Central Bank Consultation on Fund Management Company Effectiveness – Delegate Oversight

Consultation Paper 86

We welcome the opportunity to comment on the matters and questions raised in CP86. We have set out some high level comments initially, followed by our answers to the questions raised by the Central Bank.

(i) Guidance

In our experience, boards of directors of fund management companies (*noting that, for the purposes of CP86 and this response, that term covers UCITS management companies, AIFMs, self-managed UCITS investment companies and internally managed AIF plcs*) already operate in a manner generally consistent with Appendix 1 to CP86, although not in a uniform fashion. Most boards tailor how they operate to the nature and number of portfolios being managed, their investor base and their target market(s) and the number of delegates and extent of matters delegated by them.

Guidance in this area can be very useful, but care needs to be taken that boards of management companies do not feel obliged to simply follow a prescribed governance regime rather than think for themselves. Boards need to decide themselves how they are going to operate, including how they oversee their delegates in practice and how they comply with the relevant company law provisions, with their common law fiduciary duties and with fund/management company related legislation and regulation. Boards are already obliged to perform certain specified managerial functions and to do so in a manner prescribed via regulatory required business plans/programmes of activity. Our concern is that if the Central Bank now gives further guidance, at such a granular level, and indicates that it shall use that guidance as a supervisory tool, the overall governance process will become very formulaic.

In addition, in our view further thought needs to be given as to where any such guidance should come from. Our view is that the guidance should come from industry, for example, from the IFIA.

We are not entirely sure whether the Central Bank's intention was to issue the Appendix 1 document as a document of the Committee, as a document of the Central Bank or whether the Central Bank planned to adjust it based on its own views/feedback and then issue a new document. We have doubts about each such approach.

In the event that the Central Bank simply issues the Committee's paper, the question is who is actually giving the guidance. Is it the Committee or is it the Central Bank? If the Central Bank gives guidance (either by saying that it is or by issuing it on its own paper) that guidance in effect becomes a quasi-rule because, as CP86 indicates, the Central Bank may use that guidance as a "useful tool for the Central Bank's supervisors when assessing the performance of fund management companies". It would become a rule by proxy.

We think that it would be better that the industry itself issue guidance, preferably through a revised IFIA Governance Code.

In the event that there are boards which have not to date operated in a fashion broadly consistent with such guidance, we believe the issuance of industry guidance would have the result of bringing them up to the desired standard quickly.

We would also point out that a number of clients have indicated to us that they feel that if there is Central Bank guidance in this area, there should be a clear acknowledgement on the part of the Central Bank that many of the parties involved in the fund structures – the investment managers, administrators, custodians, depositaries, auditors, etc - are all subject to very onerous regulatory supervision by regulators including the Central Bank itself in many cases. Some clients felt that directors should be able to place some reliance upon this, rather than being held wholly responsible for the performance of such third parties.

We also have concerns about Appendix 2 as we think that it suggests that there is only one model for performing designated functions and we feel the recurring references to *day to day* are not appropriate and only confuse.

Some clients have indicated that Appendix 2 may lead to the pool of directors with capability becoming diluted due to the necessity to devote more time to fewer companies, with negative implications for the quality of board composition and the director fees that the investors ultimately bear.

(ii) Streamlining

We are generally supportive of the proposed streamlining of the managerial functions.

However, we think it essential that questions as to how those functions are allocated, are performed and performed by whom are addressed now.

We also have concerns about the impact and cost of further change for those firms who have recently been through the process of becoming AIFMs or becoming dual UCITS/AIFMs, as well as for the large number of existing UCITS management companies and self-managed investment companies. There may be quite an element of frustration at having to change procedures and documentation given that they have only recently done so when adopting AIFMD. At least, a transitional period and process should be agreed to make the process of change as painless as possible for existing management companies.

(iii) Director Residency

We are supportive of the change in relation to residency requirements for directors as we feel there is no need for a regulatory imposed Irish residency requirement for directors.

We are opposed to the 110 working day requirement, however.

