IMIA | Irish MiFID Industry Association

Via email: CP120@centralbank.ie

Financial Risks and Governance Policy Division
Central Bank of Ireland
PO Box 559
Dublin 1

27 June 2018

Consultation Paper 120 Second Consultation Paper on the Corporate Governance Requirements for Investment Firms and Market Operators

Dear Sir / Madam,

The Irish MiFID Industry Association (IMIA) welcomes the opportunity to respond to Consultation Paper 120 Second Consultation Paper on the Corporate Governance Requirements for Investment Firms and Market Operators.

The objectives of the IMIA are to provide a central representation to the Central Bank of Ireland and other regulatory bodies on behalf of its members, to promote good industry practices on regulatory requirements, to host educational events on regulatory issues impacting MiFID firms and to promote networking and peer interaction. The IMIA has 27 member firms, 24 of which are regulated by the Central Bank.

The IMIA supports the enforcement of high corporate governance standards for investment firms in Ireland and broadly welcome the Corporate Governance Requirements and the clear way in which they are written.

However, several of the IMIA member firms have concerns in respect of certain areas, and the observations are set out below.

Composition of the Board
4.2 A Firm shall ensure that the board is composed of a majority of independent non-executive directors.

Comment from Firm A:
We find that this requirement is too onerous. For instance if there is an owner managed firm, with four owners who are also executive directors, this requirement would require five INEDs, or for some of the shareholders to resign as directors, which may not serve any benefit to the firm.

We note that the Joint ESMA and EBA Guidelines on the assessment of suitability of members of the management body and key function holders (EBA-GL-2017-12) state:

(89)(b)
CRD-institutions that are neither significant nor listed should, as a general principle, have at least one independent member within the management body in its supervisory function. However, competent authorities may not require any independent directors within:

i. CRD-institutions that are wholly owned by a CRD-institution, in particular when the subsidiary is located in the same Member State as the parent CRD-institution;

ii. non-significant CRD-institutions that are investment firms

We request the Central Bank of Ireland (the "Central Bank") consider:

- Introducing a 'Comply or Explain' option for this requirement whereby firms could consider the nature, scale, and complexity of their activities when meeting this requirement OR
- only applying this requirement to high impact firms; medium low and medium high impact firms would only need to have a minimum number of INEDs, for example two, but INEDS would not need to be the majority

Comment from Firm B

As of 1st May 2018 there were 86 MiFID firms regulated by the Central Bank of Ireland. Some of these firms are owner-manager businesses and represent a diverse array of financial service providers which operate globally in niche sectors. The governance arrangements of such firms may represent significant shareholder/owner-manager interests where the specialised knowledge and experience of both executive and non-executive directors of the board is built over many years. For Firms that already have significant shareholder representation on their boards the protection of INEDS being in the majority is superfluous to their needs and will add an additional layer of cost to their governance arrangements.

Comment from Firm C

This requirement would be an issue for our firm – based on our current board composition we would require a number of additional INEDs which would lead to a six-figure increase in costs, at a time when regulatory costs in terms of industry levies are already increasing – certainly an issue for medium/smaller firms. Also, we believe that the pool of INEDs who fulfil all of the criteria and who are willing to take such roles is a very finite one which would lead to availability issues and difficulties in achieving diversity on boards. The likely outcome would be a reduction in board size which will cause difficulties and could be counterproductive in terms of requirement 4.1. In the case of our firm there would be operational issues our business depends on the availability of executive directors to execute documents. This could also be counterproductive in terms of shareholder protection in smaller firms such as ours where the main shareholders currently sit on the board and are actively involved in the business. We would also question whether there is sufficient evidence that a majority of INEDs on a firm or institution's board, as was likely the case in firms/institutions which failed during the recent financial crisis, is effective in managing risk.

4.3.
By way of exception to the general requirement, specified in Section 4.2, in the case of Firms that are subsidiaries of groups, the majority of the board of such subsidiary may also be composed of a following combination subject to the PRISM Impact of the Firm:

- **In the case of High Impact Firms, the majority of the board may be composed of group directors and independent non-executive directors provided that in all cases the Firm shall have at least three independent non-executive directors;**
- **In the case of Medium High Impact Firms, the majority of the board may be composed of group directors and independent non-executive directors provided that in all cases the Firm shall have at least two independent non-executive directors;**
- **In the case of Medium Low Impact Firms, the majority of the board may be composed of group directors and independent non-executive directors provided that in all cases the Firm shall have at least one independent non-executive director.**

In any case the Central Bank retains the discretion to require that the Firm shall have a greater number of independent non-executive directors than specified in this Section.

Comment from Firm C
Can the Central Bank clarify if the exception applies to firms which are subsidiaries of unregulated group entities? i.e. is it a requirement that the group must be regulated in order for the exception to apply?

6. Committees of the Board
6.1 Firms shall ensure that the board establishes, at a minimum, both an audit and a risk committee.

