IRISH FUNDS INDUSTRY ASSOCIATION

Governance, Accounting & Auditing Policy Division
Policy & Risk Directorate
Central Bank of Ireland
P.O. Box 559
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20th May 2011

Consultation Paper 51: The Fit and Proper Regime in Part 3 of the Central Bank Reform Act 2010

Dear Sirs,

General

The Irish Funds Industry Association welcomes the opportunity to respond to Consultation Paper 51.

We set out below comments on certain matters raised in the Consultation Paper (on which no specific questions were raised within the Consultation Paper) followed by responses to the specific questions raised in the Consultation Paper (using the same referencing as set out in the Consultation Paper).

Controlled Functions (CFs)

With regard to CFs, Section 20(1) of the Central Bank Reform Act, 2010 the ("Act") provides that the Central Bank may make regulations prescribing functions that are to be "controlled functions". Section 20 (2) provides that the Bank may prescribe a function under sub-section (1) if, and only if, the function is a function in relation to the provision of a financial service and then sets out in paragraphs (a) to (c) the list of criteria which can be used in prescribing activities which are to be regarded as "controlled functions". Paragraph 2 of the draft Regulations as set out in Appendix I of the Consultation Paper provides that the functions in Schedule 1 are prescribed as "controlled functions". Schedule 1 then sets out these "controlled functions". However, these are the list of the criteria as set out paragraphs (a) to (c) of Section 20 (2) of the Act which may be used by the Central Bank in prescribing "controlled functions" but they are not in themselves prescribed "controlled functions" under the Act. In our view, Schedule 1 of the draft Regulations is deficient in that it does not prescribe the "controlled functions" but merely repeats the only criteria which the Central Bank may use in prescribing a function as a controlled function.

It was clearly envisaged under the Act that CFs could be prescribed or designated drawing only from the Section 20(2) (a) to (c) criteria. The criteria set out in Section 20(2)(c) of the Act are extremely broad and could theoretically cover almost all officers and employees of an RFSP. This is acknowledged in the Consultation Paper. In paragraph 13, pages 13 and 14 of the Consultation Paper, the Central Bank states that "*positions such as call centre staff may be captured by the definition of CF by virtue of the fact that they fall within the statutory description of giving of assistance. It is important that the managers/supervisors of the centres who have responsibility for ensuring proper process and information to*

customers, rather than the call centre staff, are captured by the new powers." In our view, the power given to the Central Bank to prescribe or designate particular functions as controlled functions using only the criteria as set out in Section 20(2)(a) to (c) enables it to discriminate (particularly as regards paragraph (c)) between persons having a senior role who should be designated as CFs and those having a junior role who we would submit should not be designated as CFs. We would strongly be of the view that the designated CF's should be limited to senior roles as envisaged by the "call centre" example. PCFs are essentially a sub-set of CFs. Except in the very limited circumstances set out in Section 22(8) of the Act, a CF may only be prescribed as a PCF if it is a function by which a person may exercise "significant influence" on the conduct of the affairs of an RFSP. The list of PCFs set out in Schedule 2 of the draft Regulations is quite comprehensive and captures all of the senior posts at an RFSP.

In our view the list of non – PCF CFs should be quite limited, reflecting the fact that all senior office holders and executives are PCFs. Given the differences in size, nature, scale and complexity between classes of and individual RFSPs, many RFSPs may have no or few CFs (which are not also PCFs). We would submit that the list of non - PCF CFs for fund companies, managers and funds service providers comprise the following:

- The MLRO (a fund company or management company is unlikely to have a Head of Compliance for AML (PCF 16) but must have an MLRO).

- Persons in senior roles within an RFSP involving the supervision of staff providing financial services or who ensure, control or monitor compliance by the RFSP of its obligations in the provision of financial services and who report directly to one or more PCF.

We also note that for example, in the UK, in 2010 the FSA updated and strengthened its "approved persons" regime following upon criticism of that regime after the 2008 financial crisis. The FSA requires to pre-approve "approved persons" i.e. those who exercise a "significant influence in the conduct of" a firm's affairs (similar to the proposed Irish PCF regime) but does not have a secondary approval tier similar to CFs.

