

Submission in Response to Consultation Paper 86 – Consultation on Fund Management Company Effectiveness – Delegate Oversight. (Sept 2014)

General Comments on the Introduction (Page 2)

The statement declaring that the Central Bank strives to ensure market integrity, financial stability and investor protection is to be applauded. It is a worthy and essential statement of intent. I would offer that the aspirations require more substance in terms of open engagement with the Funds Industry and less of a position of observer and commentator on process, established custom and protocol. I would encourage the Central Bank to strive for setting the highest possible bar in terms of governance and integrity rather than striving to find the common ground of consensus by moving to standards set by strong industry lobby groups.

Two observations are offered in advance of the giving input to 5 key areas noted in CP 86.

- I believe the decision to move away from the promoter regime is a mistake and has in my view increased and concentrated the risk exposure for non-executive directors in particular. Also on this point by not having the Promoter directly involved with 'skin in the game' the central aspiration to protect investors has been materially lessened.
- I believe that there is a fundamental bias towards one model fund management structure. I am concerned that the drafters of the CP 86 chose not to differentiate between the concepts of corporate governance and fund governance. This is fundamental flaw, in my view, and needs a better balance.
- The IFIA Voluntary Code of Corporate Governance...does not 'tackle the question of standards'. As a voluntary code it remains a useful guide, but has no power other than it might be used to good effect.

Question 1:

Guidelines from the CBI are always useful. Guidelines do suffer from being too nuanced in some circumstances. This flaw is understandable in that language that is too definitive can also be too restrictive.

In my experience, Boards want to take the best advice available to achieve the strategic objective of the business. Boards also want clear (not nuanced) guidelines to ensure that the business is run in compliance with regulatory provisions. Guidelines are too often open to interpretation. The established and go-to interpreters are invariably the legal counsels appointed to the fund management company and/or fund platform. The resource can be internal but more often than not the external service provider is the acknowledged interface to the CBI, and indeed this relationship is often quoted as being a key differentiator in securing new business relationships.

Clarity requires clear direction and definite parameters for what should be delivered.

In considering publishing an oversight document....I suggest that a single structure (external AIFM) can only be one variant is assessing what resources, processes, reporting, controls and interface to an assortment of governance frameworks are required to add value and reduce risk.

I suggest that to use the empirical evidence available to the CBI through the PRISM review process would be a valuable and credible basis on which to identify trends in organisational structures (strengths and weaknesses) processes and culture in developing an oversight manual that can be used in conjunction with an internal 'internal audit' or 'audit committee' review and oversight function, reporting to the Board.

In summary, I believe a suite of oversight guidelines would add value....but the temptation to adopt a 'one model fits all' would be fundamentally flawed. A recognition of all current structures must be made and a key insight into application of corporate governance and fund governance must be obvious.

Question 2.

I would offer that the introduction of delegated function at the Board is a valuable tool to ensure full engagement of the directors. It does encourage active participation and a recognition of the need to have a real understanding of the integrity and professional qualities of responsibility, ownership, oversight, accountability and stewardship.

However, clarity is desperately needed on the threshold of involvement for function. The point at which the designation functions pull an independent non-executive director into an actual executive function needs urgent review.

There are two aspects to balance here. The additional time commitment that an active and granular designated function will require on one hand. On the other the potential loss of independence, particularly for the independent director. There is currently a race to the bottom of the integrity of Boards where functional responsibility is used a bargaining tool to gain Board appointment. This is commerce and as such it is to be expected. But some aspects of the delegated model become increasing more risky and may undermine investor protection and oversight integrity.

The value of independent challenge needs to be protected not bargained away. Setting a guideline depth thresholds for where the executive aspect of a designated function overtakes the key independent view....is now overdue.

In relation to additional board functions to be included. I would suggest that a mandated governance and board evaluation report and process be included. The suggestion that a Board to wait until perhaps a PRISM visit is advised to start collating and cascading governance policies is no longer acceptable. Including a specific Board function would help encourage an awareness of governance and develop stronger corporate cultures.

In relation to expanding the functions of the Chairman. I would suggest that the idea is a good one in that it addresses the need for a tone from the top of several key governance and operational topics. The suggestion is more complicated where the Chair is actually held by an independent non-executive director. There are other challenges where investing the expanded functions to the Chair could actually be disruptive to the enterprise and depending on the individual, completely outside their skill set.

The suggestion would work better if the Chairman was mandated to establish a multidisciplinary review committee, reporting to the Board. Such a structure would be better balanced and more attuned to the organisation.