Comment from Firm B
For smaller MiFID firms it is hard to envisage the value add of a risk committee as an extra layer of oversight between the Risk Function and the board of the firm. Some firms have no requirement for an internal audit function. The benefits of establishing an audit committee when the board is already responsible for reviewing and approving a firm's financial statements is, therefore, negligible.

6.3.
In the case of Medium Low and Medium High Impact Firms, where the board comprises 5 or less members, the full board, including the Chairman and the Chief Executive Officer, may act as the audit committee and/or the risk committee. The Firm shall ensure that the board does not carry out such functions in the absence of having obtained the Central Bank's prior approval in writing to do so. In such cases Sections 6.13 and 6.19 continue to apply. Minutes of these meetings shall reflect that the board was sitting as the audit committee or as the risk committee.
6.13
A Firm shall ensure that the Chairman of the audit committee is an independent non-executive director
6.16
A Firm shall ensure that neither the Chairman nor the Chief Executive Officer shall be a member of the audit committee

Comment from Firm D
We are a small group company, with a board composition of five people with one INED, two group directors and two executive directors and the INED is the Chairman. The firm understands that the under Paragraph 6.3, the firm can have the Chairman of the board being a member of the audit committee. The Firm requests that the firm would only have to advise the Central Bank of this, rather than seek approval.

5.3.
A Firm shall ensure that the Chairman shall be an independent non-executive director. By way of exception to this general requirement, in the case of a Firm that is a subsidiary, the Chairman may be a group director. If a deputy Chairman is required, the role shall be taken by an independent non-executive director or in the case of a subsidiary, may be taken by a group director.

6.16
A Firm shall ensure that neither the Chairman nor the Chief Executive Officer shall be a member of the audit committee

Comment from Firm E

5.3 requires the Chairman of the Board to be an independent non-executive director (albeit with exceptions) and 6.13 requires the Chairman of an Audit Committee to be an independent non-executive director. We believe that 6.16 raises a complexity where it states that the Chairman of the Board cannot be a member of the audit committee. For firms with two non-executive directors, it is viewed that this raises practical issues such as composition challenges, frequent rotations and additional costs and we would be grateful if this requirement could be reviewed, at least for those firms with two or less independent non-executive directors.

General Comments

Comment from Firm B

As outlined in the Introduction of CP120 the Central Bank of Ireland (the "Central Bank") states that "the proportionality approach has remained as per CP94" and will "apply to Firms authorised by the Central Bank that are designated as High, Medium High or Medium Low Impact under PRISM".

In the absence of a regulatory definition of proportionality in CP120, it would seem that the PRISM rating drives and defines the overall governance arrangements as opposed to Regulation 17 (2) and 17(3)of MiFID II which permits the management body to define the governance arrangements "taking into account the nature, scale and complexity of its business and all the requirements the investment firm has to comply with".

CP120 goes beyond the requirements of Regulation 17 (2) and 17(3) implementing a prescriptive governance arrangement which will impact board composition as explained below. It is suggested that the provisions of Regulation 17(2) and 17 (3) are sufficient. CP120 should specifically reference the principle of proportionality in the context of governance arrangements and as set out in Section 4 of the Guidelines on the assessment of the suitability of members of the management body and key function holder EBA/GL/2017/12.

Furthermore 4.3 of CP 120 provides for an exception 'in the case of Firms that are subsidiaries of groups'. How should this be understood? Does it imply that the parent of the group structure also be a EU regulated entity?

Comment from Firm C

Can the Central Bank give an indication of when they expect to publish the response to this CP and the final requirements? This is important from a budgetary perspective, particularly if it will result in significant costs

Comment from Firm F

CP 120 states that under proportionality, the requirements will not apply to PRISM Low impact firms, however they are encouraged to adopt these requirements as good practice.

It would be useful for the Central Bank to provide some guidance on how low impact firms may be able to adopt these requirements. Due to the fact that most boards are small, often owner led, stand-alone entities and do not benefit from group resources it would be very difficult to adopt the majority of these requirements. If a board consists of three executive directors and one non-executive director it would need to recruit three additional non-executive directors to comply with 4.2 for example. In particular niche areas such as pensions, it may be difficult to source expertise, even if the cost was not a factor for consideration. What level of adoption of the requirements would be deemed sufficient?

Chairmen are required to have comprehensive, relevant and timely training. Does this mean that the Chairman must hold specific qualifications before they can be appointed as an INED?

Comment from Firm G

We note that the Requirements do not contain transition arrangements for firms which are regraded from "Low Impact" to a higher level under PRISM. Hence, we propose that the Requirements be amended to allow for a transition period. To allow time for upgraded firms to implement the necessary structural changes and recruit appropriate personnel, we propose that the Requirements specifically allow a transition period of 12 months from the date of being formally notified by the Central Bank of a change in PRISM rating.

Yours sincerely,

Irish MiFID Industry Association