Asset Management & Investment Funds Update

March 2022

Central Bank 2022 Supervisory Priorities

On 8 February 2022, the Central Bank published the second edition of its annual Securities Markets Risk Outlook Report outlining the key risks and areas of focus for the Central Bank in 2022 (the **Risk Outlook Report**). The Risk Outlook Report highlights eight key risk areas in focus for 2022, as detailed below, and references several previously announced, planned supervisory assessments including the ESMA CSA on Valuations, follow-up from the CP86 review and the CSA on UCITS costs and fees and a proposed review of the PRISM impact rating model for funds and supervisory engagement. The Central Bank expects firms to review the risks and supervisory priorities outlined in the Risk Outlook Report and address, as appropriate, for example through the alignment of risk assessment and mitigation programmes and compliance plans with regulatory expectations (summarised below).

1. **MISCONDUCT RISK**: including risks arising from issues identified in the recent MAR thematic review findings, inconsistent Suspicious Transaction and Order Reports (STORs), deficiencies in firms' trade surveillance systems, inadequate maintenance of insider lists and a lack of informative management information (MI) reporting.

The Central Bank expects firms to address misconduct risks including by reviewing STOR submission obligations, trade surveillance systems, alert thresholds and parameters, insider list obligations and internal controls and systems overseeing trading and adherence to trade mandates.

2. **SUSTAINABLE FINANCE**: including greenwashing ("products marketed with sustainable credentials but in reality, do not meet such criteria") risk arising from inadequate or incorrect disclosures misleading investors into buying products that do not meet their sustainable expectations.

The Central Bank expects firms to address greenwashing risks by devoting sufficient resources to complying with SFDR Levels 1 and 2 and ensuring investors are fully informed of a product's sustainability characteristics in a manner that is measurable and quantifiable, using transparent parameters.

3. **GOVERNANCE**: including risks arising from inadequate governance structures, Board oversight of delegates and third-party intermediaries and delegate due diligence.

The Central Bank expects firms to address governance risks by

- thoroughly scrutinising proposed delegate arrangements including legal agreements, regulated status and stated expertise and prior relationships; adopting clear, documented governance structures including escalation chains; and developing frameworks for the management of risks associated with outsourcing in line with the Cross-Industry Guidance on Outsourcing published in December 2021
- having appropriate levels of resources and appointing local designated persons with the relevant skills and appropriate seniority for their managerial function
- in the context of third-party fund management company appointments by self-managed funds, performing adequate due diligence and ensuring operational capacity at the level of the management company
- where appointing investment advisors, by ensuring that such delegates do not have undue influence or control and that investment advisors perform non-discretionary roles adjunct to that of the investment manager. In this regard, the Central Bank highlights the regulatory oversight risks arising from structures whereby interactions, reporting and the resolution of issues are exclusively with the investment advisor as opposed to the investment manager or fund management company.

4. **CONFLICTS OF INTEREST**: including risks arising from firms' failure to consider conflicts of interest in their day-to-day operations and ensure they are not financially benefiting at the expense of underlying investors, clients or market counterparties or have a financial incentive to favour one client over another.

   In the case of investment funds, a key focus is on the risks arising from connected party transactions (**CPTs**) and identified shortcomings on the part of depositaries and designated persons to apply the appropriate level of rigour in complying with the regulatory rules for CPTs. Cases have been identified of relevant parties not being notified of CPTs and entities failing to identify themselves as connected parties e.g., as a result of side letter arrangements entered into between entities and investments managers/advisors for the purchase or financing of assets following which the valuation of the asset may be called into question.

The Central Bank expects firms to address conflicts of interest risks including by adopting robust CPT processes and procedures and engaging rigorously with depositaries and designated persons when contemplating a CPT to ensure the protection of investors' interests and compliance with applicable regulatory rules.

5. **FINANCIAL INNOVATION**: including the risks to retail investors arising from the increased use of social media to recommend/disseminate online advice and facilitate retail trading and the proliferation of new products as a result of the low interest rate environment. Special purpose acquisition companies (SPACs) and crypto assets are both cited as products of concern and the Central Bank highlights its current position, as outlined recently in new AIFMD and UCITS Q&As, that such assets are not currently suitable for retail investors.

   The influence of third parties, specifically that of index providers on the design of new products and platforms/distributors on fund dealing and settlement times, are of concern to the Central Bank.

Fund managers are cautioned to retain governance and oversight of product design and reminded of the importance of understanding the index calculation methodology and performing appropriate levels of due diligence on index providers. Adapting dealing and settlement procedures solely to access specific platforms/distributors, where such procedures are inconsistent with the characteristics and profile of the relevant fund, is deemed inappropriate by the Central Bank.

6. **DATA**: including regulatory oversight risks arising from data quality issues in firms' regulatory returns. In 2022, the Central Bank will prioritise engagement to ensure the receipt of complete, accurate and timely data which may take the form of supervisory action where data issues are identified.

The Central Bank expects firms to prioritise data quality and, where data submission is outsourced or automated technology is used, ensure a high level of delegate oversight and testing of systems.

7. **CYBER SECURITY**: including financial stability and operational resilience risks arising from cyberattacks.

The Central Bank expects firms to be operationally resilient including through the adoption of adequate ICT risk management policies and procedures, disaster recovery plans and ensuring the education of staff on cybersecurity and the reliability, security and scalability of automated systems.

8. **MARKET DYNAMICS**: including liquidity risks arising from the low interest rate environment and leverage-related risks from the use of instruments such as CFDs and TRS.

The Central Bank expects firms to address market risks by having an appropriate risk management framework in place and regularly stress testing liquidity and leverage positions while having regard to the ESMA and Central Bank findings and recommendations on liquidity risks in funds.

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