Many funds service providers delegate certain services/functions to affiliates including affiliates who are non-resident in Ireland. The control of these functions would remain in Ireland. Using the "Call centre" example it would seem to us that the appropriate level at which to designate the CF is at the level of the individual in Ireland with responsibility for the control of the delegated functions.

As RFSPs will already have in place their own robust recruitment and staff supervision and disciplinary regimes, it would be useful to understand the Banks expectations as to what standards they would expect to apply to non CF and non PCF roles. It would be disproportionate for RFSPs also to have to propose a separate "fitness and probity" regime for staff below a senior level given that this would be extremely burdensome at both a pre-engagement and ongoing basis.

HR Issues

Account should be taken of employment law difficulties and the costs involved for RFSPs in removing persons holding existing positions as PCFs or CFs when, in the opinion of the Central Bank/the RFSP (as the

case may be), they do not meet the proposed revised fitness and probity standards (the "Standards"). This may lead to lengthy litigation proceedings and legal settlements.

Processing Fitness and Probity Applications

Department for Processing Applications

We note that it is proposed that all applications will be dealt with through the Regulatory Transaction Department. We would have concerns about this process leaving the Funds Authorisation and Supervision Department ("FASD"). In the past, the unique nature of fund entities and service providers has been recognised and certain of the Central Bank's functions normally undertaken in other Departments have been internalised within the FASD. The IFIA recognises the contribution of "cradle to grave" approval to the smooth running of the regulation of the Irish fund's industry. We believe this approach has served all parties well and would propose this would continue to be the case particularly given the sensitivity of timing of fund authorisations (such that the approval of Directors meets the time-line for a funds' authorisation) and the fact that because SMICs and fund managers typically use a delegation model (whereby functions are delegated to other regulated service providers) there is significant difference between say the appointment of a non-executive Director of a SMIC/fund manager and a Director of a credit institution.

Content of the Individual Questionnaire

We would regard the current form of Individual Questionnaire, in terms of content as being more than adequate to meet the requirements of a fitness and probity regime.

Is it proposed to change the content of the questionnaire? If yes, we would be grateful if you could forward a draft to us for comment.

We note for example that the draft Standards contain requirements that:

(a) "the person must be able to demonstrate that he or she has professional or other qualifications and capabilities appropriate to the relevant function".

Would a person seeking a directorship of a fund and who graduated from University many years previously have to "demonstrate" their qualification by the production of a copy of their original degree certificate? In many cases, this might be lost or unavailable and we would suggest that there be a cut-off time period for the production of any such certificates (if anticipated).

(b) the "person must be capable of performing the relevant function on a continual basis having regard to his/her physical and mental health". Will there be questions relating to health? This appears to us to be very unusual and invasive. The FSA does not raise any such questions in its questionnaire and these appear to us to be inappropriate;

(c) appear to be open-ended or may seek information on an open-ended basis. The current questionnaire, in terms of employment history and certain other information is limited to the

previous ten years. We assume that the information sought in any revised questionnaire would also be limited in time scope. The FSA requires employment history going back over the last 5 years, with any gaps explained and candidates are required to also submit a copy of their CV. The FSA also has a one year look back for disclosure of candidates with senior involvement in a company which has been, amongst other things, put in liquidation, judged liable for fraud, been convicted of a criminal offence, or been investigated by an inspector appointed under company law.

We would also submit that, if it is proposed to amend the current individual questionnaire substantially, that either a tailored individual questionnaire for funds and funds service providers PCF positions be prepared or that an individual questionnaire be prepared such that certain sections will not have to be completed by applicants for funds and fund service providers, in recognition of the quite different responsibilities being undertaken by PCFs in the funds industry as opposed to those in certain credit institutions and insurers, for example.

Timescale for processing of Individual Questionnaire

The industry welcomes the introduction of an automated questionnaire. We are of the view that the Central Bank should agree on timescales during which applications will be processed given the sensitive nature of timing for all parties concerned in any recruitment procedure in a competitive industry. For example the FSA has a statutory obligation to determine applications within a certain time period. However, they have made a commitment in their published service standards to complete the processing of 85% of applications within 2, 4 or 7 days, depending on the nature of the applications.

