

Arthur Cox responses to individual questions within CP 86

1.

Is publishing a delegate oversight good practice document along the attached lines a good approach to encouraging the development of the supervision of delegates by fund management companies?

Arthur Cox Response:

We do not believe the publication by the Central Bank of a delegate oversight good practice document is necessary to encourage the supervision of delegates and have a number of comments in relation to the document itself.

Both a good practice document and the alternative suggestion about the issue of rules are approaches that are too prescriptive and formulaic. The document and rules would be difficult to apply across all the various different types of fund entities and fund ranges. The good practice document refers to the fact that the recommendations do not address every aspect of good practice and that a board may wish to put a broader range or alternative questions to delegates. The good practice document does not acknowledge that over time a fund management company may wish to rely on assurances already provided about certain practices and procedures by the delegates, the details of which have already been considered by the board. It may not be appropriate to consider the list of questions at each board meeting as some of the questions need to be considered only on a periodic basis and the board should be able to receive confirmation that no material changes have been made to the practices and procedures described at prior meetings. Our concern is that one size does not fit all and so the good practice document, if applied rigidly, would cut across what many fund boards are already doing. It could perhaps be a useful framework document for the smaller less resourced promoters new to establishing Irish funds. However it should not be put forward as the only way in which to manage a board's business.

Similarly, the nature of the questions may not be relevant to some delegates because of the size of the delegate organisation and/or its scale and complexity.

1. Investment management

No mention is made in the document to the fact that a board places reliance on a delegate's size, the regulatory status, ownership, capitalisation and experience of managing other funds in terms of its ability to perform its function and its capacity.

Once an Irish umbrella vehicle is established the launch of additional sub-funds within an umbrella is often a regular occurrence. These launches are not timed to coincide with scheduled board meeting dates. Some managers launch a significant number of sub-funds each year. The list of information envisaged that a board may receive is stated to be a minimum requirement for each and every sub-fund. This level of information may be unnecessary for many fund boards. In reality some sub-funds may be similar to ones already established and follow the same strategy in which case it should not be necessary to repeat this information for each and every sub-fund launch.

We also query some of the matters included in the list. Is it necessary for the board to receive the details of portfolio management teams' credentials for the task of managing a sub-fund? What relevance are the trading protocols relating to best execution and order management? The fund must have policies in place in relation to best execution and order management in any event and often relies on the investment manager's policies in this regard. These practices do not vary between sub-funds and it is not necessary to refer to them on every sub-fund launch. What kind of information is it envisaged that the investment

manager will provide to the fund board in relation to the allocation of its business to brokers and commission sharing? The Central Bank already requires specific disclosure on these matters in the fund's prospectus.

Also, reference is made to the board receiving information on the strategy for a fund where it underperforms. It should be acknowledged that funds do not perform well at all times and a portfolio manager may wish to maintain its conviction in a particular strategy over the long term notwithstanding lacklustre performance for a particular period.

The investment manager is in most cases the sponsor of the fund itself and the fund is another product within its range of products. The fund is branded with the name, style and logo of the investment manager and there is no recognition in the good practice document of the central role the sponsor/investment manager plays in the continued existence of the fund.

Mention is also made of the need for a suitable representative of the investment manager to be able to answer questions raised by the board. It should be clear that this suitable person is not necessarily the portfolio manager(s). Some investment managers prefer that a member of their management team report on investment management having obtained the information from the portfolio manager(s) rather the portfolio manager(s) directly.

Only material changes to an investment approach should be subject to board approval.

2. Distribution

We acknowledge that the board should be able to request sight of marketing material. Presumably this is in order for the board to understand the way in which the fund is marketed rather than seeking to ensure compliance with all legal, regulatory or other requirements. It is not the role of the board to check that the marketing documentation meets these various requirements.

3. Risk management

The board is not in a position to assess in any meaningful way the business continuity programme of a third party delegate. The board can seek assurances from a delegate in relation to the delegate maintaining and testing its business continuity programme and receive reports from the delegate but the board is not in a position to detect issues that may arise in the delegate's operations.

4. Investment operations and administration

We would expect all fund boards to receive regular depositary reports in all circumstances so reference to "where the board considers that they are necessary" seems odd.

5. Support and resourcing

The various items listed in the section dealing with support and resources are often provided by the investment manager/promoter. It should be acknowledged that in most cases these services are provided by and co-ordinated through the investment manager and the fund's legal advisers.

2.

Is the breakdown of revised managerial functions correct? Should other managerial functions be provided for? What are your observations about what the organisational effectiveness function might entail and how this might be performed? Do you see any obstacles to the Chairperson performing the operational effectiveness function?

Arthur Cox Response:

We consider the breakdown of the revised management functions to be useful and should streamline the reporting process. We do not consider it necessary to provide for any additional managerial functions.

With regard to the organisational effectiveness function we are unsure what the Central Bank envisages when it refers to the chairman carrying out this role between board meetings. Essentially the business plan/programme of activities already provides for escalation of matters in respect of all key management functions to a designated director and/or the board between board meetings, where necessary. What additional action does the Central Bank envisage the chair to carry out in performing this function? The chairman is not an executive director of a fund.

While the description of the various functions in Appendix 2 is useful, the danger is that the Central Bank will require these various functions to be listed in any business plan and/or programme of activities. There is no meaningful reason why the Central Bank should insist that in revised business plans/programme of activities these functions are referred to verbatim in that document.

