



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

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Feedback Statement on CP86 – Consultation on Fund Management Company Effectiveness – Managerial Functions, Operational Issues and Procedural Matters

Third consultation

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Introduction

1. On 2 June 2016 the Central Bank of Ireland (the “Central Bank”) published its third and final Consultation Paper on CP86 *Consultation on Fund Management Company Effectiveness – Managerial Functions, Operational Issues and Procedural Matters* (“**Third Consultation**”). The closing date for comments was 25 August 2016 and 54 responses were received.
2. In its Third Consultation, the Central Bank published draft guidance on managerial functions, operational issues and procedural matters. This guidance is designed to ensure compliance by fund management companies with their regulatory obligations and to allow the Central Bank to carry out its engagement model without undue constraint.
3. In addition to the draft guidance published, the Central Bank also proposed two new rules on recordkeeping and location of directors and Designated Persons with the aim of assisting the Central Bank’s effective supervision of fund management companies.
4. Respondents were asked to provide their observations on the proposed initiatives and to comment generally on the approach being taken by the Central Bank. This feedback statement briefly summarises the responses received along with the Central Bank’s comments and decisions.

General feedback on CP86 – third consultation

1. The focus of a significant number of the responses to the Third Consultation was on the proposed introduction of an effective supervision requirement in the form of a location rule. These responses outlined concerns focusing predominantly on the overall impact of this rule on the Irish funds industry and whether it was necessary to ensure effective supervision of fund management companies by the Central Bank. A summary of the main points raised in this regard are set out in the section of this feedback statement on Question 3.
2. Regarding the other feedback received, respondents were broadly supportive of the draft guidance on *Managerial Functions*, *Operational Issues* and *Procedural Matters*. Many respondents welcomed the issuance of the *Managerial Functions* and *Operational Issues* draft guidance. It was noted that, along with the first three chapters of guidance issued on *Organisational Effectiveness*, *Directors' Time Commitments* and *Designated Persons*, it would achieve the Central Bank's objective of enhancing the effectiveness of fund management companies to improve investor protection. One respondent noted that the Central Bank's issuance of guidance in the form of principles, designed to assist relevant companies by providing an overview of relevant good practices, avoids the imposition of a "one-size-fits all" approach to fund management company effectiveness.
3. Certain respondents argued against the detailed nature of the *Managerial Functions* guidance on the basis that compliance would represent an increase in costs for fund management companies and therefore impact negatively on fund investor returns. One respondent cautioned against the detailed nature of some of the matters set out in the draft *Managerial Functions* guidance and believed that setting out such detailed guidance may lead to a "check-the-box" approach or the potential for fund management companies to interpret the guidance as imposing a particular compliance model. The mapping of regulatory obligations under the AIFMD and UCITS Directive was welcomed with only a limited number of respondents citing the guidance as excessively detailed.
4. Several respondents commented that paragraph 9 (all references to paragraphs are to the numbering used in the Third Consultation) of the *Managerial Functions* draft guidance, on co-location of Designated Persons, should be removed. Many of the same reasons set out in response to Question 3 were also used to justify the deletion of the co-location guidance.
5. A number of respondents commented on the role of the Designated Person(s).

In summary, the main points raised were:

- a. respondents disagreed with the need for a separate letter of appointment for a director acting as a Designated Person;
- b. the ability for a director to perform the role of Designated Person should be specifically referenced in the guidance;
- c. whether the simultaneous performance by an individual of the role of director and that of Designated Person could result in a conflict of interest for the individual in light of paragraph 7 was raised;
- d. in paragraph 13, the assumption in the first line that a Designated Person must always occupy a more senior role than the delegate being overseen is inappropriate and should be removed;
- e. a number of respondents suggested that the final line in paragraph 15, regarding an investment manager contracting to carry out its tasks in accordance with the AIFM Regulations, be amended as it may present contractual difficulties, in particular with respect to non-EU investment managers;
- f. a number of respondents disagreed with the reference in paragraph 40 to reporting

