

Irish Funds Response to Consultation Paper 156
Central Bank approach to innovation engagement in
financial services

February 2024



Introduction

The Irish Funds Industry Association (Irish Funds) is the representative body for the international investment funds industry in Ireland. Our members include fund managers (52%), fund administrators, transfer agents, depositaries, (21%) professional advisory firms (18%), and other specialist firms (8%) involved in the international fund services industry in Ireland. By enabling global investment managers to deploy capital around the world for the benefit of internationally based investors, we support saving and investing across economies. Ireland is a leading location in Europe and globally for the domiciling and administration of investment funds. The funds industry employs over 17,000 professionals across every county in Ireland, with over 34,000 of a total employment impact right across the country¹ and provide services to over 8,800 Irish regulated investment funds with assets of just under EUR 3.9 trillion².

Ireland's funds and asset management industry has seen material development and gained a global reputation for excellence since its inception in the 1980s. It exists in a highly competitive international environment where the regulatory, policy and political landscape is agile and in a constant state of flux.

The industry also sits at the intersection of two great global intergenerational challenges, rapidly changing demographics, and the transition to a sustainable climate. Both will require strong responses which can be bolstered by Ireland's expertise and knowledge. Innovation will be core to this if we are to meet the needs of the next generation of investors, with solutions powered by next generation talent and technology.

Irish Funds and our members recognise the benefits of creating clusters and ecosystems to support innovation across the country. Consequently, we appreciate the engagement and commitment shown by the Central Bank of Ireland (Central Bank) in improving the current Innovation Hub and endorse the proposal to implement an Innovation Sandbox Programme as detailed in Consultation Paper 156 (The Paper). Irish Funds see this initiative as a welcome addition to the overall innovation eco-system, allowing for better two-way learning to occur; the Central Bank learning from industry and Industry learning from the unique sectoral and cross-sectoral insights that the Central Bank should gain through this initiative. This initiative should further encourage and foster collaboration, support building new capabilities, and ultimately offer novel solutions to satisfy end customers' requirements, all whilst ensuring the highest customer protection codes are maintained. We warmly welcome this commitment, recognizing that fostering additional innovation is crucial for a significant influx of new products and choices into the Irish market in addition to building operational efficiencies and maintaining Ireland competitiveness on a global stage.

In terms of the Innovation Hub enhancements, the Paper highlights the need to be "future focused by adopting a forward-looking approach, so that we can anticipate and respond proactively." Irish Funds and our members acknowledge this as a common goal which is demonstrated by our recent Capability Review, which was presented to the Central Bank, and also our vision; Ireland will be the premier location to enable and support global investing through its reputation for trust, capability, and innovation³. Irish Funds would note that based on our review of the Innovation hub 2022 update⁴ there is relatively low engagement with our

¹ Source: Economic Impact of the Funds & Asset Management Industry on the Irish Economy, Indecon, 2021

² Source: Central Bank of Ireland, November 2023

³ Our Vision & Values | Irish Funds Industry Association | International Investments

⁴ Innovation Hub 2022 Update (centralbank.ie)

members and therefore potential for significant progress to be made in levels of engagement. To maximise this opportunity, our members would benefit from increased clarity, and it would be helpful to define the categories and type of innovation for appropriate engagement. A considerable proportion of innovation in the industry supports sustaining, maintaining, and incrementing the ecosystem such as adopting regulatory change and improving existing products and services. Increased clarity on how, when and where our members can engage would be beneficial.

Question 1. What is your feedback on the enhancements underway with the Innovation Hub? Are there other areas that should be developed?

As noted above, Irish Funds is supportive of the proposed enhancements of to the Innovation Hub and actively engages with the CBI as an industry representative in the Financial Innovation sub-group of the Financial Industry Forum. The ongoing enhancements encourage a structured process and an enhanced outreach program which would benefit our industry. To optimise engagement with our members, the CBI should consider further defining and clarifying the service offerings and specify the types of organisations these services apply to. Building a comprehensive product/service benefits matrix would aid in managing expectations of constituent members. Additionally, transparency and notification around the outreach and engagement program are crucial for maximising engagement. As our members often interact with new FinTech, a well-functioning Innovation Hub would contribute to the overall ecosystem, fostering a culture of product development. We envision the Innovation Hub to evolve into a key resource for industry insights, providing valuable learning experiences at both individual and sector levels. The acid test of its success will be somewhat measured by the volume and type of traffic through the hub, so would ask the Central Bank to consider building website analytics into requirements to allow for greater transparency around usage of the website. This data can be added to the annual update that is currently performed.

On creating an enhanced structure and defining how and where to engage, our members will further understand how the Innovation Hub will act as a learning resource for both the CBI and the innovators and stakeholders in the common goal of a future-focused and innovative ecosystem.

