A Response to Central Bank consultation CP86: Fund Management Company Effectiveness - Delegate Oversight

Markets Policy Division
Central Bank of Ireland
Block D
Iveagh Court
Harcourt Road
Dublin 2
Submitted via email to: fundspolicy@centralbank.ie

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Dear Sirs,

RiskSystem is pleased to have this opportunity to offer our response to the Central Bank of Ireland's consultation paper on Fund Management Company Effectiveness - Delegate Oversight. We have approached this response from the view of a service provider rather than the point of a non-executive director.

RiskSystem is a Dublin based provider of risk management services to the funds industry. Our clients include AIFMs, AIFs and UCITs as well as asset managers that use our system as a front office risk management tool. We combine experienced risk analysts with proprietary risk analytics to provide a complete financial risk solution for investment funds.

We are available to discuss this further with the Central Bank at any time.

Yours faithfully,

Simon O'Sullivan

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General Comments

An issue to those of us at RiskSystem that have studied corporate governance[1] in detail is the blurring between executive and non-executive duties. A non-executive is meant to bring independence, outside expertise and a wide variety of experience gained from external roles and is not expected to perform day to day executive duties – that is the role of management. We obviously have sympathy with the view that the funds industry is different to regular companies and therefore good fund governance may at times differ from good corporate governance. The delegated model that Ireland has in place means funds do not have any direct employees and that therefore oversight of service providers is crucial. Delegation without robust supervision can, potentially, lead to issues. We fully understand that the Central Bank, with regards to AIFMs in particular, has to walk a fine line between a full delegated model and avoiding brass plate operations. If a fund has to retain some substance, and it is very unlikely the overseas promoters will move their portfolio management teams to Ireland[2], then risk management is the function most likely to be retained by the fund. This should involve hiring locally based risk management expertise either directly by the fund or by outsourcing to companies such as RiskSystem.

RiskSystem already provides risk services (being identification, measuring, monitoring and reporting) of all relevant risks on behalf of UCITS funds, AIFs, AIFMs etc. We provide independence between the portfolio management team and the risk management team as required by AIFMD. A key objective of AIFMD must be to reduce the chances of a Madoff or Weavering type fraud taking place. We believe outsourced independent risk can diminish the chances of such cases occurring. Whilst the very large houses have well-resourced risk management functions in house, the vast majority of smaller investment houses likely do not have anything approaching best in class risk management. We have demonstrated to our clients that full compliance with the risk requirements of AIFMD is neither overly burdensome nor expensive[3].

Timing

One concern we have is the timing of bringing out CP86 – virtually all promoters are struggling to get to grips with a wide variety of legislation currently including AIFMD, MIFID2, UCITS V, FATCA, ICAV etc. One would imagine the last thing a promoter needs right now is further changes in the legislative framework no matter how sensible. In addition many promoters are having to either bear considerable cost of regulatory compliance themselves or are trying to pass the cost to investors. At the very least CP86 would imply to us that most business plans need to be rewritten. This would involve considerable extra time and costs.

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[1] Two of the founders of RiskSystem have completed the Diploma in Corporate Governance at the Smurfit School of Business in UCD.

[2] Pioneer Global Asset Management is probably the only large asset manager to locate its front office operations in Ireland. All four founding partners of RiskSystem have worked at Pioneer at some stage and so speak from experience.

[3] As an aside RiskSystem largely sees AIFMD as codifying best practices in risk management and is largely quite sensible, achievable and should not be overly expensive for AIFMs to comply with.

Q1

RiskSystem believes publishing a delegate oversight good practice document is a good approach provided the guidelines are just that – guidelines that allow some flexibility to take into account the differing fund structures that exist.

Q2

Streamlining of the Managerial functions

RiskSystem broadly welcomes the streamlining of the Managerial functions. Sixteen managerial functions risked becoming unwieldy with much overlap of functions.

The Role of the Chairman

In particular the "introduction of a clarified task of organisational effectiveness oversight" will have an outsized impact on the chairman – it would be expected that this person will be Irish given the role "is one of oversight of the adequacy of the internal resources within the authorised entity". It would seem reasonable to conclude this person may have "day to day" oversight of the service providers. We believe this again blurs the distinction between the role of the executive and non-executive roles.