(iv) Board Composition

In our experience, the process of appointing directors upon the initial establishment of a management

company or investment company, and thereafter, is one that is given thought by the promoters and board members (for subsequent appointments). Consideration is given to the skills of the incoming directors.

Before directors can be appointed, there is a requirement for reasons to be given why the appointment is being proposed by the sponsoring entity within the individual questionnaire submitted to the Central Bank as part of the fitness and probity process. We do not believe anything further is required.

Answers to CBI Questions

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?*

   Although we believe that boards of fund management companies could benefit from a good practice guide which suggests or recommends how such boards might operate and might oversee delegates, we think that further thought needs to be given as to the source of such a good practice guide, the purposes for which it is used as well as its application.

   The operation of fund management company boards is the subject of company law, common law, financial services/fund law and regulation (UCITS/AIFM), a fitness and probity regime and regulator rulebook(s), as well as existing industry guidance. If boards are going to receive further guidance, where will that guidance fit within the already existing body of law, regulation and guidance?

   If this is guidance issued by the Central Bank, directly or indirectly, we feel that the guidance will become a *quasi* rule – it will be seen as such by the boards. That would not, in our view, be a positive development as it could lead to a very formulaic governance approach from fund boards who feel compelled to follow a particular method of operation. If instead an industry guidance was issued (subject to further industry consultation), it may achieve what appears to be the overall objective of lifting standards in places.

   We do not, however, have any particular difficulty with the content of Appendix 1 provided that it is clear that it is not a rule, does not have to be followed in every instance, is subject to proportionality, to the particularities of individual funds, their investment managers etc. We would, however, suggest that references to "*day-to-day*" be consistently deleted as we believe that term creates a significant confusion for all involved – boards, their advisors and regulators. The term "continuous" similarly should be re-considered.

   We also think it unnecessary to adopt a formal risk appetite statement as that can be addressed within and when adopting the risk management framework is sufficient.

   In relation to the Support and Resourcing section of Appendix 1, we have not found these issues to be problems in practice. We found that where boards work closely with the promoters, these issues readily addressed. In addition, many boards have now adopted new technology

for board papers, board communication, libraries of board documents, capacity to diary boards and other calendar events etc,. We do not consider that this really requires guidance.

In relation to Appendix 2, we are concerned that this is too prescriptive in terms of how designated persons' functions in the relevant areas are performed. If this Appendix is issued by the Central Bank it would very much seem to be a further extension of the AIF Rulebook and not guidance. We recommend that this does not form part of guidance.

We are also concerned that this Appendix 2 is suggestive of this one model only. It is not the only model. We would also suggest that all references in Appendix 2 to "*day-to-day*" be deleted given the confusion that that term creates.

2. *Is the breakdown of revised managerial functions correct? Should other managerial functions be provided for? What are your observations about what the operational effectiveness function might entail and how this might be performed? Do you see any obstacles to the Chairperson performing the operational effectiveness function?*

There is no right or wrong answer but generally the breakdown proposed seems fine. The real issue is who can carry the functions and from where.

(a) Core Issues for Clarification

What needs to be made clear is:

(i) that more than one individual (whether director or designated person) can be responsible for one function. The allocation decision should be for the individual boards, exclusively. For example, if the board wants, it can appoint one designated person for the entirety of risk management or appoint more than one person and split risk management into a number of parts. There is no threat to accountability in so doing;

(ii) that the role of the designated person (irrespective of who performs it) does not have to be performed by an Irish resident or in the State;

(iii) that the role of the designated person can be performed by a director, employee, secondee, delegate etc.

(iv) that the role of the designated person can be performed by substantive allocation of decision making responsibility or as a review and escalation arrangement;

(v) that decision on resources and how addressed etc is a matter for the boards.

We are also opposed to the suggestion a single individual could not be appointed with responsibility for oversight of both portfolio management and risk management functions. The required separation is of portfolio and risk management, not of investment and risk

management. Secondly this is an oversight role, not one that involves performance of the actual portfolio or risk management activity.