We note the paper refers to launching “a Digital Centre for knowledge sharing of dedicated content with all stakeholders in the innovation ecosystem which will contain existing materials but over time, we will develop dedicated content including innovation-related FAQs, case studies, best practices and webinars”.

It would be helpful to understand whether the innovation-related FAQs will create additional guidance for each regulatory regime (UCITS, AIFMs etc) or will it draw together relevant sections of existing Q&As noting the potential risk of adding additional layers of regulatory complexity. If new regulatory guidance will be created, it will be important that it is appropriately adapted for each regulatory regime. Additional clarity would also be helpful to understand whether the hub will engage at an individual sector level i.e. fund industry versus banking, insurance etc and whether there would be networking and knowledge sharing opportunities between members of individual sectors to further deepen the innovation ecosystem.

To summarise, we would suggest that the Central Bank consider the following as part of the development of the Innovation Hub:

- define the context of innovation to include the scope and type of innovation themes relevant to the Funds industry that the bank is seeking to focus so that our members can better understand how and when to engage with the hub.
- facilitate better knowledge sharing, networking, and insights between industry peers.

- facilitate insights from the Central Bank engagement with referenced international peers, institutions, and forums.
- ensure there are dedicated individuals with specific knowledge on relevant regimes, for example a person designated to deal with sector specific innovation matters.
- ensure that guidance is aligned with existing regulatory guidance for relevant regulatory regimes.
- define and make public, key performance indicators for the hub e.g. usage number, move to regulation, user feedback.

Question 2: What is your feedback on the proposal to establish an Innovation Sandbox Programme? Will the proposal support the Central Bank in meeting our overall objectives, including the needs of consumers and the wider economy?

Irish Funds welcomes the establishment of an Innovation Sandbox Programme as a positive move and one which is in keeping with Ireland’s role as an international leader in financial services. We believe it will be a useful tool for the Central Bank to gain market insight knowledge from early adopters, start-ups and FinTechs. Initially, we do not envision significant participation from Irish Funds members as our members are well-established regulated entities with embedded products, regulatory and policy teams and as such would likely not require the sandbox testing facility. That said, we believe the sandbox will be seen as additive for our members in total, for example, start-ups require access to key stakeholder groups, including industry bodies such as Irish Funds, enterprise organisations such as the IDA and Enterprise Ireland and regulatory bodies namely the Central Bank, to build out their knowledge and product offerings. Additionally, as the Programme grows and develops there may be further opportunity for engagement between our members and the sandbox. Our understanding is that the Innovation Sandbox Programme is open to regulated and unregulated entities. It would be useful if its remit were further defined to apply to firms that intend to operate new business models, noting that sometimes innovation may come from service and business model innovations which require sandboxing, and not just technology.

Question 3: What is your feedback on the operating model of the Innovation Sandbox Programme?

It would be helpful for the CBI to provide more detail on how the sandbox will operate. In particular, we note that the following, “The Innovation Sandbox programme, as it proposed, will not provide any derogation or waivers from regulation but we will seek to apply the applicable regulatory frameworks proportionally with an outcome focused, risk-based approach. There will also not be any digital testing of products with consumers in the proposed programme. Nor will the Sandbox programme provide an endorsement of any innovative product or service, but rather support innovators in understanding the regulatory context.”

We note that the sandbox “will not provide any derogation or waivers from regulation” and “will not permit any digital testing with consumers.” In contrast, the FCA has a regulatory sandbox⁵ and a digital sandbox⁶ each of which has clear objectives “to test products and services in a controlled environment” and “a reduced time to market at potentially lower cost” while our understanding is that this will not be available to users of the Central Bank’s Innovation Sandbox Programme.

We acknowledge and agree as outlined in the Paper that a key benefit of an Innovation hub and Innovation Sandbox is the engagement between the Central Bank and participants to facilitate two-way learning. However, we also highlight the requirement for an appropriate level

⁵ [Regulatory Sandbox | FCA - https://www.fca.org.uk/firms/innovation/regulatory-sandbox](https://www.fca.org.uk/firms/innovation/regulatory-sandbox)

⁶ [Digital Sandbox | FCA - https://www.fca.org.uk/firms/innovation/digital-sandbox](https://www.fca.org.uk/firms/innovation/digital-sandbox)

of testing which is crucial. Therefore, additional clarity and guidelines would be helpful in terms of the testing parameters in the framework and specifically the level of testing the sandbox can support.

Additionally, if a regulated firm wishes to provide an innovative product, has taken legal advice that that product is within the scope of its authorisation, and has the necessary control, procedures and systems in place to provide the product, engagement with the sandbox may (i) add additional time for the product to get to market, and (ii) result in the Central Bank imposing conditions or amending the nature of the product which would not otherwise had been the case if the firm had not engaged with the regulator. How will the Central Bank ensure that the sandbox provides a real and tangible benefit to participating firms which will be key in ensuring participation.

