

The Fund Governance Boardroom Panel



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Fund Management Company Effectiveness -Delegate Oversight Consultation
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Dear Sir or Madam,

**Re: Consultation on Fund Management Company Effectiveness – Delegate Oversight
Consultation Paper CP86**

We welcome the opportunity to submit our comments to the Central Bank in relation to the consultation paper CP86 "Fund Management Company Effectiveness – Delegate Oversight"

We attach our comments, observations and recommendations and if you have any questions or require any clarification please do not hesitate to contact us.

Yours faithfully

Damian Keane

John Oppermann

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Introduction

We welcome the publication of the Consultation Paper 86 (“CP86”) dealing with “Fund Management Company Effectiveness – Delegate Oversight” and note that CP86 sets out a number of proposed initiatives which are designed to underpin the substantive control by fund management companies, *acting on behalf of investment funds*, over the activities of delegates. We also note that the name assigned to the committee associated with the document is the Committee on “Collective Investment Governance” and with this in mind we set out hereunder our considered response to the consultation document.

Collective Investment Governance

The Alternative Investment Fund Managers Directive (“AIFMD”) has redirected the primary target of regulation at the Management Company level as opposed to at the Investment (Fund) Company level. We also understand that the European Securities and Markets Authority (“ESMA”) has a particular supervisory focus on ensuring that Management Companies have substance and do not become letter-box entities.

Whilst the Consultation Paper deals with Fund Management Company Effectiveness, we believe that an opportunity has been missed to incorporate a comprehensive view of “Collective Investment Governance” in one document which encapsulates both the Management Company and the Investment (Fund) Company. The fundamental governance principle of Independence has not been incorporated within the Consultation Paper and our opinion is that any structurally sound foundation stone for “Collective Investment Governance” should always include this principle. We would recommend that the Central Bank sets a minimum number of independent directors on a Board and we also recommend that the majority of a Board of a Management Company and of an Investment (Fund) Company should be composed of independent directors.

The Consultation Paper should also recognise, incorporate and leverage off the key perspectives and distinctions between **Corporate Governance** and **Fund Governance**. Fund Governance involves the oversight on behalf of investors of a unique model where all roles associated with the Fund entity are outsourced to specialist service providers. It is recognised that Ireland as a jurisdiction has to date been very successful as a Fund Governance centre and we are of the firm opinion that this strength should not be dissipated, diminished, weakened or made peripheral by a primary and total focus on the creation of substance at the level of the Management Company. Such a focus at the expense of Fund Governance could potentially lead to problems associated with the overall “Collective Investment Governance” framework and could ultimately result in reputational damage for this jurisdiction.

Board Composition

We are in agreement with the proposal to present the initial rationale for board composition as part of the authorisation process, in order to ensure that there is a balance of skills and competencies on the board.

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We would recommend that it may not be appropriate for a Management Company or an Investment (Fund) Company Board to have Directors that serve for more than a defined maximum number of years. In line with governance standards, rotation of independent directors is recommended in order to preserve independence, to freshen up the board and to encourage new perspectives and constructive challenge.

We welcome the clarification in respect of the established practice of appointing lawyers to the boards of Management Companies and Investment (Fund) Companies. Where legal firms provide advisory services to a Management Company and/or an underlying Investment (Fund) Company, we would recommend that no representative of that firm should be approved to serve as a Director on the board of the relevant Management Company or underlying Investment (Fund) Companies. We believe that this situation represents a significant conflict of interest. We would also reiterate our recommendation that the majority of the board should be composed of independent directors.

We believe that CP86 should be unambiguous in this regard and incorporate the above recommendation. We would also propose that a nine month grandfathering period be applied before full implementation of the board composition rules.

Residency, Skills Pool and Directorial Concentration

We note the proposal to relax the Irish resident director requirement and your objective to encourage a broad range of relevant skills and competencies on fund management company boards. We agree with the proposal to broaden the range of skills and competencies on such Boards, although we believe that the proposed relaxation of the Irish Residency requirement has the potential to significantly reduce the Central Bank's regulatory reach. In particular it could present difficult challenges for the Central Bank at times where key Management Company or Fund related issues need to be swiftly addressed, and the Central Bank is forced to chase cross border and to deal with Directors who are outside of the State. Irish resident directors have a vested interest in the reputation of the jurisdiction. They have "skin in the game" and an Irish resident Director will be more reactive to the Central Bank in swiftly addressing and resolving any issues that may arise. It could also be difficult to establish the independence of non-resident directors.