- on an exceptions-only basis being insufficient. They noted that reporting on all regulatory obligations would be overly burdensome;
- g. certain respondents regarded the guidance in paragraphs 41 and 42, ‘Meetings between Designated Persons and delegates’ inappropriate for certain models, in particular those which hold board meetings on a bi-monthly or more frequent basis;
 - h. in reference to the sub-section ‘Matters requiring design’ on page 10 of the draft guidance, it was argued that the board of directors and not the Designated Persons should design, create, structure and ensure adherence to the fund management company’s policies and procedures; and
 - i. one respondent commented that it would be useful for the *Managerial Functions* guidance to include provision for the establishment of committees of Designated Persons and the appointment of alternate Designated Persons.
6. One respondent commented on bullet point 3 of paragraph 8 of the draft *Operational Issues* guidance stating that it was unreasonable to expect systems to ensure no manipulation of documentation can occur. The respondent commented that an alternative was to include an obligation for systems to be in place which allow for manipulations to be recorded.
7. A number of respondents commented that the term ‘immediately’ in the *Retrievability of records rule* should be replaced for example with ‘reasonable time’ or ‘without undue delay’. Respondents argued that this term implied no time delay between a request for documentation and the production of same. One respondent stated that it is not practical to require the immediate production of documentation where documentation may be held by a fund management company’s delegate and suggested that account be taken of the fact that records may be held offsite or in a disaggregated raw form, requiring processing and formatting in order to produce an appropriate format, context and focus to respond to a request.
8. The requirement at paragraph 6 of the *Operational Issues* guidance for the record retention policy of a fund management company to be audited was queried as suggesting something more significant than a review of the policy for sufficiency from time to time in line with general organisation effectiveness principles. In which case, this would be considered an undue burden on the fund management company.
9. Respondents were principally in favour of the maintenance of a monitored email address for the purpose of complying with any Central Bank requests for information pursuant to relevant statutory provisions. One respondent commented that the monitoring of an email address is overly burdensome.

Central Bank:

The Central Bank has the following observations on the feedback received (paragraph numbers reference the general feedback above):

3. The UCITS and AIFMD regimes place a substantial regulatory burden on fund management companies. Those obligations are in addition to rules imposed under other legislation such as the Companies Act 2014, market abuse law, EMIR, etc. It is important that fund management companies know and understand their regulatory obligations, comply with them and are able to demonstrate compliance.

To assist in this process, the Central Bank has prepared the *Managerial Functions* guidance including Annexes I and II which list obligations imposed by Level 1 and 2 of the AIFMD and UCITS Directive. This guidance does not constitute additional obligations on fund management companies but rather provides fund management companies with the Central Bank's expectations of how they may ensure compliance with the UCITS and AIFMD regimes and additional obligations under other applicable legislation.

4. In light of the refinement of the effective supervision requirement (as set out below in the section on question 3 of the Third Consultation), the Central Bank has decided to delete paragraph 9 of the *Managerial Functions* guidance on co-location of Designated Persons.

5.

- a. The role of director and Designated Person are quite distinct and separate. As evidence of this distinction, the Central Bank has concluded that it is appropriate that where a director is appointed as a Designated Person, he/she should receive two separate letters of appointment – one for the role of director and one for the role of Designated Person. The Central Bank will look to receive a copy of each Designated Person's letter of appointment to be submitted as part of the fund management company authorisation process.
- b. The draft *Managerial Functions* guidance does not prohibit the appointment of an individual as both director and Designated Person and there are already references to requirements in the event of such dual appointment. For clarity, reference to directors has been included in paragraph 8 of the guidance.
- c. The Central Bank does not consider the appointment of an individual to the role of director and as Designated Person will automatically give rise to a conflict of interest. To the extent that such appointment is considered to represent a conflict of interest or subsequently gives rise to a conflict of interest such conflict should be managed in accordance with the applicable regulatory obligations of the fund management company.
- d. The *Managerial Functions* guidance has been amended at paragraph 13 to clarify the Central Bank's expectations as regards the seniority of Designated Persons. The Central Bank considers that appointees must be sufficiently senior in their roles to meet these expectations. An example of what may be an inappropriate appointee, in the context of the role of the Designated Person vis-à-vis the supervised delegates of the fund management company, has been included in the guidance.
- e. The *Managerial Functions* guidance has been amended at paragraph 15 to better reflect the intention of the Central Bank in this context which is to ensure that the fund management company should not assume that its delegate, because it is authorised, will discharge the regulatory obligations placed on the fund management company. This should be avoided by the fund management company and its delegate agreeing and recording in writing, using whatever wording is considered appropriate, the fund management company obligations which the delegate is required to discharge.
- f. The Central Bank is of the view that exceptions-only reporting does not demonstrate a sufficient level of oversight and engagement by a Designated Person.