To summarise, our membership would like feedback and further clarity from the Central Bank on the following points:

- Time to market efficiencies – Is there a benefit of the sandbox for firms which are applying for authorisation? For example, will firms be required to engage with the sandbox where their product meets certain criteria? If firms do engage with the sandbox will this add additional time to the authorisation process? Authorisation teams typically require walkthroughs of products/systems already as part of authorisation applications – accordingly, what would the additional role of the sandbox be where a participant firm is also applying for authorisation?
- Regulatory status - Will unregulated firms with unregulated products which tangentially relate to financial services (such as software for updating fund documents) be considered or must there always be a regulated element to the product/firm?
- Testing framework guidelines and how the operation will run - Will the Central Bank issue further guidelines and clarity on how the sandbox programme will run? Albeit that our members are well-established, they often meet with start-ups/innovators on a continual basis and as such our members would welcome the opportunity to direct some of these innovators to the sandbox.
- We note that participation in the sandbox will not result in an endorsement by the Central Bank. While we appreciate that this an endorsement of this nature would not be appropriate, will there be any “qualification” or other language which participants can use as part of their brand marketing where they do participate. Again, this relates to what the potential benefit is for a sandbox participant.

With regard to the proposed thematic approach, we believe this is a sensible approach. We would welcome guidance and clarity from the Central Bank regarding the call to action for instance:

- how are the unique challenges and issues to be derived from the key themes that are identified.
- how do you plan to balance the requirements of unique operator level, sector level (funds industry) and cross-sectoral (financial services) challenges.
- In any cohort, how many themes can be supported simultaneously.

We note under “call for proposals” that the Central Bank will look for third party operators to partner with the Central Bank to facilitate the delivery of the sandbox programme.

We would like further clarity as to how an interaction with a third party as well as the Central Bank would operate in practice. There may be significant lead times in approving and setting up a third-party permission in place to operate in this capacity. What protections will be in

place to ensure that no conflict of interest exist between the third party and the participant firm and to ensure that third party cannot influence the Central Bank's assessment of the participant firm.

Question 4: Are there specific themes or areas of innovation that the Central Bank Innovation Sandbox Programme should address?

The key opportunity for the funds sector in the medium to long term is to leverage digital technologies and innovation to enhance customer experience, operational efficiency, risk management and regulatory compliance and to build strategic partnerships and collaborations with other industry players, such as fintech firms, banks, insurers, and platforms, to create synergies and value-added services.

Technological change and innovation will influence the funds sector's future development in the following ways:

- ESG and Sustainable Finance – ensuring Ireland is a leading funds domicile for ESG/ Sustainable related products.
- Access to Private Markets
 - while Ireland has been very successful in enabling, largely European savers to invest through the highly regulated undertakings for collective investment in transferable securities (“UCITS”) funds, we see greater potential for future growth in what is typically referred to as Private Funds, in particular in private equity, real asset and infrastructure funds.
- Fund Tokenisation and access to Digital Assets
 - An opportunity to establish the infrastructure for fund tokenisation in the Irish Funds market and we would welcome regulatory engagement in order to help develop an appropriate framework that operates within the existing regulations as well as exploring potential future stages of development.
 - Enable Irish funds to leverage Distributed Ledger Technology (DLT).
 - Central Bank Digital Currencies (CBDCs) are being explored by governments and tokenised assets offer investors greater access to a wider pool of assets and returns.
- Digitalisation of the Fund and Investment Operations
 - Generative AI and Cognitive computing/ Machine Learning has the potential to transform and enhance the customer experience for the Funds Services and Asset Management industry. With the ability of AI to process vast amounts of data at unparalleled speeds, there is the ability for AI to drive operational efficiency and lead to reduced cost savings in terms of both time and resources.
 - The creation of new business models, delivery mechanisms and revenue streams arising from the digitisation of the funds and asset management sector make it imperative that its constituent organisations embrace new roles and professions, reorganise current jobs, and prove to be innovative in their management systems.
 - Significant opportunities in areas such as;
 - Cybersecurity and data protection
 - AML and Fraud
 - Fund Distribution
 - Greater automation in Fund NAV Valuation
 - Transformative change in relation to issuance, post trade processing, regulatory and jurisdictional considerations, and payments.
 - RegTech - Solutions to help organisations navigate the complex regulatory environment by leveraging technology to automate, monitor, and improve compliance processes. The benefits include increased

efficiency, cost savings, adaptability to regulatory changes, and enhanced risk management.

- Talent, Financial Literacy, and the Democratisation of Investing – the future of saving - allowing for greater participating in financial markets and investing for the purposes of saving for one's future.
 - Building innovative solutions for Investor education and Financial Literacy

As a general comment, we believe the programme will need to be forward looking, flexible and adaptable – given the ever changing and fast developing space in which it will operate, and that proper implementation would be in the best interests of consumers and the wider economy.

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