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Fund Management Company Effectiveness - Delegate  
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**BY EMAIL: FUNDSPOLICY@CENTRALBANK.IE**

12 December 2014

Dear Sir/Madam:

**CP86 - Consultation On Fund Management Common Effectiveness - Delegate Oversight  
(the "Consultation Paper")**

Dechert is a leading adviser to asset managers, investment funds and other financial services firms, many of the world's largest asset managers as well as smaller and emerging market managers. We have offices in all of the EU's leading centres for investment funds and in the United States and Asia.

As such, we are exposed to many differing fund governance structures.

In this response, we intend to address the specific questions posed in the Consultation Paper but would like to begin with some general comments.

**General Comments**

- We have reviewed the very detailed response prepared by the Irish Funds Industry Association ("IFIA") on the Consultation Paper. We support most of the major themes set out in the IFIA response and our response will not seek to duplicate such themes.
- We note that the Central Bank is separately reviewing the impact of the IFIA Corporate Governance Code. As you will see from the IFIA comments, it is difficult to decouple the issues addressed in the Consultation Paper from the issues which you will be reviewing as part of your review of the IFIA Corporate Governance Code (the "Corporate Governance Code").

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- We note the Central Bank's comments with regard to the appointment of lawyers to the Boards of fund management companies. It is worth pointing out that Dechert has a firm policy not to accept appointments as directors to the Boards of client companies as we consider this to constitute a conflict of interests. However, we do believe that lawyers have an important part to play in fund governance as trusted advisers to Boards.
- It must be noted that our client base is very happy with the governance processes that are in place for Irish funds as they currently exist and feel very well served by their Irish directors.

### Questions for Consideration

1. *Is publishing a delegate oversight good practice document along the attached lines a good approach to encouraging the development of the supervision of delegates by fund management companies?*
  - Given the model employed by fund management companies, the question of how oversight of delegates can be effectively achieved is one that Boards are asked to consider in detail and the guidance offered by Appendix 1 of the Consultation Paper is welcome. We agree that the publication of a delegate oversight good practice document is a good approach. There are a number of other good examples of sound practice documents being issued by industry stakeholder such as the Guides to Sound Practices issued by AIMA including those co-sponsored by the IFIA.
  - The Central Bank moved away from the approach of issuing Guidance Notes with its approach to AIFMD where the regulatory position is set out in the AIF Rulebook supplemented by the Q&A documents. We would be strongly supportive of the view of the IFIA that any such practice document should be an industry document and is best incorporated into the Corporate Governance Code.
  - The Consultation Paper does not require further comment beyond commentary on the approach. While we would consider much of what has been proposed to constitute current best practice for Boards, we would consider that by incorporating the document into the Corporate Governance Code (as the one stop shop for all matters concerning Fund Governance), the document would benefit from further consideration in the context of the Corporate Governance Code review.
  - With regard to Appendix 2, we have no issue with there being some guidance with regard to what the role of the designated person should be in respect of each of the designated functions. We do agree that the reference to day-to-day should be removed.

2. *Is the breakdown of revised managerial functions correct?*

The proposed breakdown of revised managerial functions is acceptable. As you will appreciate, the principal concern with this proposal is the fact that it will require considerable amendments to the business plans/programmes of activities currently (and in many cases recently) put in place. We note your acknowledgement with regard to transitional arrangements. It would be helpful if AIFMs did not have to complete any major projects in 2015 and similarly if UCITS changes could be tied in to any changes consequent on UCITS V.

There should also be guidance on what will be expected with regard to revised business plans/programmes of activities. For example, will the Central Bank expect reference to the existing functions within these documents?

We note that the Consultation Paper does not invite comments on Appendix 1. We agree with the broad thrust of Appendix 1 but would repeat our previous comment that consideration of these issues should only be finalised in the context of a review of the Corporate Governance Code.

*Should other managerial functions be provided for?*

Based on comments below with regard to organisational effectiveness, there may be scope for a separate function for the Chairman.

*What are your observations about what the operational effectiveness function might entail and how this might be performed?*

The operational effectiveness function is proposed to take over from the supervision of delegates function which was previously the responsibility of the entire board. The Corporate Governance Code sets out a sensible approach to the role of the Chairman. Taking this role into account, we would consider that most of the matters referenced under the organisational effectiveness function should be matters for the Board as a whole.

*Do you see any obstacles to the Chairperson performing the operational effectiveness function?*

Yes, see above.

The Consultation Paper appears to contemplate the Designated Person charged with operational effectiveness to be more of a "Chief" than a "Chairman".

3. *Is relaxing the two Irish resident director requirement the correct approach?*

Up until the publication of the Consultation Paper, we have not seen any demand on the part of our clients for relaxation of the two Irish resident director ("IRD") requirement and the raising of this issue has been the main talking point from the Consultation Paper with differing views from Boards and Managers.

The differences can largely be broken down to those in favour of the status quo with a bias towards US/UCITS managers (“Category A”) and those who see merit in the proposed relaxation (“Category B”).

For Category A, these managers see the two IRD as being part of the DNA of Irish funds and central to the evolution of Ireland as a domicile with fund governance at its heart. These managers cite:-

- third country registration issues for countries with weaker corporate governance requirements;
  - concerns about the centre of effective management and control of the Fund;
  - a plentiful supply of skilled directors (we maintain a list of over 200 Director candidates);
  - availability and proximity of Directors (more important for US managers);
- the fact that IRDs often act as a team bringing different competencies to boards and ensuring that they are not isolated - “Two are better than one because they have a good return for their labour”;

the difficulties that may be engendered by the resignation of an IRD.

