

Fund Management Company Effectiveness – Delegate Oversight Consultation,
Markets Policy Division,
Central Bank of Ireland,
Block D,
Iveagh Court,
Harcourt Road,
Dublin 2.

Sent by email to: fundspolicy@centralbank.ie

12 December 2014

Dear Sir/Madam,

CP 86 - Consultation on Fund Management Company Effectiveness – Delegate Oversight

The Irish Funds Industry Association¹ (“IFIA”) welcomes the opportunity to comment on this important Consultation Paper regarding Fund Management Company Effectiveness – Delegate Oversight (the ‘Consultation Paper’). The IFIA supports policies and guidance designed to enhance the effectiveness of fund management companies. The IFIA have consistently supported this goal as is evidenced by the publication of an industry Corporate Governance Code for Collective Investment Schemes and Management Companies (issued in December 2011) and more recently the publication of an industry Corporate Governance Code for Fund Service Providers (issued in August 2014).

While we will respond to the specific questions posed in the Consultation Paper in due course, first we would like to make some general comments regarding the proposals contained in the Consultation Paper.

General Comments:

- Given significant cost and effort would have only recently been incurred in preparing programmes of activity for AIFM’s to be compliant with the AIFM Directive requirements by the 22 July 2014 deadline, it would be imperative that there be a sufficient transition period to submit revised programmes of activity and any restructuring of managerial functions in order to reflect the final Central Bank position following the conclusion of this consultation. While UCITS business plans would not have necessitated amendment on foot of the AIFM Directive, they would have been recently updated to reflect UCITS IV requirements and subsequent changes requested by the Central Bank. Accordingly, a similarly appropriate transitional/grandfathering period would be required for UCITS SMICs and Man Co also. We would suggest that a transitional period of one year would be appropriate.
- There remain key differences between the UCITS and AIFMD regimes as regards managerial functions and tasks. Therefore, while Industry welcomes the streamlining of the managerial functions into 6 key functions, the revised 6 managerial tasks should apply to UCITS SMICs and UCITS Man Cos only to the extent that the relevant managerial function currently exists under the UCITS regime (for example, operational and liquidity risks, liquidity management, AIFMD reporting, remuneration, record keeping and conflicts of interest do not apply to UCITS). The UCITS and AIFMD regimes remain very different in many respects and UCITS V did not seek to align the regimes in terms of substance requirements or what managerial functions must be undertaken by the UCITS SMIC/Man Co. A very significant constituent of our Industry is represented by managers who have established UCITS SMICs and it is

¹ The Irish Funds Industry Association (IFIA) is the industry association for the international investment fund community in Ireland, representing custodians, administrators, managers, transfer agents and professional advisory firms. Ireland is a leading centre for the domicile and administration of investment funds. As the leading international funds centre, there is in excess of €3.2 trillion of assets in over 13,000 funds administered in Ireland. These assets are comprised of €1.6 trillion in 5,687 Irish domiciled funds (including sub-funds). Additionally, the industry services €1.6 trillion in non-Irish funds administered in Ireland.

critical that there be no gold plating of UCITS provisions when there is no legislative basis to do so under the UCITS Directive.

