CAR.

Justification for amendment to CAR and notification

In 2019, the Central Bank undertook an assessment of the current Irish client asset landscape. The assessment considered the population of investment firms and Irish authorised credit institutions holding client assets in connection with the provision of MiFID investment business to their clients and recent authorisation activity (including Brexit related applications). This assessment indicated significant client asset holdings reported across 6 credit institutions undertaking MiFID business that was in excess of client assets being held in investment firms.

While credit institutions holding client assets are subject to the MiFID II safeguarding of client asset rules by virtue of Article 1(3) of MiFID II, currently, the scope of the CAR does not extend to credit institutions holding client assets in the context of undertaking MiFID investment business.

The significant holdings and the complexity of activities observed in some credit institutions indicates that these entities should now be subject to the CAR (in addition to the MiFID II client asset rules) to ensure their clients are afforded the highest level of client asset protection. There should be a level playing field and uniformity of approach in the client asset regimes applied to credit institutions and investment firms holding client assets in Ireland.

The Central Bank is proposing that credit institutions should be brought within the scope and application of the CAR, to strengthen client asset protection and reduce the risk of client exposure, particularly in an insolvency scenario. This will ensure a level playing field for the regulation and supervision of all Irish regulated entities holding client assets. The scale of client assets held by Irish credit institutions, as well as the nature and complexity of their MiFID investment business, highlights the need to ensure the highest level of protection is afforded to clients.

Credit institutions being brought in scope will need to comply with all the requirements contained in the CAR (including those provisions previously notified to the Commission, as well as amendments now being notified) in the same way as investment firms, in addition to the MiFID II safeguarding of client asset rules to which they are already subject.

The Central Bank consulted on proposals to enhance the CAR in [date] and the proposal to extend the scope and application of the CAR to credit institutions undertaking MiFID investment business was broadly supported by respondents to the Consultation Paper[1]. Respondents noted that this would allow for a common framework for all entities who hold client assets and consistency of protection for clients.

It is the Central Banks opinion that extending the scope of the CAR to credit institutions is proportionate and will not restrict or otherwise affect the rights of investment firms or credit institutions under Articles 34 and 35 MiFID II as the scope of the CAR does not extend to investment firms or credit institutions authorised in other Member States.

The Central Bank is proposing to provide an 18 month transitional period from the date of publication of the third edition of the Central Bank (Investment Firms) Regulations for credit institutions undertaking MiFID investment business to comply with the CAR. This will provide sufficient time for credit institution to adapt their operational procedures and systems to comply with the requirements in the CAR.

It is considered that this amendment is a key change to the current scope of the CAR which was previously notified to the Commission and as such requires notification.

2. Principle of Client Disclosure and Consent – Prime Brokerage

The Central Bank is proposing to introduce new provisions requiring regular reporting by investment firms providing prime brokerage services to clients, to ensure that clients have access to up-to-date and accurate information concerning any assets the investment firm holds on their behalf. This is important

[1] https://www.centralbank.ie/docs/default-source/publications/consultation-papers/cp133/feedback-statement-cp133.pdf?sfvrsn=5

given the frequent movement of assets into and out of third party client asset accounts associated with prime brokerage services. The following are the proposed amendments:

(i) Prime Brokerage daily statement – Regulation 69

This provision will require investment firms holding client assets while providing prime brokerage services to make available to clients a statement, which must include, where relevant:

a. The total value of client financial instruments and the total amount of client funds held by the investment firm on behalf of a client;
b. The location of client financial instruments held by the investment firm on behalf of a client, including financial instruments deposited with a third party; and
c. A list of all the third parties where client funds held by the investment firm on behalf of a client are deposited.

(ii) Prime Brokerage Client Asset Annex – Regulation 70

This provision will require prime brokerage firms to summarise in the client asset annex the key provisions relating to the investment firm's prime brokerage business and associated risks of those provisions and how it may impact the assets held by the investment firm on behalf of the client. For example, the prime brokerage client asset annex may include, where relevant:

a. The contractual limit, if any, on the client financial instruments which an investment firm is permitted to use;
b. A statement of key risks to client financial instruments where they are used by the investment firm, in particular those risks that may arise in the event of an insolvency of the investment firm.

Justification for amendment to CAR and notification

The Central Bank has identified a significant increase in client asset holdings relating to wholesale activities, including prime brokerage activity. Due to the increase in this particular activity, the Central Bank has considered the approach to client disclosure and consent in the context of more complex business activities.