Central Bank:

- g. Regular meetings between Designated Persons and delegates should be held to allow Designated Persons properly perform their role. Paragraphs 41 and 42 of the *Managerial Functions* guidance set out examples of the type and frequency of such meetings. However, these may differ depending on the nature, scale and complexity of the fund management company.
- h. Amendments have been made to the sub-section entitled ‘Matters requiring design’ to clarify the Central Bank’s expectations regarding the role of the Designated Persons and that of the board of directors in this area.
- i. While the *Managerial Functions* guidance does not preclude the establishment of committees of Designated Persons, it is not proposed to be prescriptive in this regard as it is a matter for the board to determine the resourcing of the fund management company to meet its regulatory obligations. Notwithstanding the establishment of any committees, the Central Bank obliges a Designated Person to be responsible for the performance of his/her managerial function. Regarding alternate Designated Persons, Designated Person is classified as a Pre-Approved Control Function in accordance with the Central Bank’s Fitness and Probity regime. There is no ‘alternate Designated Person’ role under that regime. Stakeholders should refer to the Fitness & Probity statutory requirements, standards and regulatory guidance in relation to the appointment of a ‘temporary officer’.

6. Having regard to the comment received, the Central Bank has clarified its expectations as regards its minimum requirements for record retention, archiving and retrievability of the relevant documents of a fund management company. While it is acknowledged that systems cannot guarantee the prevention of document manipulation, the Central Bank places significant importance on proper and adequate recordkeeping and procedures and processes should be in place which seek to avoid manipulation in so far as is possible.

7. The Central Bank considers that a fund management company, notwithstanding the delegation of activities or the manner in which documentation is stored, must be able to produce records on request from the Central Bank. This is essential to the Central Bank’s ability to effectively supervise fund management companies. By way of assistance and having regard to the responses received, clarification of what the Central Bank considers the term ‘immediate’ to mean in terms of actual timeframes has been included in the final *Operational Issues* guidance. A fund management company should store its documents in a manner that ensures it can retrieve them within the timelines outlined by the Central Bank.

8. The Central Bank’s expectation that fund management companies subject their record retention policies to an audit is a more significant task than a review of the policy as provided for in bullet point (i) of paragraph 6. The annual review which should be undertaken of the record retention policy will be carried out by the directors whereas an onus to audit the policy provides for the expectation of the Central Bank that this policy be independently reviewed. This reflects the level of importance which the Central Bank places on a fund management company’s recordkeeping. The Central Bank has clarified that such an audit may be undertaken by an external party or internally, for example by the internal audit function of the fund management company.

Final rule on Retrievability of records

A management company shall keep all of its records in a way that makes them immediately retrievable in or from the State.

Central Bank:

9. In light of the almost exclusively positive feedback received, the Central Bank is proceeding to publication of the guidance setting out that fund management companies should maintain a dedicated and monitored email address.

In addition to any amendments to the draft guidance as highlighted in this feedback statement, the Central Bank has made a number of clarifications to the guidance reflecting drafting comments received from respondents and to correct identified typographical errors.

Feedback on questions posed in CP86

Question 1: The detailed nature of the *Managerial Functions* guidance serves to set out the Central Bank's expectations regarding how Designated Persons should carry out their roles. It also illustrates the full breadth of responsibility under the Designated Person's remit. Are there further practices that need to be considered for inclusion in this guidance to assist Designated Person in carrying out their roles? If so, please detail.

- The significant majority of the respondents considered no additional practices warranted inclusion to assist Designated Persons in carrying out their roles.
- One respondent commented that it would be preferable to publish a series of examples of good and poorer practices encountered by the Central Bank.