For Category B, the central theme is that there should not be “gold plating” of any applicable regulatory requirements and that the two IRD requirement is an example of gold plating, therefore, any proposal that removes a gold plated requirement should be welcomed. These managers would welcome the flexibility that a relaxation of the two IRD requirement would permit in terms of:

- the ability to replicate the boards of similar funds domiciled in other jurisdictions;
- the incorporation of skill sets with regard to portfolio management and risk management which, while not scarce in Ireland, is in plentiful supply in other jurisdictions;
- having Directors not connected with the investment manager with the experience and expertise to challenge all delegates including the investment manager;
- recognising that non-IRDs are approved by the Central Bank; and
- the cost savings.

The balance of convenience here lies in permitting the relaxation thereby allowing Category A managers to retain two IRDs and giving Category B managers flexibility with regard to Board composition.

However, a far more pressing concern with regard to relaxation would be a relaxation of the requirement to have non Irish Resident Designated Persons.

*Will relaxing this requirement have an adverse impact on the ability of the Central Bank to have issues with distressed investment funds resolved? If so, how could this be addressed?*

With regard to possible issues with distressed funds, Category B managers expressed some surprise at the suggestion that non-IRDs would not deal with their statutory obligations. The Central Bank may have data on this dating back to the financial crisis.

Since the financial crisis, there has been considerable regulatory change, most notably with respect to AIFMD and UCITS V, which should reduce the risk of fund distress and which, in the case of the AIFMD, places increased regulatory responsibility with regard to AIFs on the AIFM as opposed to the Fund board.

Other considerations would be whether to retain the two IRD requirement for self-managed and/or UCITS funds.

4. *What are your views on the proposed approach to measuring time spent in Ireland? Can you suggest any alternatives or any enhancements to the definition proposed by the Central Bank?*

We do not agree with this approach. The Consultation Paper suggests that there are a wide variety of options in defining this. In all of our discussions on the subject, there has only been one approach and that is tax residency. This metric can be easily determined by declaration of the Director concerned. We would query whether it would be intended to impose an obligation to review the record keeping of the Director concerned. In addition, the time commitment of some IRDs may exceed 110 days.

5. *Is there a downside to requiring fund management companies to document the rationale for the board composition?*

The Corporate Governance Code sets out relatively detailed provisions with regard to board composition and, in particular, paragraph 4.2 requires that there be a good balance of skills and expertise on the Board.

A typical Irish fund board will be comprised of 3 representatives of the Promoter/Investment Manager/AIFM and two Irish resident directors – typically one with a legal background and one with a fund administration background. Given the Central Bank’s comments with regard to the role of lawyers on boards and with regard to the IRD requirement, it would appear that the Central Bank’s preference is for “experienced Directors from a range of fields making themselves available as directors” is weighted towards the fields of portfolio management and risk management.

It would also appear that the Central Bank is looking for alterations to the composition of boards that they not meet the defined criteria. Aside from the legal issues that might arise from the possible requirement to remove a Director, we would consider

that “affirmative action” in favour of candidate directors from these fields would not be in the best interests of the funds industry in Ireland.

It has been commented that the dynamics of board composition is more of an art than a science and seeking to have the selection process documented will upset that dynamic. The key question should be “will they add something to the board?” We think that the downside to the Central Bank’s proposal is that board strength may be weakened from the imposition of a formulaic papering exercise.

*Will fund management companies require a transitional period during which they can alter their board composition to ensure they have sufficient expertise and how long do you consider would be a reasonable timeframe for such adjustments?*

The second question presumes that changes to board composition will result from the outcome of the Central Bank’s consultation. However, Fund boards have been complying with the requirements of the Corporate Governance Code with regard to “balance of skills and expertise” for a number of years now without change being effected and even if changes were to be made, removal of persons from boards (especially when directorships are the primary source of income for most directors) would be legally problematic.

Having said all of this, we do feel that it is open to the Central Bank to require Boards to demonstrate a range and depth of competencies and to provide that this issue be the subject of thematic review by the Central Bank. We would expect that without “change for the sake of change”, most fund boards would be able to demonstrate that they possess the range and depth of competencies required.

Both the original and ongoing Board composition should be a matter for the Board as a whole and not for the person responsible for organisational effectiveness.

6. *Are there any other elements which should be included by the Central Bank in a Fund Management Company Effectiveness — Delegate Oversight initiative?*

We have brought the Consultation Paper to the attention of the Boards that we represent at Board meetings and the Central Bank would be aware of the debate that has arisen as a result of the issue of the Consultation Paper. What is most notable about this debate is the fact that it has given rise to discussion of issues which are outside of the scope of the Consultation Paper and which may, in fact be on the Central Bank’s mind, to address as part of the review of the Corporate Governance Code.

The issues raised for discussion include:

- (i) time commitments;
- (ii) number of directorships/relationships;
- (iii) number of/majority independent Directors;
- (iv) requirement for Directors representing the Investment Manager;

- (v) retirement by rotation; and
- (vi) how to ensure an effective board review process.

We hope you find these comments helpful and wish you well during the Consultation process.

Yours sincerely

**Declan O'Sullivan**  
**Dechert**