- There is a strong desire that the regulatory and governance environment should continue to support the various fund models that have served us well over the years. We do not believe this current review/consultation should seek to alter the existing structures or reduce the flexibilities of the various models currently available.
- There is a concern over the apparent mismatch between Appendix 1 and 2 as regards the role of the Designated Persons and further discussion/engagement would be necessary to better understand the interaction of these appendices, as there is some confusion as to what role the Designated Persons should undertake. For example, some managers are now putting risk managers or portfolio managers on the board of Self-Managed Investment Companies (“SMICs”) and Management Companies (“Man Cos”) in order to ensure sufficient resources are employed. While this might assist in terms of meeting the level of granularity required under Appendix 2, it is arguably contradictory to an alternative view of what the Designated Persons role should be, which is to act as an escalation point for the SMIC/Man Co. When one considers Appendix 1 and Appendix 2, neither view is incorrect but it is becoming increasingly difficult for clients to understand which is the best way to proceed.
- At one level it appears the Central Bank is looking to deal with resourcing through control but at another level, the proposals regarding the relaxation of Irish resident director requirements would suggest greater flexibility in permitting more activity to be undertaken, by someone with appropriate skills and expertise, but who is located outside of the jurisdiction. However, at the same time, that purported flexibility is severely limited by the continuing prohibition by the Central Bank on secondees or other non-director persons carrying out Designated Persons functions outside of Ireland. As part of this review/consultation, we believe it important that the Central Bank revisit the ability for secondees or other non-director persons located outside of the jurisdiction to carry out Designated Persons functions. The Central Bank’s rationale for the proposed relaxation of the Irish resident director requirement is difficult to understand, particularly when viewed against the Central Bank’s apparent reluctance to permit a Designated Person to be appointed where that person resides outside the jurisdiction. We would suggest that where a SMIC/Man Co has two Irish resident directors, it should be easier for the Central Bank to contemplate a situation where certain Designated Persons are located outside the jurisdiction.
- We believe the Central Bank should permit designated functions to be split between two or more directors in circumstances where the skill and expertise of the various Board members can more appropriately be deployed. By way of example, it would be more appropriate to facilitate different directors assuming supervision of delegates, with directors with greater investment management expertise supervising the investment manager, and directors with, say, an accounting background, supervising the administrator.
- We see no merit in concentrating the new role of organisational effectiveness in the chairman. The role should be performed by the director most suited to perform its twin prongs of delegate supervision and conflicts of interest.
- Regarding the statement "We believe this document can also form a useful tool for the Central Bank's supervisors when assessing the performance of fund management companies"² it would be essential that the Central Bank inspection teams recognize that there are other ways of achieving the same result based on logic and common sense interpretation of key principles.
- Appendix 1 seems to focus heavily on the delegation model, which is understandable, given the prevalence of this structure. However, externally managed companies³ receive less focus in the paper and therefore, it is less clear how the externally managed company model is intended to work in relation to the "good practice" and who takes responsibility.

² Page 3 Paragraph 3 of the Consultation Paper

³ Funds with separate management companies

- We feel there is a risk in housing similar governance requirements in a number of places i.e. the UCITS Rulebook, AIF Rulebook, IFIA Corporate Governance Code for CIS/Man Co's and now the Committee on Collective Investment Governance guidance. Having requirements for delegated functions, for instance, covered in four different places could lead to confusion. We would suggest that such governance requirements, to the extent possible, be consolidated into a single document, like the IFIA Corporate Governance Code for Collective Investment Schemes and Management Companies.
- With respect to Appendix 2, General Observations, Relationship between management company and delegates (page 16) we would also like to note in the General Observations (page 16 of CP86), the paragraph titled "Engagement" provides that "*A delegate should recognise the directors' duties and facilitate the discharge by the directors of their ultimate responsibility for the delegated tasks;*" we believe each party should recognise the role of the other and that whilst delegates need to be mindful of the directors' duties as delegates perform their tasks, Directors should equally recognise that delegates are not there to provide services to them specifically but to the entity which has contractually engaged the delegate to provide services to it, which in most cases is typically the Fund or a management company.

Questions for Consideration

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?