Central Bank:

The Central Bank is proceeding to publication of the *Managerial Functions* guidance largely in the manner proposed in CP86, but taking account of some points arising from the consultation as highlighted in this feedback statement.

Question 2: In the first consultation on CP86 and the feedback statement to the first consultation, the Central Bank advised that the organisational effectiveness role included the previous managerial functions of conflicts of interest, internal audit and supervision of delegates (to the extent that this is not performed by the designated persons). The principal purpose of the organisational effectiveness role is to have someone constantly monitoring how well a fund management company is organised and resourced. By also allocating internal audit to the organisational effectiveness role, there may be a risk that it makes it more difficult for the individual performing the organisational effectiveness role to carry out their main purpose. Stakeholders are asked to consider whether responsibility for oversight of internal audit be better placed with the Operational Risk managerial function.

1. A limited number of respondents supported placing responsibility for oversight of internal audit with the Operational Risk managerial function. Some who supported the proposal noted that the function fits more naturally with the Operational Risk function and that there are significant overlaps between the Operational Risk function and the role of oversight of internal audit.
2. A further limited number of respondents considered the responsibility for oversight of internal audit could sit within the Organisational Effectiveness role noting that the responsibility extends beyond the Operational Risk managerial function with one respondent citing the importance of Operational Risk having visibility from a risk perspective.
3. While not specifically in favour of the proposal, some respondents agreed with the Central Bank's view that placing responsibility for oversight of internal audit may pose an excessive time burden for the Organisational Effectiveness role. One respondent noted that, given the extent of the Organisational Effectiveness role, it should be responsible for only minimal management functions.
4. A number of respondents commented in the negative stating that oversight of internal audit should not be placed with the Operational Risk managerial function. Respondents commented that internal audit be undertaken independent of the managerial functions with reporting to the full board of directors of the fund management company. If, however oversight of internal audit must be assigned to an individual as a function then the board of directors should have discretion as to the appointee.

Central Bank:

Annexes I and II of the Managerial Functions guidance allocate internal audit tasks to the Organisational Effectiveness role. In light of the divergent views expressed by respondents, the Central Bank has decided not to change this. However, as noted in paragraph 19 of the *Managerial Functions* guidance, the precise allocation of regulatory obligations amongst managerial functions is a matter for each fund management company and it may be that, for any particular company, the particular regulatory obligations should be attributed differently.

Question 3: The location rule balances the need for sufficient expertise against the need to be able to access persons and supervise fund management companies. Please provide any factual analysis you have on the impact of this.

1. Respondents expressed concerns about the imposition of the proposed requirement to enhance effective supervision in the form of a location rule. Respondents focused mainly on the impact of this proposed effective supervision requirement.
2. In summary, the main points raised were:
 - a. the Central Bank's impact analysis underestimated the impact on fund management company boards and their senior management as it could not adequately account for changes in business models resulting from the *Managerial Functions* guidance. It also did not acknowledge the unknown impact on those who might consider establishing fund management companies in Ireland;
 - b. the prevalence of US (40%) and UK (36.9%) based fund promoters is noteworthy. These are most heavily impacted by the effective supervision requirement and make up the majority of fund promoters;
 - c. changes to fund management company boards in the manner prescribed would likely result in sub-optimal governance models being employed to comply i.e. some directors who are employees of the promoter/investment manager and who bring a particular expertise to the role will have to be replaced by directors who are located in the EEA. This would not be in the best interests of investors.
3. The following paragraphs set out some of the points made by respondents in more detail.
4. Balancing expertise with location: Respondents argued that investors would suffer negative impacts if key personnel employed by the promoter with a wealth of experience and specific promoter knowledge were replaced in favour of individuals located in the EEA. Respondents believed that the presence of these senior executives from the fund promoter on the fund management company board was important. These firms often employ a global strategy and the same individuals would look after a suite of mirror funds.
5. Timing/Brexit: Respondents noted that the landscape of the EEA has changed in the wake of the UK referendum to leave the EU, which exacerbated the difficulty in implementing the proposed effective supervision requirement in its current format. Furthermore, it raised concerns amongst respondents about the overall impact the proposal could have on the Irish funds industry.
6. Previous analysis lacked the full picture: Numerous respondents highlighted that Irish resident directors will be less inclined to act as Designated Persons overseeing managerial functions in the wake of recent legislative amendments and the Fund Management Company Guidance issued. Given the state of flux that fund management companies are in, it is not possible to accurately assess the impact of the effective supervision requirement but it is reasonable to assume that it will affect a significant number of fund management companies and it seemed that this impact has been underestimated by the Central Bank.
7. Physical proximity should not be seen as reflective of the accessibility to an individual or the supervisability of a fund management company: Respondents said that individuals were just as available to engage and/or meet with the Central Bank in jurisdictions outside the EEA. Virtual communications and effective travel infrastructure were cited as key factors in the ability to access an individual. In industry's view, distinguishing specifically on the basis of EEA/non-EEA location does not equate to accessibility. Respondents viewed it as an inappropriate basis for distinction, not least due to the recent UK referendum on EU membership.

