

Response to Consultation Paper CP60

Sir

The list of “Questions for consideration” within the consultation paper CP60 does not include any real proposal to improve the level of service provided by the *directors* of Alternative Investment Funds (AIFs) and offers little change to the industry’s existing voluntary Corporate Governance Code. If anything, the voluntary code is watered down in several places, such as the lack of a requirement for any independent directors within CP60.

This is a major oversight within the paper and ignores a governance problem that is an increasing concern for both the investment community and the general public. The paper does state an intention to “clarify the obligations of directors when an AIF gets into difficulties” but unfortunately it does not sufficiently call for directors who are appropriately independent, skilled and available to help ensure that AIFs don’t get into these situations in the first place.

As we have seen clearly in the Caribbean, the directorship industry cannot be trusted to self-police. If the Central Bank does not explicitly apply minimum standards for fund boards, the natural consequence is likely to be Irish fund boards staffed with conflicted individuals, who are paid by the fund manager in another capacity, taking on excessively large portfolios of directorship roles. The problem is further compounded by the requirement for two directors to be Irish residents which, given the nature of the local financial industry, practically guarantees an insufficient breadth of experience around the board table for many funds.

The stated aim of the single AIF Handbook is “a framework for the protection of investors”. The fund’s board of directors should be a crucial part of this protection, and ensuring a high standard of board governance should be a process driven by the regulator. There is no shortage of information on this topic, or any lack of clarity on what investors want to see.

High profile articles in the Financial Times, New York Times and very recently the Guardian, have highlighted the problem of offshore rent-a-director firms, where individuals build up ridiculously large portfolios of directorship roles, to the detriment of investors whose interests are not being properly supervised. The Irish Central Bank must also be aware of an on-going letter writing campaign, organised by some of the largest alternative investment firms with combined assets probably in excess of \$500 billion, to the Cayman regulator CIMA, pressing the regulator to disclose the portfolios of roles held by local directors. In addition, recent industry specialist conferences have been dominated by this topic and seen heated exchanges as investors have made their dissatisfaction clear. If new Irish regulation does not address one of the main operational problems currently facing hedge fund investors, in at least this crucial area, it will have failed.

CP60 does set out new requirements of experience and independence for the directors of the *depositories* (below with my italics) that, inexplicably, it does not also make binding on the directors of the investment funds.

“A **depository** must satisfy the Central Bank that it has the appropriate expertise and experience to carry out its functions as set out in these Requirements, the AIFMD Regulations and AIFMD Level 2. The depository must satisfy the Central Bank on a continuing basis that it has sufficient management

resources to effectively conduct its business. In addition, its directors and managers should be persons of integrity and have an *appropriate level of knowledge and experience.*”

“The board of directors of the **depository** appointed for an AIF *must not have directors in common* with the board of directors of the AIFM or the management company, the fund administrator, the investment company or the general partner.”

It makes no sense to specify that the directors of the depository are appropriately qualified and independent to perform their function, but not to apply these same standards to the directors of the fund; where instead the priority appears to be informing them of their duties after the fund gets into trouble.

Investors have three main areas of concern when evaluating AIF directors ; Independence, Capacity and Experience, none of which are adequately addressed in CP60.

Independence – One of the first compliance questions asked by any potential hedge fund investor, is whether the directors are independent. Too many of them have experienced poor service from conflicted directors during the financial crisis, to again trust the objectivity of directors who are also service providers to the fund manager. This is an obvious area where the Central Bank should be seeking to legislate. The current proposal, that fund directors need only be independent from the depository, is not sufficient. Instead the same standards being set for the depository’s directors, most importantly being independent from the fund manager, should clearly also be applied to the directors of the funds.

Capacity – The varied and lumpy nature of the directorship function, together with the multiple classes of similar vehicles often used, makes prescribing a single maximum number of roles difficult. Difficult, but not impossible. Given that even the most straightforward fund should require at least a couple of hours a week to oversee, then it’s hard to see how any individual director could sensibly take on more than 20-30 fund relationships. A “comply or explain” ceiling would be one possible solution to this issue. Alternatively, the Central Bank should require full disclosure of roles not just to the board, but to the investors, whose interests the directors are ultimately supposed to serve.

Experience – Widespread guidance on board composition, whether alternative or traditional, is that a board of directors needs to be balanced across a sufficient range of skills to adequately oversee the business. A board comprising of the portfolio manager and two conflicted service providers is highly unlikely to achieve this, particularly in the some of the specialist strategies employed by alternative investment funds. The Central Bank’s stated requirement that fund directors need experience “*in relation to the organisation of AIFs*” is much too vague. Instead, it should apply the same requirement as for depositaries, that there is an “*appropriate level of knowledge and experience*” and clarify that this experience needs to be balanced across the board.

Residency - The latter point brings into question the requirement for a minimum of two directors to be Irish resident. This requirement looks actively detrimental to the objective of improving fund boards and protecting investors. While Dublin possibly has sufficient numbers of suitable lawyers, accountants and fund administrators to provide these specific oversight skills, it does not have a large enough AIF management business. This means that there are simply not enough residents with the relevant asset management and investment skills. Without access to appropriate portfolio management and operational due diligence expertise on fund boards, the warning signs for hedge

fund blow-ups have been missed many times in the past, and will be again in the future. There is an obvious weakness here that new legislation should be seeking to remedy, not exacerbate.

If there is an argument that the Irish authorities require individual directors who can be locally accountable, then *one* resident director would seem sufficient to fulfil this function, while still allowing the fund board to access the other skills that it needs.

In summary, if the AIF Handbook is aiming to consolidate Ireland's position as the European domicile of choice after the introduction of the AIFMD, then it needs to set new standards of fund governance. Investors are deeply dissatisfied with current dominance of unsuitable, conflicted and over-stretched directors. This is a problem that has dogged the alternatives industry since its inception and which has done serious harm to its reputation. If Ireland now rejects this opportunity to redress the balance and to hold fund directors to a higher professional standard, it will be a major disappointment to European investors.