The CAR does not currently contain any express requirements in the context of investment firms providing prime brokerage services. Based on the Central Bank's supervisory experience, investment firms providing prime brokerage services may, with the client's consent, take ownership of a client's assets in the course of providing such services. For example, to manage any collateral movements with a counterparty to a transaction on behalf of a client.

Where an investment firm takes ownership of an asset, that asset is no longer subject to client asset protection. Given the nature of prime brokerage services and the extent of transactions, an asset may pass in and out of client asset protection on a frequent basis, this can have consequences for client asset protection, particularly in the event of insolvency. The Central Bank is therefore of the view that investment firms that hold client assets in the context of providing prime brokerage services should be required to provide regular reporting to clients.

The introduction of the prime brokerage statement of client assets seeks to provide a standardised approach to more frequent reporting to clients. This builds on the MiFID II requirements that client asset statements be sent to clients on at least a quarterly basis, as set out in Article 63[2] of the MiFID II Delegated Regulation. The proposed enhancements underlying the principle of client disclosure and consent set out the minimum in terms of the information that investment firms should disclose to clients.

It is the Central Banks opinion that the new provisions requiring regular reporting by investment firms providing prime brokerage services to clients is proportionate and will not restrict or otherwise affect the rights of investment firms under Articles 34 and 35 MiFID II as the scope of the CAR does not extend to investment firms or credit institutions authorised in other Member States.

It is considered necessary to notify the Commission of these amendments as there is no specific MiFID II requirement which deals specifically with a firm carrying out prime brokerage activities. These amendments to the CAR build on requirements in Article 63 of the MiFID II Delegated Regulation and Article 5 of Commission Delegated Directive (EU) 2017/593[3], which sets out requirements for firms regarding the use of client financial instruments.

[2] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02017R0565-20210822 – Article 63 Statements of client financial instruments or client funds

[3] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32017L0593 - supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients

Annex 2

For information to the Commission

Amendments to the CAR

1. Extension of the Scope and Application of the CAR

Use of the MiFID Banking Exemption

The Central Bank is proposing to amend Regulation 62 (1) to require that, where a credit institution holds money on behalf of a client in the context of MiFID investment business as a deposit in accordance with Paragraph 3(2) of Schedule 3 to the MiFID Regulations[4] (i.e. under the 'banking exemption'), the credit institution must, prior to undertaking MiFID investment business on behalf of a client, disclose in its terms of business:

a. That the money is held and protected by the credit institution as a deposit, and not as client funds; and
b. The circumstances (in respect of the MiFID investment business), if any, in which the credit institution will cease to hold money as a deposit, and will instead hold that money as client funds.

Justification for amendment to CAR

Under Paragraph 3(1) of Schedule 3 to the MiFID Regulations, investment firms are required, on receiving client funds, to promptly place those funds into one or more accounts opened with:

a. A Central Bank;
b. A credit institution authorised in accordance with the CRD;
c. A bank authorised in a third country; or
d. A qualifying money market fund.

This requirement does not apply to a credit institution authorised in accordance with the CRD in relation to deposits within the meaning of the CRD, held by that institution. This is sometimes referred as the 'banking exemption'.

[4] https://www.irishstatutebook.ie/eli/2017/si/375/made/en/pdf - Subparagraph (1) shall not apply to a credit institution authorised in accordance with Directive 2013/36/EU in relation to deposits within the meaning of those Regulations held by that institution.

The Central Bank is of the view that clients of credit institutions should have clarity as to how they can expect their money to be held, and the associated protections (under the relevant regulatory/legislative regime) that will be afforded to them when credit institutions undertake MiFID investment business on their behalf. Therefore, additional disclosure requirements may be warranted under the CAR.

It is considered that the amendment is clarification/guidance on the implementation of Article 4(1) of Level 2 Delegated Directive (EU) 2017/593 which sets out the manner in which client funds may be held by investment firms and credit institutions and as such does not require notification.

2. Principle of Reconciliation

Under the current requirements in Regulation 57, investment firms and credit institutions are required to ensure that their internal records of client financial instruments reconcile with the records of third parties where the financial instruments are held.

The Central Bank is proposing enhancements to the reconciliation requirements in Regulation 57 of the CAR. Under these proposed enhancements to the CAR, the Central Bank is seeking to clarify what checks are required for the following:

- Client financial instruments not deposited with a third party (Regulation 57(4))
- Physical financial instruments (57(5) and 57(6)).