8. Strain on the pool of Irish directors if fund management companies restructure: If the proposed effective supervision requirement is imposed, fund management companies would have to restructure to take on additional EEA directors. This would put a strain on the availability of Irish resident directors with appropriate expertise to fill these positions.
9. No similar requirement imposed in other prominent fund jurisdictions: At least one other EU jurisdiction may require that a minimum number of directors or management personnel be resident in that Member State. Other than that, respondents said that they are not aware of any similar effective supervision requirement in the EEA. Generally, there is no effective supervision requirement in other non-EEA jurisdictions.
10. Stifling Ireland's global competitiveness: Respondents expressed concerns around the potential impact such legislative measures could have on the competitiveness of Ireland as a key investment fund domicile, particularly where other EEA jurisdictions do not impose similar requirements.

Central Bank :Introduction

- a. In this part of the Feedback Statement, the Central Bank articulates further the concept of effective supervision (or supervisability) and the challenges involved in calibrating the effective supervision requirement. It also provides some detail on its assessment of the impact of the effective supervision requirement, a commentary on some of the feedback received and an explanation regarding why it has been decided to maintain the effective supervision requirement. In examining the responses received, we have also been able to refine the calibration of that rule.

Effective Supervision

- b. As described in the Third Consultation, supervisability is the capacity to carry out the Central Bank's engagement model without undue constraint and the ability to react in a crisis. This includes the Central Bank's ability to exert effective influence over a firm on an ongoing basis. This influence exists where a firm and its management are appropriately conscious on an ongoing basis of the presence of the supervisor and of its demands and expectations; and appropriately concerned as to the consequences of falling below expected standards. It impacts the culture of a firm, the way in which it behaves (including the ability to change that behaviour if needs be) and the way in which it interacts with its regulator.
- c. As regards the location of key personnel within jurisdictions other than Ireland, there are a number of factors which determine the extent to which the Central Bank is well-positioned to exert effective supervisory influence over a firm and its management. These include:
- physical proximity;
 - demographic, cultural and historical ties;
 - ease of travel;
 - homogenous legal and regulatory environment;
 - common supervisory network;
 - similarities of approach to regulation, supervision and enforcement;
 - the extent to which the Central Bank engages with the relevant regulatory authority in a joint-rule making capacity;
 - commonalities of legal system;
 - signatory of the IOSCO MMoU or equivalent;
 - the ability to access documents, records and other data and the ability to request this information from any person involved in the management of a regulated financial service provider;
 - the ability to request verification of any information held by a relevant regulatory authority;
 - the carrying out of investigations and on-site inspections;

- the provision of existing records of telephone conversations and electronic communications; and
 - the identification of the owner (individual or company) of a telephone number and the obtainment of the telephone numbers of an individual or a firm.
- d. Based on these factors, looking beyond Ireland, the Central Bank considers that the EEA countries are within a close sphere of influence, while other jurisdictions are less so.
- e. A number of respondents raised the issue of how the proposed exit of the UK from the EU will affect the Central Bank's approach. In formulating this feedback statement and the final rules, we have been cognisant of this aspect. Clearly, the UK's exit from the European Union has not yet occurred and the terms of that departure and the subsequent arrangements remain the subject of major negotiations to come. It is not possible for us to predict the outcome of those negotiations. In this feedback statement we have set out in some detail the factors which are relevant to our assessment of the extent to which an authorised entity can be considered to be subject to effective supervision (see paragraph - c). These factors should allow interested parties to assess the likely impact, if any, of different forms of Brexit on the application of our rules.