Also, the reference to “day to day” oversight is misplaced as the directors role is not an executive one. A director is not responsible for the day to day management of the fund.

Does the organisational effectiveness function mean that for the most part the Central Bank will expect the chair to be a person within the investment manager organisation? An independent director often serves as the Chair of a board and the proposed increased responsibilities may mean that independent directors may be unwilling to continue in this role.

Will the Central Bank impose requirements on how many functions can be assumed by any one director? Often two or more of these functions can readily be assumed by a senior executive within the investment manager who is on the fund board as his/her executive role covers these areas of activity. Will the Central Bank require that certain functions be assumed by the Irish resident director or a delegate of a director based in Ireland?

Within what period of time will the Central Bank require that changes to the business plan/programme of activities be updated to reflect these requirements? Given that many of these documents have just been updated under UCITS IV or put in place in July 2014 under AIFMD the timing of new requirements being introduced as a result of this consultation is a sensitive issue not just for clients (who recently adopted those documents in accordance with the Central Bank’s requirements) but also for the jurisdiction’s reputation as a fund domicile. There should be a long transitional period to allow clients to address any new requirements and that transitional period should not be affected by an existing umbrella fund creating new sub-funds prior to the end of the transitional period.

3.

Is relaxing the two Irish resident director requirement the correct approach? Will relaxing this requirement have an adverse impact on the ability of the Central Bank to have issues with distressed investment funds resolved? If so, how could this be addressed?

Arthur Cox Response:

We do not believe that the relaxing of the two Irish resident director requirement is the correct approach. We question the usefulness of making changes to this requirement. In consulting with clients on this consultation paper, we do not expect promoters of existing funds to avail of any relaxation of the two Irish resident director requirement. It is a requirement that has been there from the start of the industry in Ireland. It is curious that a decision would be made at this time to relax this requirement given the focus internationally on low tax domiciles and substance requirements. However we do not think that this change would have an adverse impact on the ability of the Central Bank to resolve issues affecting distressed investment funds.

With regard to the dispensing of the requirement for the second Irish resident director, CP86 refers to that director being unconnected to “the depositary and/or the service provider”. If the second Irish resident director requirement is being relaxed to allow for other experienced individuals to sit on a fund board, particularly those with risk management expertise, then often the best candidate to assume this role is likely to be an employee of the investment manager. The benefit of relaxing this requirement will be lost if the Central Bank insists that the director must be unconnected to the investment manager.

The availability of directors to the Central Bank within the 24 hour period presumably should also be by way of video conference or telephone and not just a physical meeting.

4.

What are your views on the proposed approach to measuring time spent in Ireland? Can you suggest any alternatives or any enhancements to the definition proposed by the Central Bank?

Arthur Cox Response:

We note the proposed approach of measuring time spent depending on a full working day. We do not see the need to adopt a new approach to determining a director's residency. The rules on Irish tax residence are quite clear despite any suggestion to the contrary. Such a departure from generally accepted standards of residency should only be warranted in light of a clear and obvious need to address a serious industry issue. We do not believe there is such an industry issue. This may be a proposal that will benefit a few to the detriment of the reputation of the industry as a whole.

We advise our clients of the requirements in relation to board constitution and it is for the client to decide both how to select and terminate the appointment of the board members.

It should be noted that this change should not affect the way in which the decision-making of the fund is carried out. Decision making will need to continue to be performed at board meetings held in Ireland so that the mind and management of the fund takes place in Ireland and the fund's tax residency is unaffected.

5.

Is there a downside to requiring fund management companies to document the rationale for the board composition? Will fund management companies require a transitional period during which they can alter their board composition to ensure they have sufficient expertise and how long do you consider would be a reasonable timeframe for such adjustments?

Arthur Cox Response:

We need to understand more clearly the way in which the Central Bank envisages the need to document the rationale for the board composition taking place. Would it be by way of minutes taken at the first board meeting at the launch of the fund, an extract of which would then be provided to the Central Bank? Will a new form be prepared by the Central Bank requiring answers to certain questions in relation to the board composition? A simpler approach would be for the justification for the board composition to be provided in the business plan/programme of activities. How is it intended that existing funds will address this requirement?

As a consequence of the implementation of the Corporate Governance Code and fitness and probity regime Irish funds now consider their board composition more formally than they might have done in the past. Many funds will have already considered the complexion of the fund boards in the context of the requirements of the Code. Also, fund boards have typically been considering informally on a yearly basis the workings of the board and of individual directors in line with the Code requirements and also in the context of an increasing focus on corporate governance matters more generally. The three year written review of the board (which is due for most fund boards in 2015) may also prompt an opportunity for Irish funds to change the board composition.

6.

Are there any other elements which should be included by the Central Bank in a Fund Management Company Effectiveness – Delegate Oversight initiative?

Arthur Cox Response:

CP86 does not acknowledge the role of the promoter/investment manager in determining board constitution and as the fund is essentially a product of the promoter/investment manager who must retain the ability to be able to terminate a director's appointment.

It should be noted by the Central Bank that some directors are unwilling to assume the designated director role responsible for certain management functions as they regard this as an executive function. Is this appropriate for a director not to agree to take on the designated director function?