It is also proposed to set out requirements:

- for associated record keeping (please add cross reference);
- for firms where discrepancies are identified in the process of carrying out these checks (57(9)(b));

Justification for amendment to CAR

Regulation 57 of the CAR sets out requirements for an investment firm to conduct regular reconciliations between its internal records and those external records of a third party with whom client assets are deposited. Under this regulation, the CAR sets out the approach to be taken in respect of a reconciliation difference, in terms of investigation, identification of cause and resolution.

The purpose of the reconciliation process is to ensure the completeness and accuracy of an investment firm's internal client asset records against those of a third party where the client assets are deposited.

The overarching objective of these proposed enhancements is to ensure that investment firms maintain complete and accurate records, thereby ensuring that the correct amount of client assets are being held and safeguarded by investment firms on behalf of their clients at all times.

It is considered that the amendment is clarification/guidance on the implementation of Article 2 of Commission Delegated Directive (EU) 2017/593, which sets out requirements for the safeguarding of client financial instruments and funds held by investment firms and credit institutions and as such does not require notification.

3. Principle of Calculation

Regulation 58 of the CAR sets out the requirements regarding the performance of the daily calculation of client funds. These provisions require investment firms to ensure, each working day, that the total amount of client funds held in third party client asset accounts at the close of business on the previous working day is equal to the total amount of client funds that an investment firm owes to its clients.

The Central Bank is proposing the following amendments to Regulation 58 to align the process for the remediation of client fund differences or discrepancies, identified through the performance of the daily calculation, with the process for remediating reconciliation differences as set out in Regulation 57(9).

- A requirement under Regulation 58(2) for investment firms and credit institutions to ensure that an internal check for client financial instruments is completed on at least a monthly basis;
- A requirement under Regulation 58(6) and (7) for treatment of shortfalls and excesses, including records of actions taken to address shortfalls and excesses in client financial instruments;
- A requirement under Regulation 58(8) to ensure records are maintained accurately and discrepancies resolves as soon as possible.

Justification for amendment to CAR

Currently the CAR does not expressly specify how client fund differences or discrepancies identified through the performance of the daily calculation should be remediated (other than how a shortfall or excess of client funds should be addressed under Regulation 58(4) and (5)). The proposed amendment would require investment firms to investigate, within one working day, the cause of any difference or discrepancy, identify the cause of the difference or discrepancy within five working days and resolve the difference or discrepancy as soon as practicable. The objective of this proposal is to ensure that the internal records an investment firm uses in the performance of the daily calculation are accurate.

It is considered that the amendment is clarification/guidance on the implementation of Article 2 of Commission Delegated Directive (EU) 2017/593 which sets out requirements for the safeguarding of client financial instruments and funds held by investment firms and credit institutions and as such does not require notification and as such does not require notification.

4. Principle of Client Disclosure and Consent

The Central Bank has identified a significant increase in client asset holdings relating to wholesale activities. Due to the increase in this particular activity, the Central Bank has considered the approach to client disclosure and consent in the context of more complex business activities. In addition, the Irish investment firm landscape has undergone significant restructuring and consolidation in recent years, partly due to take-overs and group-restructuring within the asset management sector

The Central Bank is proposing the following amendments to a number of areas where enhancements could be made to the CAR:

a. Investment firms' use of client financial instruments: The Central Bank is proposing to introduce new provisions in Regulation 65 and 66 to require investment firms to evidence that prior express consent has been received from a client, allowing the investment firm to enter into arrangements for securities financing or otherwise use that client's financial instruments;
b. Title Transfer Collateral Arrangements (TTCAs): The Central Bank is proposing to introduce new provisions in Regulation 67 and 68 regarding the establishment and termination of TTCAs.
c. Transfer of business: The Central Bank is proposing to introduce a new requirement in Regulation 76 (5), whereby an investment firm shall notify the Central Bank of its intention to effect a material transfer of client assets to or from another entity as part of a transfer of business. In addition, the Central Bank is proposing to amend Regulation 59(1)(d)(iv) of the CAR, to include a reference to an investment firms' arrangements relating to transfer of business in the firms' terms of business.

Justification for amendment to CAR

Investment firms entering into securities financing transactions or otherwise using a client's financial instrument must strive for the highest possible standards in relation to safeguarding client assets, in order to ensure risks to investor protection are effectively mitigated. In particular, the Central Bank expects investment firms to establish and maintain robust procedures and controls in order to comply with paragraph 4(5) of Schedule 3 to the MiFID Regulations and Article 5(4) of the Commission Delegated Directive (EU) 2017/593. These procedures should ensure that the borrower of client financial instruments provides appropriate collateral. Investment firms must monitor the continued appropriateness of such collateral and take the necessary steps to maintain the balance with the corresponding value of client financial instruments.