Impact

- f. The results of any impact analysis of the effective supervision requirement are unavoidably constrained by the fact that it is being introduced at the same time as other changes which also affect how fund management companies are organised. Notably:
- managerial functions are being streamlined from 15 to 6 for AIFMs and 9 to 6 for UCITS; and
 - the possibility of increased reluctance amongst Irish resident directors to assume Designated Person roles to the same extent as previously due to the substantial nature of the role and the Central Bank's expectations of Designated Persons as set out in the *Managerial Functions* guidance.
- g. Notwithstanding the imperfect nature of any impact analysis of the effective supervision requirement, the Central Bank invited stakeholders to provide their assessment of its likely impact. Many respondents provided information of that nature which has been useful for the Central Bank in testing the impact and proportionality of its original proposal.
- h. The Central Bank assessed the impact of the board composition element of the effective supervision requirement on (i) all medium/high and medium/low fund management companies and (ii) a representative sample of low impact fund management companies. (A sample of 50 low impact fund management companies was selected for the purpose of Tables 1 and 4 below). For (i), 83% of medium/high and medium/low fund management companies already comply with the at least two-thirds rule and 67% comply with the three Irish resident directors rule.
- i. For (ii), 64% of low impact fund management companies comply with the at least two-thirds rule. It is worth commenting that because fund management companies are already required to have two Irish resident directors, it appears that the "distance to compliance" is not great. In other words, we do not consider that making the necessary changes to achieve compliance with the effective supervision requirement would require a great deal of additional expenditure. Some directors who are employees of the promoter based outside the EEA may need to be replaced with directors who are located in the EEA and not employed by the promoter. We note that promoter-employee directors generally waive their director's fees while their replacements will have to be remunerated by the fund management company. However, we do not believe that this

will be an increased cost for the promoter because promoter-employee director appointments do not come at no cost to it. The employee carries out its director role during business hours and is remunerated for this by the promoter as part of the employee's salary.

- j. In terms of the extent of restructuring required, we note that for no fund management company that would not currently comply with the proposed rules would a change of more than two directors be necessary. To the extent that a more fundamental board restructuring is required, those changes (and any associated costs) are likely driven by the increasing expectations of, and demands placed on, directors and not by the effective supervision requirement. For example, the Central Bank has set out its expectations on how directors of fund management companies should carry out their roles in its *Delegate Oversight* guidance published last year.

Table 1 – Low Impact Fund Management Companies – Residency of Directors

Total fund management companies	50
Total Directors	245
Irish Resident Directors	125
UK Resident Directors	42
US Resident Directors	39
EEA (not incl. UK)	20
Non-EEA (not incl. US)	19

Table 2 – Medium High ('MH')/Medium Low ('ML') Fund Management Companies – Residency of Directors

Total number of fund management companies	18
Total Directors	114
Irish Resident Directors	60
UK Resident Directors	23
US Resident Directors	13
EEA (not incl. UK)	10
Non-EEA (not incl. US)	8

- k. An assessment of the impact of the effective supervision requirement on Designated Persons roles is more difficult. On the one hand, as the tables 3 and 4 demonstrate, the number of Designated Person roles currently carried out by persons located outside the EEA is relatively low. On the other hand, this statistic needs to be read in light of the current supervisory practice which only permits individuals located outside Ireland to perform Designated Person roles if they also act as directors.