A PCF acquiring an additional PCF or other PCF Role

We assume, in relation to persons who have been previously approved as a PCF, that there will be some fast-tracking system for a person moving in an executive role in a PCF to either another PCF position in the same RFSP or to a PCF position in a different RFSP.

In relation to say non-executive directors of fund companies/management companies who (have completed the revised questionnaire) and are taking on new directorships, will the current system under which the person declares the information contained in the existing individual questionnaire is up to date still prevail? What is the position of say a person in a fund administration company who has been approved by the Central Bank as head of transfer agency but then additionally becomes a Director of the same fund administrator. Will that person have to go through a separate PCF process or will there be a shortened process? We note that the FSA use a shortened application form for the following circumstances:

- Where an approved person is applying to perform an additional controlled function under an arrangement with the same firm;

- The candidate has ceased to perform a controlled function under an arrangement with firm A, and now requires approval to perform a controlled function under an arrangement with firm B. These can be two entirely different firms and not just firms in the same group;

- An approved person is applying to perform a controlled function and is already authorised for that group of functions for another firm.

Timing of Implementation

We note that the proposed new regime is to come into effect on 1 September 2011. Individuals who hold positions as PCFs and CFs at that date will continue in these positions. However, RFSPs, under Section 21, must be satisfied on reasonable grounds that a CF complies with the Standards issued under Section 50 and the CF must have agreed to abide by such Standards. RFSPs are required to carry out diligence on PCFs and CFs "at transition", and to supply a list of PCFs as at transition by 31 December 2011 and to confirm in writing that they are satisfied that the CFs are fit and proper according to the Standards.

If the new regime does not come into operation until 1 September 2011, firms will not be in a position to carry out the relevant due diligence until the Standards have been issued and finalised (presumably not until 1 September 2011). There needs to be a reasonable period between the "transition" (assuming 1 September 2011) during which this due diligence can be carried out and confirmations being given under Section 21. It appears to us that a four month period is too short in light of the level of due diligence which may have to be undertaken and, if necessary, changes made in CFs/PCFs at particular RFSPs. We would submit that RFSPs be given until 31 March 2012 to submit lists and confirmations under Section 21.

Questions relating to proposed PCFs and CFs

16.1

(a) **Do you consider any PCFs or CFs should be removed from the list? If so, the reasons why?**

We do not consider that any PCFs should be removed from the list. However, as regards fund entities and fund managers specified under paragraph 6 of Schedule 2, Part 2 of the draft Regulations, it should be noted that in many cases these would be operating on the basis of a delegated model and will not have a "Head of Transfer Agency" (PCF – 38) or "Head of Accounting Valuations" (PCF – 39).

We note that company secretaries are prescribed as PCFs. Many company secretaries to fund companies and fund management companies are corporate entities, owned and controlled by the Irish law firms who act as legal advisers to the fund/management company. The directors of these corporate company secretaries will typically be partners in the legal firm and the senior executives will typically be persons with a legal company secretarial qualification. The "fit and proper" regime applies to individuals only and we would question how this would be applied in practice to corporate company secretaries.

Please also see our comments under "Controlled Functions (CF)" above in relation to CFs.

(b) **Do you consider any other positions or functions should be added to the list of CFs and PCFs?**

We do not consider that any other positions or functions should be added to the list of PCFs.

Please see our comments under "Controlled Functions" (CFs) above in relation to CFs.

(c) **With regard to Section 20(2)(c) of the Act:**

(1) **Should we formally exempt specific categories of staff from the definition of CF, or**

As stated under "Controlled Functions (CFs)" above, in our view CFs have not been "prescribed" so it is not possible to respond to this question. Assuming, as we have suggested, that the list of non-PCF CFs prescribed will be limited to certain senior personnel, then there should be no requirement for exempted categories.

(2) **Should we provide non-statutory guidance to firms on what we consider to be appropriate levels or types of due diligence which firms should carry out prior to appointing staff thereby allowing for firms to adopt varying levels of due diligence (for example providing reduced vetting for assistance roles with a lower risk profile, such as call centre staff)?**

Again, in the absence of a list of prescribed CFs, it is difficult to respond to this question. This will depend on whether the list of prescribed non-PCF CFs is broad or, as we have suggested, reasonably limited. Either way, it will be essential to have clarity on this matter.