In considering new provisions regarding TTCAs in the CAR, the Central Bank reviewed the requirements set out in Article 16(8), (9) and (10) of MiFID II[5] and Regulation 23(1)(k)–(m) of the MiFID Regulations and Paragraph 5 of Schedule 3 to the MiFID Regulations. While these provisions contain factors that an investment firm should take into account to ensure any use of TTCAs is appropriate, the amendments build on the requirements and specify how the terms of a TTCA should be agreed with the client or how the termination of a TTCA should be managed by an investment firm.

In so far as a TTCA relates to client assets, the Central Bank's amendments will help reduce the potential for disputes, regarding the status of assets subject, or previously subject, to a TTCA, particularly in the event of an insolvency of an investment firm. For example, in the absence of a written agreement documenting the use by an investment firm of a TTCA, the ownership and status of assets may be unclear to an insolvency practitioner. This may create ambiguity as to whether certain assets are in the ownership of the investment firm or a client at the point of insolvency, and create potential delays in the return of client assets.

With regard to the transfer of business, the proposed amendments would require an investment firm to disclose to clients or potential clients, in the terms of business, the investment firm's arrangements relating to a transfer of business involving client assets.

These proposals seek to provide additional investor protection to clients by ensuring that the arrangements between investment firms and clients are clearly documented in writing.

It is considered that the amendment to requirements on investment firms' use of client financial instruments is clarification/guidance on the implementation of Article 5 of Commission Delegated Directive (EU) 2017/593 which sets out provisions for investment firms with regard to their use of client financial instruments. The amendments to the requirements of TTCAs is also considered to be clarification/guidance on the implementation of Article 6 of Commission Delegated Directive (EU) 2017/593 which set out provisions regarding the inappropriate use of title transfer collateral arrangements and as such do not require notification.

With regard to the transfer of business, the amendment clarifies the requirement for investment firms to notify the Central Bank of a material change in circumstances regarding the transfer of business relating to client assets versus those at the time of authorisation and as such does not require notification.

[5] https://www.esma.europa.eu/databases-library/interactive-single-rulebook/clone-mifid-ii/article-16-0

5. Principle of Risk Management- Client Assets Management Plan ("CAMP")

The Central Bank is proposing to amend Regulation 72 (4) to require investment firms to develop and maintain a Client Asset Applicability Matrix in their CAMP. An existing provision of the CAR Principle of Risk Management is the requirement for investment firms to develop and maintain a CAMP in order to document the risks to safeguarding client assets and how these risks are mitigated.

The purpose of the Client Asset Applicability Matrix is to ensure that the investment firm carries out a robust assessment of where client assets arise across its business lines and services.

The Central Bank is also proposing to enhance Regulation 72(4)(k) and Regulation 74 of the CAR to require investment firms to include details in the CAMP of where an investment firm outsources to another party any activity relating to the safeguarding of client assets, and the manner in which an investment firm will exercise oversight over the outsourced activity.

Justification for amendment to CAR

The Central Bank expects investment firms holding client assets to have developed and embedded appropriate risk management processes and systems to ensure the identification and management of risks relevant to their business models that could impact their client asset holdings and arrangements. While the risk management arrangements for client assets are distinct (i.e. derived from the CAR and MiFID II), they may be incorporated as part of an investment firm's overall risk management and governance framework.

The purpose of the Client Asset Applicability Matrix is to provide an independent reader with a succinct overview of where and how client assets arise within an investment firm, so that it is readily understood where client assets arise across the product offering within each business line.

The Client Asset Applicability Matrix should set out a clear rationale as to why a product or service is in or out of scope of the applicable client asset provisions. For example, the Central Bank would expect a Client Asset Applicability Matrix for investment firms entering into TTCAs with clients to indicate where full title transfer of client assets may arise, and provide this as a rationale for circumstances under which client assets may be outside of client asset protection.

In assessing whether enhancements should be made to the current CAMP requirements, the Central Bank took into account good practices and issues identified through direct client asset supervision and authorisation work.

The CAMP should be reflective of an investment firm's evolving business model and emerging risks and effectively embed in an investment firm's overall risk management framework. This is especially important in the current environment, as new risks relating to client assets emerge, for example due to the global COVID-19 pandemic, Brexit and the evolving client asset landscape.

The CAMP is an existing requirement in the CAR and it is considered that this amendment is clarification/guidance on the implementation of Article 2 of Commission Delegated Directive (EU) 2017/593 requiring firms to introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client assets and as such does not require notification.