1. For the MH / ML fund management companies, the overall breakdown of Designated Person roles is as follows:

Table 3 - MH / ML Fund Management – Designated Person Residency

Total fund management companies	18
Total DP roles	234
Irish DPs	161
UK DPs	27
US DPs	27
EEA (excl. UK) DPs	10
Non-EEA (excl. US) DPs	9

- m. Other Key Figures extracted in relation to MH/ML rated fund management companies:

- 141 DP roles – carried out by directors, broken down as follows –
 - a) 73 DP roles – carried out by non-Irish resident directors
 - b) 68 DP roles – carried out by Irish resident directors

- n. For the Low Impact fund management companies, the overall breakdown of Designated Person roles is as follows:

Table 4 - Low Impact Fund Management Companies - DP Residency

Total fund management companies	50
Total DP roles	601
Irish DPs	409
UK DPs	90
US DPs	53
EEA (excl. UK) DPs	14
Non-EEA (excl. US) DPs	35

Other key figures extracted in relation to Low Impact fund management companies:

- 381 DP roles (63%) – carried out by directors
 - a) 192 DP roles – carried out by non-Irish directors
 - b) 161 DP Roles – carried out by Irish directors

- o. In terms of concluding on the direct impact which the effective supervision requirement will have on fund management companies, it is reasonable to surmise that the impact of the proposed effective supervision requirement is low when performing an impact assessment on a static basis. In respect of a dynamic impact consideration the picture is

more complicated but, again in purely financial terms, it is not considered that the effective supervision requirement would create material additional impact.

Indirect impact

- p. In terms of indirect impact, respondents argue that having to maintain two-thirds of Designated Persons in the EEA would impact their business model whereby Designated Person roles can be filled by expert and experienced members of the promoter's staff who will very often be located outside Ireland and/or the EEA
- q. Expertise is important because it helps to ensure that fund management companies are run in an appropriate manner and in a way that leads to the best outcome for investors. The feedback received to the consultation provides an insight into respondents' views of the organisational model which will provide fund management companies with maximum expertise. This model has some, and perhaps a majority, of directors who are employees of the promoter/investment manager and all Designated Persons are employees of the promoter/investment manager. The complicating factor is that most promoters/investment managers of Irish authorised investment funds are not located in Ireland. Most are located in the UK (35%) and the US (40%).
- r. The difficulty in calibrating the effective supervision requirement is that the more demanding the effective supervision requirement (which increases supervisability), the less expertise which is available to the fund management company. Conversely, the more flexible the effective supervision requirement (which decreases supervisability), the more expertise which is available to the fund management company. Respondents argue that the proposed effective supervision requirement has been calibrated too strongly in favour of supervisability/location at the expense of enabling fund management companies to maximise their use of the expertise available within the promoter.
- s. However, the contrary position is also valid. The effective supervision requirement is calibrated to ensure that fund management companies are organised in a way that ensures they are supervisable by the Central Bank. Further, there can be merit in having some managerial functions performed by individuals who are not employed by the promoter. For example, this may be for reasons of independence or because an Irish resident Designated Person may be better placed to perform the regulatory compliance managerial function because they are closer to regulatory developments in Ireland and the EEA. In addition, it is not unreasonable to believe that a strong pool of 'independent' Designated Persons could develop in Ireland and the EEA.

Commentary on feedback received

- t. Balancing expertise with effective supervision: In order to ensure the Central Bank can adequately supervise a fund management company, we must ensure the directors and Designated Persons are appropriately located so that as a whole the fund management company is subject to effective supervision. This needs to be weighed together with the arguments for and against Designated Persons being members of staff of the promoter.
- u. Timing/Brexit: The analysis cannot account for future governance model shifts, nor can it determine the optimum model for each fund management company.
- v. Physical proximity should not be seen as reflective of accessibility to an individual or the supervisability of a fund management company: The physical proximity argument does not take into account the need for a fund management company to be within the sphere of influence of the Central Bank. This may be achieved by requiring a preponderance of directors and Designated Persons to be located in a jurisdiction where the regulatory culture is similar to ours and where we have interaction with the regulators from that jurisdiction on an ongoing basis.

- w. Strain on the pool of Irish directors if fund management companies restructure: This view contradicts arguments made by respondents to the first CP86 consultation where they argued strongly that there was a deep pool of talent amongst Irish resident directors. In any event it should be viewed as positive if this pool is further developed.
- x. No similar requirement imposed in other prominent fund jurisdictions The proposal is without doubt a new initiative in the sphere of fund management regulation. Practices in other jurisdictions may not be a useful guide to the Central Bank's work.