Question 3

The aspiration to have the right skill set around the Board table to best aid the success of the business and ensure compliance in protecting investor's interests is completely worthy.

If the proposal to relax the requirement for two resident director is linked to the suggestion that sufficient expertise in the areas of investment management and risk management are deficient in the Irish Funds Industry....then I would refute that suggestion as being wholly inaccurate.

There may well be empirical evidence available to the CBI through the PRISM review process that would indicate that some skill sets are variably represented. I believe strongly that a material influence in forming a negative view is actually based on a constricted gene pool of active directors. I have conducted my own primary research on this issue and will gladly share the results with the CP 86 Review Teams. I am of the view that there are ample and very able specialists in the INED space with real and current industry expertise in the areas of risk and investment management (for example) who simply are not presented as being viable candidates to potential Board appointments. The appointment process itself is factually a business advocacy model that would benefit from a more open and transparent process.

Finally on this point. Reducing the requirement to have two resident directors may be counter-productive. I would suggest that in reducing the resident to one...that role becomes factually more isolated and more exposed to adverse risk and industry challenge. The level of independent challenge would be factually weakened and the advocacy of regulatory compliance and investor protection significantly lessened.

Question 4.

The consideration of time spent in IrelandI have to offer that this inclusion appears to be specific to a very specific vested interest. I would have expected the opportunity to include and discuss a more substantive governance related topics – Board induction processes, Annual Board Reviews and/or the inherent conflict of interests in some of the more popular AIFMD structures.

Question 5.

The contribution of the Board to the effective and efficient attaining of strategic objectives merits careful review. The depth of skill set and diversity of the board directors should be have a measurable delivery. Given that the Board, as a collective, is responsible for the legal and regulatory well-being of the business....relying on 'luck' to have the 'right' skill sets available to oversee and guide the business is too weak a position to hold.

The composition of the board needs to reflect the developmental stage of the business be it start – up, development, mature or in decline...the skill sets needed at each stage will be different and the regeneration of the board should reflect the needs of the business. Documenting this process and the deliberate assessment of the needs/risks/aspirations of the business has to be a key resource audit and should be factored into the Strategic Business Plan.

The documentation process would also enable contingency and succession planning to be factored into the management oversight and culture. In the case of the INED community serving on Boards, I believe that the documentation process for nomination, assessment and appointment would have key criteria that each appointment and fitness and probity submission would benefit in making reference to. Documenting the resource need....would help encourage a culture whereby executive and non-executive directors have initial induction processes on appointment and continuous professional training thereafter.

Including some narrative in the strategic plan, which is reviewed by the CBI on an annual basis ...also provides a better basis for pre PRISM reviews and context building as and when events prompt a closer look.

In terms of a transition period....I believe yes. But....if the aspiration is to encourage a cultural shift from vagueness to clarity around Board transparency...I would suggest that a six month period to include an initial and strategic inclusion in the annual Business Plan submitted to be reasonable. Leaving a period that is too long (12 months) will create more risk.

Question 6:

I would offer the following;

- There needs to be a recognition of the legitimacy of various models of management companies and fund board structures. Having a one preferred model presents an unbalanced and ultimately dysfunctional funds industry.
- There needs to be a better balance in the CP on the inference that Investment Management is the key driver of the Irish Funds Industry. Factually it's not. Ireland offers a specialised service hub.
- There appears to be a real issue in the CP on the issue and differentiation needed between corporate governance, as might apply to an external AIFM and the fund governance that might apply to the Fund. Not recognising the difference will lead to a blurring in the roles and responsibilities of board directors. This will in turn weaken the 'protection of investors' aspiration which has been central to EU directives in this area since 2009.
- Threshold levels for designation functions. At what point is independence lost.
- Director capacity on the quantum of positions that can reasonably held. Set a number and work to it...if necessary re-calibrate at some point in the future. The industry needs clarity on this ASAP.
- The depth of the talent pool of directors not utilised, the process of selection, appointment and inherent conflicts of interests that can emerge. This needs immediate review, particularly if the CBI are of a view that key skill sets in Investment Management and Risk Management are poorly represented in the industry. If there is empirical evidence to support this, the question then needs to be asked as to why the CBI approved these appointments in the first place?
- Product Development is a key function with the Funds Industry....is should feature as a key resource review at the Board.
- Conflicts of Interest....particularly in the area of service provider representation at Board level should present a more urgent dialogue...why not?

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