If non-statutory guidance is to be provided, then we would request that this be given on an industry specific basis rather than on a general basis given the very broad range of RFSPs covered by the Consultation Paper.

Questions relating to the proposed Standards of Fitness and Probity.

41.

(i) **Do you consider that the standards as set out in Appendix 2 of the Consultation Paper ("Standards") are comprehensive in setting the appropriate standards for Fitness and Probity of individuals working in the financial services industry in Ireland? If not, have you any additional standards or considerations to add?**

Some of the Standards are rather vague, e.g.:

(a) the list set out under paragraph 4 is very open-ended. As we have suggested above there should be time limitation on some of the requirements.

(b) 4.1(e) Most company strike-offs are voluntary. The words "on an involuntary basis" should be inserted between the words "off" and "the" on line 2.

(c) 4.1(n) We would suggest that the person must be in a position of "significant influence". We would also suggest that "trade business or profession on line 4 be replaced by "financial services business or profession". A similar amendment should also be made to paragraph (o).

(d) 4.1(p) We would suggest that the responsibility or influence involved must have been significant and that the investigation etc. must be in relation to a period in which the person held such a position of responsibility or influence.

(e) 5.2(g) We would suggest that the person must have been concerned in the management of the entity at a senior level.

Financial Soundness

- The overall requirement is that a person shall manage his or her affairs in a sound and prudent manner. Whilst we would accept the principles surrounding financial soundness, there are many difficult situations thrown up by the recent financial crisis and not all should render a person being unfit for a position of PCF or CF. Paragraph 22 states where a person experienced difficulty in the past but subsequently honoured all debts it may not necessarily prevent their appointment to PCF or CF. In our view this should be expanded to include more minor debts which are not repaid in full and fall outside a certain timeframe. This more measured application of the requirement for financial soundness is welcomed and should be reflected in any guidance notes published. Presumably a distinction needs to be drawn between directors within credit institutions whose conduct may be regarded as having being reckless in recent years, from the situation of a PCF/CF who is in negative equity in relation to their only residence and may have lost their position in a redundancy and have thus been unable to fulfil his/her financial obligations, i.e. there needs to be an element of proportionality introduced to the application of the "Financial Soundness". The latter example should not prevent an otherwise suitable person from filling the position of PCF / CF within an organisation.

- The practical application of the requirements also needs to be given further consideration. For example, is this information / disclosures that an RFSP can compel a person to provide? While an external candidate for a PCF / CF position may be inclined to provide the information in order to secure the position, an existing employee of the RFSP may not be quite so anxious to provide this information. Consideration needs to be given to whether in all circumstances an RFSP can withhold or withdraw the offer of a CF / PCF position to either internal or external candidates where the information on financial soundness is not forthcoming as this could expose the RFSP to legal challenge. This is a very material point which needs to be given consideration before the standards are finalised.

- We believe that it is important that a cut off period (say five years), be included so that where a financial incident relating to the personal finances of an individual occurs outside of such timeframe it is not necessary to make a disclosures.

- Consideration should also be given to compliance with other legal requirements such as data protection when maintaining financial information to satisfy the requirements of ongoing appropriateness of persons in CF / PCF positions.

(ii) **Do you consider that any of the Standards are superfluous? If so, the reasons why?**

Please see comments at (i) above.

(iii) **Do you consider that the Standards specified are sufficiently clear to be adopted by firms for their internal Fit and Proper process?**

Please see comments at (ii) above.

42. **We are considering the benefit of providing guidance on the statutory Standards. Such guidance will be provided on a non-statutory basis and would take account of responses received to this consultation. Comments are therefore also invited as to whether non-statutory guidance would be useful to firms. If so, what issues should the guidance cover to assist firms in carrying out their own fit and proper test for persons proposed or holding both PCFs and CFs?**

Please see our response to Section 16.1 9(c)(2) above in relation to due diligence.

We would also welcome the opportunity to discuss with you our comments in the context of the implementation by you of the revised regime and the processing of the relevant documentation.

Yours faithfully,

Gary Palmer
Chief Executive