Final rule on effective supervision requirement

A management company shall conduct a preponderance of its management in the EEA.

Where a management company has a PRISM impact rating of -

(a) Medium Low or above, the management company shall have at least -

(i) 3 directors resident in the State or, at least, 2 directors resident in the State and one designated person resident in State,

(ii) half of its directors resident in the EEA, and

(iii) half of its managerial functions performed by at least 2 designated persons resident in the EEA, or

(b) Low, the management company shall have at least -

(i) 2 directors resident in the State,

(ii) half of its directors resident in the EEA, and

(iii) half of its managerial functions performed by at least 2 designated persons resident in the EEA.

Rationale for recalibrating the effective supervision requirement

- y. The effective supervision requirement as proposed in the Third Consultation was an attempt to balance expertise with location and supervisability. One of the purposes of the consultation was to test whether the Central Bank had achieved the correct balance. The Central Bank has carefully assessed all of the feedback received.
- z. The Central Bank did not find arguments concerning increased costs or Ireland's competitive position convincing. On increased costs, these are being driven not by the effective supervision requirement but by the increased compliance burden introduced by regulatory initiatives such as UCITS IV and the AIFMD. Those increased burdens are reflected in the increasing expectations which the Central Bank has of directors and Designated Persons. Those expectations are set out in the Central Bank's guidance on *Delegate Oversight and Managerial Functions*.
- aa. On Ireland's competitiveness, it is important to be clear that it is not the Central Bank's mandate to promote the Irish investment funds industry. However, consumer protection and financial stability are within its mandate. The Central Bank helps to protect consumers by ensuring that Irish authorised fund management companies (i) comply and demonstrate compliance with their regulatory obligations and (ii) are supervisable by the Central Bank.
- bb. The Central Bank was swayed, however, to a certain extent by arguments concerning expertise and the need to facilitate organisational models which draw appropriately on

the expertise of the promoter/investment manager. Applying their expertise to the operation of an Irish authorised fund management company should help to ensure that it is run in the best interests of investors and in a way that achieves the best outcomes for investors.

- cc. As a result, the Central Bank has adjusted the calibration of the effective supervision requirement to permit more involvement by persons located outside the EEA by reducing the ratio from ‘at least two thirds’ to ‘at least half’ of directors and managerial functions in the EEA.

Question 4: The proposed rule and guidance on retrievability of records focus on the outcomes to be achieved rather than the IT systems to be used to achieve those outcomes. Is this the right approach?

1. Respondents were universally in favour of the focus of the proposed rule and guidance on retrievability of records on the outcomes to be achieved rather than the IT systems to be used.

Central Bank:

The Central Bank will proceed to issue the rule and guidance on retrievability of records with a focus on outcomes to be achieved.

Next steps and transitional arrangements*Central Bank management company guidance*

1. The Central Bank published the first three chapters of its Fund Management Company Guidance in November 2015 on (i) delegate oversight; (ii) organisational effectiveness; and (iii) directors' time commitments.
2. In conjunction with the publication of this feedback statement, the Central Bank is issuing the final three chapters of its Fund Management Company Guidance on (i) managerial functions; (ii) operational issues; and (iii) procedural matters.
3. Divergence from the guidance will not be a regulatory breach. However, the Central Bank's supervisors will have reference to this guidance when forming a view as to whether a fund management company has complied with its regulatory obligations.

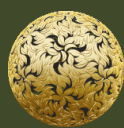
Transitional arrangements

4. Fund management companies must comply with the new rules introduced by CP86 by 1 July 2018. These new rules relate to the streamlining of managerial functions to 6 managerial functions, the Organisational Effectiveness role, the retrievability of records rule and the effective supervision requirement.
5. The Central Bank will only approve applications for authorisation from any new fund management company submitted on or after 1 July 2017 where the fund management company will be organised in a way which complies with the new rules introduced by CP86.
6. The new rules will be included in the amended Central Bank UCITS Regulations¹ and in the forthcoming Central Bank AIF Regulations².

¹ Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1) (Undertakings for Collective Investment in Transferable Securities) (Amendment) (No. 2) Regulations 2017

² Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1) (Alternative Investment Fund) Regulations 2017

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