We disagree with the proposal to relax the Irish residency requirement for two Irish resident directors, either at the Fund Management company board level or at the Investment (Fund) Company board level, if this is also envisaged at a later date. We believe that the perceived issue noted in the document related to competencies and skills, for which a solution is sought, is not actually a problem that has been comprehensively researched and defined. An unfortunate by-product of this is also that an uncoordinated headline message has been given in CP86 to the global market that Ireland has a scarcity of appropriate skills. We would recommend that the Central Bank enters into consultation with the industry prior to any permanent changes to further assess the level of skillsets available in the Irish market.

We believe that there has been no narrowing of the skills pool within the Irish jurisdiction, if anything the pool of expertise has increased in recent years. There is a wealth of existing talent within the Irish market and there has also been an increased engagement and focus on Directorial education by new entrants to the market who are undertaking the role of professional non-

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executive director on a full time basis. However, there continues to be a substantial pool of Directors with the appropriate skillsets who are not being considered for appointments and the over-concentration on a small group of directors continues to limit the pool of directors being appointed.

We would highlight the concentration of a relatively small number of individual directors on a proliferation of Irish Investment (Fund) Company boards and Management Company boards. There also appears to be repeated pairings of the same Directors from this small pool on multiple Boards. We believe that this lack of diversity is a latent and masked prevailing risk for “Collective Investment Governance”. A review of existing Irish Management Companies and Irish Investment (Fund) Companies indicates that there has been little diversity of individual directors and the pool that has been engaged and consistently approved for such roles to date is unusually small. In addition to their Irish directorships, this small pool of directors may also hold a number of directorships of regulated entities in other jurisdictions.

The potential risks over time of extreme directorial concentration are behaviours such as “groupthink”, “confirmation bias” and “anchoring” amongst others. An intangible risk associated with a Director holding for example greater than 25 Management Company and/or Fund directorships (Irish domiciled Funds and maybe other Non-Irish Domiciled Funds), is the real potential for “Quasi-Focus”, as opposed to appropriate oversight engagement with the “DNA” of the Management Company or the Investment (Fund) Company.

We recognise that the Fund Governance framework within Ireland under the legacy Promoter approval regime has been robust in the past and the jurisdiction has not to date witnessed any major reputational damage associated with Irish Domiciled Funds. However, as a consequence of the changing regulatory environment, increasing governance standards and an effective and appropriate “Collective Investment Governance” framework, the current status quo concerning directorial concentration needs to be addressed and changed. This should not however be addressed in a manner which ignores the high level of Corporate and Fund Governance expertise which already exists within this jurisdiction. We believe that the Consultation Paper should have addressed the directorial concentration issue.

We recommend that the Central Bank of Ireland address the Directorial concentration issue by implementing a cap on the number of regulated entity directorships held by any one individual. Irrespective of an individual’s perception of their own work capacity, we would recommend that this cap should be 25 directorships. This is based on 220 working days per annum (52 weeks x 5 days, less 30 days Holidays and 10 Bank Holidays). In addition, directors should be allocating time for professional education, attendance at conferences, seminars and other industry related events. They should also allocate a percentage of their capacity as a buffer for ad hoc issues as they arise in relation to their directorships and we would suggest 20% of their capacity be set aside as a buffer. There may however be exceptional circumstances where a Director has a number of directorships under one client relationship and the Central Bank could use its discretion in this regard.

In respect of the perceived scarcity of appropriate resources, we would recommend that the Central Bank creates a public register of approved Directors and their current appointments. This should also include the number of directorships of non-Irish regulated entities. We would envisage that all

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available Directors would apply to have their details included in this register of directors, and this would also include other roles and occupations that the director undertakes or holds. This register would provide a database of available directors to any new entities establishing a Management Company or Investment (Fund) Company in Ireland or for existing entities seeking to appoint new Directors. This may bring an additional level of transparency and visibility to the process.