- In responding to this question, it would be important to understand the status of such "good practice document" and its legal standing. In principle, we are supportive of the development of a document which would assist industry practitioners to meet their regulatory obligations. However, it would need to be clear that the document is to assist in providing guidance with regard to good practice and that non-compliance can be accepted in specific instances (using common sense), rather than absolute rules that must be followed in every instance, which could lead to many administrative "tick the box" exercises. We would suggest that such guidance might best be provided through a revision of the IFIA Corporate Governance Code for Collective Investment Schemes and Management Companies.
- In relation to Appendix 1, we are supportive of the notion that a more "principles- based" approach is needed. While many of the listed items are examples of good practice, they may not always be relevant, given particular circumstances. By way of example, the first requirement for an investment manager to provide a presentation to inform the Board of the proposed "investment approach" provides a good example of this. In many instances, such a presentation may be both necessary and desirable. However, there are instances when having to comply with this as an inflexible "rule" won't make a huge amount of sense, particularly in relation to index tracking or index replicating funds (e.g. where the investment strategy of a fund is to track the FTSE 100). In other words, the principle should be "The Board should, prior to launch of the fund, satisfy itself as to the investment strategy and operations of the relevant fund." with the items listed thereafter in Appendix 1 (page 19) being examples/explanations of how a Board might do that.
- We have a fundamental concern with regard to the Designated Person role as implied by Appendix 2, as it does not appear consistent with the various different models that are currently in existence. Appendix 2 seems to suggest that the Central Bank views the Designated Person's role as only ever being one where the Designated Person is personally involved in all of the detail relating to the relevant function, very much an active day to day "hands on" role, more akin to an executive role. Whilst some Boards may implement this as its Designated Person model, it is far from the universal approach. Often, the Designated Person is instead seen as an escalation point between the management company/fund Board and the entity/individuals involved in the detail of applying the controls relevant to the managerial function i.e. the Designated Person receives reports and makes decisions on issues that need to be escalated. This is particularly the case where the day-to-day portfolio management function is delegated to a third party investment manager. In that scenario, the focus should be on the fact that the controls/tasks under the relevant managerial functions are being covered by the Board through whatever model best suits its particular circumstances, and that there

are proper structures in place to ensure that issues are escalated to the management company/fund Board in an appropriate and timely manner. Both models should be acceptable so that it should be possible for the portfolio manager to undertake the investment management function but equally, where the day-to-day investment management role is delegated to a third party investment manager, the Designated Person with responsibility for investment management should be permitted to act as an escalation point without undertaking the portfolio management function.

- The drafting of Appendix 2 appears overly simplistic, with all tasks being described as having involvement "on a day-to-day basis". We believe that while certain tasks may need to be performed daily, some will, by nature of the fund/dealing cycles etc., be performed less frequently (e.g. weekly) and as drafted Appendix 2 does not recognise this.
- We would like to understand how the good practice document would operate with the IFIA Corporate Governance Code for Collective Investment Schemes and Management Companies (if not contained in a revised industry Code).

2. Is the breakdown of revised managerial functions correct? Should other managerial functions be provided for? What are your observations about what the operational effectiveness function might entail and how this might be performed? Do you see any obstacles to the Chairperson performing the operational effectiveness function? [Note: We understand the reference to the Chairperson performing the "operational effectiveness" function is a reference to "organizational effectiveness" function].