Q3

Relaxation of the one Irish resident director rule

We would have general reservations on the proposed policy and more specific ones based on our role as a service provider. From the general perspective a single Irish director may feel very isolated and could well end up doing most of the work particularly if there is a major problem on the fund (we note too that following the withdrawal of the promoter regime directors can now not resign until issues with the fund are sorted out). An Irish based director is obviously in a better position to meet the Central Bank at short notice. In addition when there is an issue the Irish based directors will likely end up being the ones that meet the auditors, the lawyers and other service providers where face to face meetings are deemed optimal as most service providers are themselves Irish based. Anecdotally we have heard several INEDs saying they would not in fact want to be a sole Irish director on an Irish fund board for the reasons outlined.

From the specific perspective there is a significant burden placed on the board for the supervision of delegates. Given that it would be best practice for the delegates to be Irish domiciled a single Irish director may be responsible for the large majority of the supervision role, which would require considerable extra commitment than is currently required.

Q4

We do not have a strong view on the proposed approach to measuring time spent in Ireland. It is not clear to us as to how the 110 days figure was arrived at.

Q5

Skills and Competencies

“the Central Bank is particularly concerned to encourage a broad range of relevant skills and competencies on fund management company boards.”

We would argue that a better way to achieve this is to encourage more qualified Irish people to see the role of director as a potential career path. Currently it is seen as somewhat as a sinecure for retirees. In our opinion The Central Bank would be better advised to continue with the two Irish resident rule, thus keeping control of the board in Ireland and seeking a higher skill level from current and future board directors. This could be done by means of minimum competency requirements, CPD requirements and working closely with the various corporate governance courses. The suggestion that a board has to rationalise its composition at inception seems sensible. This would be even more important if the requirement to have only one resident director becomes the norm.

We fear that reducing the requirements to have only one Irish resident director might in fact cause the opposite effect – new younger persons with skills that the funds industry could use as potential INEDs are put off a career as an INED as they believe, rightly in our view, that there is very little chance of securing enough non-exec roles from which they would be able to make a living. The Central Bank is no doubt aware that the market for non-execs resembles a closed shop with a concentrated number of individuals having an outsized share of directorships. Attempts by the Central Bank to cap the number of relationships held by this “magic circle” and encouraging newer younger directors with a broad set of skills garnered from Ireland and abroad will widen the skill set.

Specifically there are many potential non-execs in Ireland with the investment management experience to appropriately monitor the risk and liquidity management functions. What is required is the necessary expertise at the service provider level to give them the timely information to carry out their obligations. At RiskSystem on a daily basis we are performing cutting edge risk management that is on a par with anything performed in London, Frankfurt, Tokyo, New York or elsewhere. We have the ability to tap into the Irish universities to find the graduates with the educational training that we require and train them in a very skilled, high end and relatively well paid industry. Ireland needs to move up the value chain as the IFIA are continually reminding us. Given Ireland is unlikely to be a front office location it means we as a country need to focus on other specialist areas such as risk management and compliance. The harsh reality is that largely repetitive tasks (such as much of NAV production and financial reporting) will continue to be outsourced to low cost countries such as East Europe and the Far East.

Q6

An issue we feel is of great importance is the issue of substance. A non-executive is not supposed to be the actual risk management function for example. However with the oversight model as exists in Ireland this is sometimes the case. Again as we have referred to earlier, this confuses the executive and non-executive roles in our view. We have come across several examples of ManCos where not only is portfolio management delegated (to the “Investment Advisor”) but in reality so too is risk management (or possibly there is no risk management at all other than in the IM’s front office). A non-executive with very little or no actual risk management experience is then given the task of assuming the Risk Management (and likely the Liquidity Management) managerial functions. His or her role then becomes reading the front office risk reports. Notwithstanding nature, scale and complexity clearly this violates the AIFMD regulations but would seem to be a feature of the Irish delegated model structure. Some clarity from the Central bank on how this ought to operate in practice would be a very helpful starting point.