(b) Regulatory Fatigue

A major concern in relation to the stream lining of the designated managerial functions is promoter exasperation/regulatory fatigue.

Promoters have put their UCITS business plans in place already. All AIFM clients have just been through the process of writing (and settling with the Central Bank) their AIFM programmes of activity. We would expect there to be some exasperation (to say the least) if they – existing UCITS and AIFM Clients – have to amend processes most recently worked on, at considerable cost, to deal with this change.

(c) Oversight of Distribution Strategy

We disagree with use of "*day-to-day*" in statements such as "someone should be formally designated to monitor compliance with this strategy by receiving and reviewing regular reports on distribution on a "*day-to-day"* basis. That term should not be used as it simply creates confused expectations.

(d) Board Operation

We think that board operation and the role of the chair should be left to the boards and shareholders themselves. Our experience is that most boards already consider their own effectiveness periodically, already have conflicts of interests policies and some have had an operational plan for the purposes of overseeing how the company operates. In fact, sometimes the existence of UCITS business plans and AIFM programmes of activity are obstacles to development of such operational plans as those business plans and programmes become seen, instead, as such, which they are not.

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

We would recommend simply removing (not relaxing) the two Irish resident director requirement. There should be no regulatory imposed residency requirement. It is for promoters, shareholders and boards to decide - and they may decide to have (or not to have) Irish resident directors, but it should be their choice.

We are not aware of any real concern about directors being unavailable to the Central Bank or that directors who are not based in Ireland are less available than Irish resident directors either generally or in the case of distressed funds. We have not seen any evidence of that.

More generally, we do not believe that Irish residency or time spent in Ireland are relevant to prudential supervision (or its effectiveness) of fund management companies. .

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 the proposal to introduce a 110 working day per year requirement. We do not consider it necessary and it would simply introduce another rule to have to create a compliance procedure around.

We think that the Irish residency requirement should be removed. It does not need to be replaced with another rule.

We also do not agree with the concept of a director who is "unconnected" with the depositary or a service provider. If the Central Bank wants to introduce a requirement to have an "independent director", then we think that there should be a consultation on that more generally.

5. *Is there a downside to requiring fund management companies to document the rationale for the board composition? Will fund management companies require a transitional period during which they can alter their board composition to ensure that they have sufficient expertise and how long do you consider would be a reasonable timeframe for such adjustments?*

We do not agree with the requirement to document the rationale for board composition, given the existing fitness and probity requirements and how, in practice, new board members are appointed.

In our experience, the process of appointing external directors (ie. other than those who come from within the promoter group) generally involves assessing multiple candidates, sometimes sounding out the other board members informally, interviews and then presentation of names/CVs to the board for formal consideration. We do not see any need to further document the process or for whose benefit that would occur.

It is also important to note that when proposing a new board candidate to the Central Bank for its approval under the fitness and probity regime, the proposing entity must set out the reasons why it thinks that the candidate is suitable. We do not believe anything further is required.

The second part of this question is "*Will fund management companies require a transitional period during which they can alter their board composition to ensure that they have sufficient expertise and how long do you consider would be a reasonable timeframe for such adjustments?*" That pre-supposes that boards do not consider that they have sufficient expertise. We do not believe that to be a widely held view.

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

Given the focus on board composition we do think that consideration needs to be given to what appears to be a procedural oversight which undermines shareholders' ability to exercise their

right (where they have the voting power to do so) to appoint directors.

This problem arises because there is no capacity for a shareholder to unilaterally complete an Individual Questionnaire (as shareholder) or to access the ONR system to submit it. The current process only allows promoters/other directors to nominate directors and the Individual Questionnaire requires sign off by an existing board member.

Where a shareholder, for whatever reason, wishes unilaterally (and without reference to the existing board) to appoint a director to the board of a management company or to a fund it would appear that it is not able to do so due to procedural limitations. We also feel that shareholders should not be required to justify their decision to appoint a board member.

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