- We are supportive of the proposed streamlining of the UCITS management company and alternative investment fund managers ("AIFM's") designated managerial functions into 6 managerial functions. However, the UCITS & AIFM Directives have a very different focus and legislative basis. The UCITS Directive is primarily a product directive and has embedded measures to protect shareholders, such as diversification, liquidity, depositary oversight. Consequently, it does not need such an operational overlay/focus as is required by the AIFM Directive. On the other hand, the AIFM Directive is a manager's directive and has a broader and deeper operational focus. The proposed streamlining of the designated management functions should only apply to UCITS where appropriate, for example operational and liquidity risks, liquidity management, AIFMD reporting, remuneration, record keeping and conflicts of interest do not apply to UCITS. We do not believe it appropriate to unilaterally require UCITS SMICs/Man Co's to introduce functions and structures that were clearly designed with respect to the operation of AIFMs rather than UCITS. Therefore, the revised management functions should only be interpreted as replacing the corresponding management functions that exist under the UCITS regime, rather than applying additional managerial functions that exist under AIFMD but not UCITS.
- We can see some potential practical issues that might arise with the proposed streamlining of managerial functions, particularly given the Central Banks requirement that one individual be the appointed Designated Person. As referenced in our general comments, in circumstances where there are currently two different Designated Persons with separate skill sets responsible for different managerial functions, where such managerial functions are now to be streamlined into one managerial function we believe the Central Bank should permit more than one Designated Person to be responsible for an individual managerial function. This would ensure the same expertise for the current functions are carried over to the consolidated function.
- It is not practical to expect the Chairperson of the Board to take on such an overarching function of Organizational Effectiveness alone. The proposed new role of overseeing decisions taken at and in-between board meetings would appear to be confusing the management of the board with the management of the organisation. As currently drafted the Consultation Paper appears to anticipate a Chairperson as some form of executive Board member involved in the day-to-day operations of the fund/management company, which may not always be possible. In considering this further it would be useful to better understand the Central Banks intentions for the Chairpersons role and the depth and breadth of the role. Relevant points of note are;
 - The role would appear to overlap with a majority of other functions.
 - The role would appear to be an operational effectiveness role that looks at performance of delegates with reference to agreed service level parameters. This does not seem to sit with

the Central Bank's statement "one of oversight of the adequacy of the internal resources within the authorised entity etc..." as such this appears a corporate governance issue being amplified into an issue of substance and independence.

- We accept that there should be "arrangements...for supervision of delegates...in interests of investors" however this is implicit in the IFIA's Corporate Governance Code and the approach the Central Bank appears to be taking in explicitly differentiating this is likely to cause confusion.

- The proposal to receive "regular reports on distribution on a day-to-day basis" is not workable and would potentially have a significant impact on Ireland as a fund jurisdiction. It is difficult to understand how daily reporting (as opposed to monthly/quarterly) would make any material difference in identification and mitigation of risks to the funds/investors. Distributors are an important stakeholder when a promoter is selecting a jurisdiction to domicile a fund. The introduction of this proposed requirement on distributors, many of whom are decision makers, would act as a potential disincentive to domiciling funds in Ireland, particularly where similar obligations do not exist in other competing jurisdictions and where it is not evident as to the real risks this requirement is seeking to address.
- We would suggest that the "Supervision of Delegates" be a separate managerial function.
- In terms of Appendix 2 and the bullet points on organisational effectiveness, we believe the first, seventh and eight bullets are Board responsibilities and sit outside this management function. It would also seem challenging for one Designated Person to oversee another Designated Person.

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?

The rationale cited by the Central Bank in considering this change is contained under heading iii, "Requirement for Irish resident directors", hinges on the absence of a definition of residence and an assertion that competencies in certain areas are relatively scarce and could limit the available pool of individuals. Before detailing our response it is important to state that we do not believe that the assertions behind the rationale provided by the Central Bank is valid and/or proven:

- Firstly, we believe that residency, in particular tax residency, is both well-defined and understood. Introducing a regulatory definition which is new, arbitrary and which differs from that which exists when determining tax residence would be both unnecessary and confusing. Changing the basis on which Irish residency for directors is determined would also lead to inconsistencies within the sector, for example the residency test for a director who sits on the Board of a fund service provider would potentially be different from the residency test for a director who sits on the Board of a SMIC/Man Co. We believe this would be unwelcome.
- As regards available skills and competencies, we would be keen to understand what evidence exists of the scarcity of such skills set. We feel it is misplaced as we do not believe that skills such as portfolio/risk management are in such scarce supply. It is our experience that typically these roles (portfolio/risk management) are already filled by individuals within the investment manager or promoter, as such we do not believe a problem exists here that needs to be addressed.

In assessing the questions posed we considered the following perspectives:

Stakeholder	Comments
Investor	<ul style="list-style-type: none"> • An investor's primary concern (in the context of the consultation) is that the Board of the fund (Man Co) is effective in representing their interests and that the composition and competencies of the Board support this. At first glance it appears that the investor should therefore be agnostic as regards the residency of the Directors.