In exceptional cases where a Management Company or Fund Promoter has been unable to find a very specific set of skills in Ireland for their Board, the Central Bank could also use its discretion to relax the residency requirement for one of the Directors upon receipt of the evidence of the search undertaken for the Irish Directors. We note your proposal in respect of the requirement to spend not less than 110 days in Ireland but this will create significant confusion when compared with Irish taxation legislation requirements in respect of residency. The administration involved in tracking and monitoring the relevant time spent in Ireland by the non-resident could be quite cumbersome.

Management Company Models

Management Companies (including those either affiliated or not affiliated with the underlying Investment Fund) will usually have a limited group of shareholders whose goal is to maximise shareholder value. Fees are in most cases charged based on some level of basis points applied to the underlying Investment Fund Assets under Management. The interests of Management Companies and Investment (Fund) Companies may therefore not always be aligned.

The Consultation Paper does not make any distinction between different types of Management Companies, for example External AIFMs (i.e. a third party AIFM solution), Internal AIFMs (i.e. a Promoter AIFM), UCITS Management companies and Self-Managed Investment Companies. Our view is that one size does not fit all and the operating models of the different types of management companies need to be addressed in the Consultation Paper.

Where an External AIFM also provides Advisory Services, Designated Role or Directorial Support services to underlying Investment (Fund) Companies, our opinion would be that there is the potential for conflicts of interest to arise where persons connected to the Management Company or an Advisory firm (with common ownership) are also appointed as Directors to the boards of underlying Investment (Fund) Companies. This scenario is similar to the point made previously about legal firm representatives sitting on boards and at the same time also providing legal advice. We would refer to the precedent where service providers in the past (such as Fund Administrators) had their own representatives sitting on client Fund boards and have since resigned their directorial positions due to the conflicts of interests that this presented. As previously stated, we would recommend that the majority of the boards should be made up of independent directors and that the Central Bank clarify the meaning of independence.

We believe that this matter should be addressed at this juncture within CP86 as opposed to being dealt with piecemeal at a later stage or only after a matter causing significant jurisdictional reputational damage occurs either within a Management Company or within an underlying Investment (Fund) Company.

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Designated Roles

We welcome the streamlining of the designated managerial functions and we believe the guidelines presented by the Committee are a move in the right direction. However, we do not believe that the proposed delegated managerial role of “Distribution” should be a standalone task. The distribution strategy should be addressed as a separate agenda item at every board meeting.

We believe that a Designated Role should never be assigned to an Independent Non-Executive Director, either at Investment (Fund) Company Board level or at Management Company Board level. Our opinion is that there is a fundamental difference and perspective required for “Knowledge of the Trenches” (a designated role and an executive role) and “Knowledge of Oversight” (a directorial role). It is at the executive level that there should be a significant operational skillset, expertise and mind set. The role of the independent non-executive director is one of oversight and should not be confused with that of an executive role.

We would recommend that the “Organisational Effectiveness” designated role should not be assigned to the Independent Non-Executive Chairman of the Management Company, whose objectivity should never be compromised. Given the scale of the “Organisational Effectiveness” role, it may be more appropriate to assign this role to the CEO of the Management Company with the Chair left to ensure that the Board is run effectively and efficiently.

Conclusion

Independence is critical to effective Corporate and Fund Governance and we recommend that the CP86 document should incorporate this fundamental principle. The structural weaknesses associated with certain types of Management Companies need to be addressed by the Central Bank rather than adopting a one size fits all approach. The directorial concentration issue was identified as a latent but key prevailing risk within the industry and one which we recommend is properly addressed as a solution to any perceived market skills shortages by the Central Bank of Ireland.

Whilst we understand that the IFIA Corporate Governance Code will be reviewed at a later stage, we believe that an opportunity has also been missed within CP86 to incorporate all-encompassing guidelines for both management companies and investment (Fund) companies. We would encourage the Central Bank to build a strong foundation for “Collective Investment Governance” within CP86. We believe that a piecemeal approach which does not address this issue could have significant consequences and downstream reputational risks for the Irish jurisdiction.

We are grateful for the opportunity afforded to us to comment on CP86 and we are available to further discuss any of the observations and recommendations which we have made within this response document.

11 December 2014