	<ul style="list-style-type: none"> Delving into this more deeply, there is a valid argument that direct access via regulation and law to locally based Directors is easier than those based outside of the jurisdiction.
Manager or Promoter	<ul style="list-style-type: none"> A relaxation of the requirement would afford greater flexibility to managers/promoters of investment funds and, based solely on this criteria, is attractive. In discussing this with managers/promoters who currently use the jurisdiction it was clear that the flexibility aspect mentioned above is attractive, however most were keen to stress that they were unlikely to change the current dual Irish resident director structure they have in place. Given the current trajectory of European regulation in respect of oversight, governance and exerting control there is a valid line of argument which underscores the existence of two resident directors (as part of an overall board) as being supportive of substantive control and diligent oversight.
Regulator	<ul style="list-style-type: none"> The Central Bank, in its Consultation Paper, did not express any evidence or view as to whether regulatory engagement or regulatory capture is aided or diluted by virtue of the number of resident directors. While the industry in Ireland has been strong in terms of governance and the protection of investor interests we must turn our mind to the consideration of possible “worst case” scenarios in thinking prospectively about this. Therefore we consider what might be required when there is a significant and pressing issue as between a Board and the Regulator. In summary we tend to favour the two resident director structure as: <ul style="list-style-type: none"> the proximity and availability at short notice of more than one director is advantageous board responsibilities are collective two resident directors will automatically cover a broader range of competencies than a single resident director

The requirement for two Irish resident directors helps demonstrate that the mind and management of the Board is located in the jurisdiction. The “anchoring” of the Board within the jurisdiction in which it is regulated and governed by tax and other requirements appears consistent with the overall thematic of aligning activity, control and governance. Given the ongoing changes occurring in the regulatory landscape, Irish resident directors are also increasingly involved in ensuring the entire Board is current with respect to such developments and local market practice.

Given the Central Bank’s assertion regarding the potential availability of certain skills such an approach is supportive of allowing the certain Designated Person functions being carried on outside the State, complimented by strong local directors.

Taking all of the above together it is not entirely clear that what might be gained from relaxing the requirement could be expected to compensate for what might be lost. This comment is also grounded in a consideration of the merits of retaining the existing model, one which has served all stakeholders well over time.

Finally, if the Central Bank were to proceed as suggested in the Consultation Paper, the requirement that one of the directors if not Irish resident is “unconnected” to the depositary or a service provider is a new requirement and could be problematic, depending on what is meant by “unconnected”. The proposal that an individual is “unconnected” is different to independent and it would be important to understand the parameters of this new requirement. While we understand the prohibition of an individual connected with a depositary from sitting on the Board of a management company what is proposed goes beyond this to include an individual connected with a service provider, which could have far greater implications. We would ask the Central Bank to clarify what its expectations are in this regard and in what circumstances a director might be considered “connected” to a depositary or a service provider.

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?

- We do not believe it necessary to alter existing residency requirements, similarly we do not believe the basis on which residency is determined needs to be altered.
- Notwithstanding our position with respect to residency we would make the following comment on the proposed approach to measuring time spent in Ireland;
 - We feel the proposal to determine residency as being in Ireland for 110 working days per year could be confusing, particularly when it differs from the test for tax residency. Changing the basis on which Irish residency for directors is determined would lead to inconsistencies within the sector, for example the residency test for a director who sits on the Board of a fund service provider would be different from the residency test for a director who sits on the Board of a SMIC/Man Co.
- It is unclear as to what would happen if for example there were unforeseen circumstances and a director did not meet the required 110 working days per year? How would the Central Bank propose dealing with such a situation?

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?

- We have concerns about fund management companies being required to document the rationale for the Board composition prior to launch. We disagree with the Central Bank's contention that promoters are not already engaging in a deliberate and detailed process when selecting Directors to ensure that there is the right blend of skills and expertise and people who are suitable to undertake the Designated Persons functions (to the extent the Designated Persons functions are undertaken by directors). Given the Consultation Paper references the fund management company documenting the rationale for its Board composition "*as part of its authorisation process*" we would ask whether the Central Bank would also see itself in having a role in determining Board composition? We do not believe it would be appropriate for the Central Bank to undertake such a role, particularly when Directors already undergo an IQ process with the Central Bank which includes a Fitness and Probity determination.
- We have concerns with this proposal particularly as it appears this assessment would form part of the authorisation process and suggests direct intervention from the Central Bank with regard to Board composition. We believe this is more properly a matter for the Board itself and it would be difficult to understand how a "tick the box" approach to perceived fund specific competencies would be of value to good corporate governance. To give an extreme example, take a Board member who could be hugely competent in the area of risk but have less ability to engage meaningfully as a Board member, would the Central Bank have a view that such an individual was a "good" board member or a "bad" one?
- Feedback from industry and those with experience serving on Boards is that Board composition is often more art than science, with the dynamics of the Board being extremely important and something that is not possible to gauge in a purely formulaic way. Boards should remain self-regulating in terms of composition, as relying simply on areas of expertise as the primary basis for Board selection should not be the basis to achieving good corporate governance practices. This is especially the case where directors would have already have been subject to the Central Banks IQ and fitness and probity review(s).
- There is a risk that simply looking for areas of expertise in Board composition would potentially narrow the pool of directors for fund management companies/funds to select from, as there may be a flight to a smaller number of directors who are able to demonstrate (a wholly subjective) competence in maximum number of areas of expertise identified by the Central Bank in its guidance. We do not believe this would be in the interests of investors.

- The specific requirement that the rationale for the Board composition be prepared and relevant at the launch of a fund and not maintaining it throughout the life of the fund is difficult to understand. If one accepts the rationale for documenting Broad expertise as being a primary driver for Board composition then it raises a question as to why it is only relevant at the beginning of a fund's life? We believe a more appropriate approach would be to ensure a Board can justify the appointment of directors if/when requested to do so by the Central Bank.
- In summary we do not believe that the proposed documenting of the rationale for board composition as set out in the Consultation Paper is necessary. We believe an ongoing assessment is more appropriate such as that contained in the IFIA's Corporate Governance Code for Collective Investment Schemes and Management Companies (Para 8.2) which states "*The Board shall review the overall Board's performance and that of individual directors annually with a formal documented review taking place at least once every three years.*"

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

- We note that during the AIFMD authorisation process, the Central Bank appeared to query whether a person involved in the portfolio management function was the best person to undertake the Designated Persons function of monitoring investment performance and strategy, which suggested that SMICS/Man Co's needed a Designated Person responsible for monitoring the investment management performance and strategy that would be independent of the investment management function. That suggestion was subsequently dropped and we note that the new managerial function simply refers to "investment management" which presumably means that the portfolio manager can undertake this managerial function on the board of the AIFM. Furthermore, if the Designated Person responsible for investment management were to be independent of the portfolio management function and operated as an escalation point, we do not see why the Designated Person for investment management could not also be the Designated Person for risk management. If, in that scenario, the role of the Designated Person is primarily an escalation point, the requirement under the Directive for the risk management and portfolio management functions to be hierarchically and functionally separate is not compromised by having a single person undertaking both of those Designated Persons functions, where the person in question is independent of both the portfolio management and risk management functions. Where a Designated Person receives information which is assessed and is an escalation point they can be equally "objective" to both risk and investment management at fund level. If there are any actual conflicts these could be identified and mitigated.

We hope you find these comments helpful, and we remain at your disposal to discuss the issues raised in this response further.

Yours faithfully,



Pat Lardner
Chief Executive