



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

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Implementing CP86
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Introductory Remarks

Good evening everyone, it's a pleasure to speak with you at this event organised by KPMG and thanks to Niamh and to Feargal for inviting me.

I have been asked to provide some thoughts to you today on “implementing CP86”. I am sometimes asked what “CP86” means particularly by those not so connected to the Irish funds industry. In response I explain that it refers to the Central Bank of Ireland’s work on the organisational effectiveness of fund management companies which took place over a number of years and resulted in some rules, but mostly guidance, in relation to these entities. Those rules and guidance apply to all fund management companies since 1 July 2018 and so it is timely to look at their implementation.

I think it is important however that industry participants understand why the Central Bank undertook this work and therefore I will structure my presentation to you as follows:

I will briefly take you back to the why – the background and motivation to the work; the what – what is in there in the context of the rules and guidance and who they apply to; and then move on to implementation issues.

Background to CP86

The origins can be linked to the evolution of funds legislation and increasing comprehensiveness of regulation, under AIFMD and the UCITS Directive. The Central Bank recognised that enhancing the effectiveness of fund management companies would improve investor protection. Fund management companies play a critical role in the functioning of the European funds industry. Moreover, as noted recently by Michael Hodson, the Central Bank’s Director for Asset Management, fund management companies allow promoters and investment managers from outside the EU to gain access to EU products, be they UCITS or AIFs, and access to EU investors. Access can only come with responsibility and accountability so that a fund manager must be able to demonstrate its independence in decision making and substance in its operations. More generally, Irish funds are marketed throughout the Union and the European authorities rightly expect that they are provided, managed and controlled by entities that comply with all EU rules.

The Central Bank’s review led to a number of initiatives designed to underpin substantive control by fund management companies over the activities of their delegates and three key areas were examined: Governance; Compliance and Supervisability. A fund management company which is strong in each of these areas is one of substance which better protects investors.

In early 2014 the Central Bank convened a group of industry experts to provide it with advice on how directors of fund management companies should oversee delegates. This was followed by three separate consultations. The first two of these, in September 2014 (CP86) and June 2015, looked at governance issues; the third consultation in June 2016, addressed compliance and effective supervision.

The review of issues related to Governance led to a number of rule changes including:

- A Definition of Irish resident;
- A revised number of managerial functions – the functions carried out by designated persons within a fund management company; and
- Introduction of the organisational effectiveness role to be performed by an independent Chair or an independent board member of the fund management company.

These rules were of course additional to existing Central Bank requirements relating to the organisation of fund management companies.

It also led to Central Bank guidance in relation to:

- Delegate oversight: This is an extensive piece of guidance which covers the relationship between a fund management company and its delegates, tasks which must be retained and oversight of delegated tasks, with guidance on delegation of investment management, distribution and risk management, investment operations and administration. It includes guidance on resourcing and on boards of externally managed investment companies.
- Organisational effectiveness: The concept of an independent board member with responsibility to keep the effectiveness of the organisational arrangements of the company under review was well received. Some guidance on that role is provided and I will speak further about that later.
- Directors time commitments: The outcome from a Central Bank themed review on this matter led to several areas of guidance on individual time commitments. In particular this highlights the need to treat a designated person role for managerial functions as a separate appointment to an appointment as director in terms of time commitment, with separate letters of appointment setting out job specifications, time expectations and fee arrangements.

CP86 consultations drew attention to the substantial regulatory burden on fund management companies under the UCITS and AIFMD regimes. CP86 also emphasised the obligations which

flow from other areas of regulation including cross sectoral legislation, such as Market Abuse law and more recent EU texts such as EMIR and SFTR together with obligations under Irish company law. The Central Bank did not need to consider additional rules in this context but set out guidance on compliance with these obligations.

In order for an entity to be effectively supervised, the Central Bank must have the capacity to carry out its responsibilities without undue constraint. Accordingly the third consultation set out proposed rules in relation to the location of directors, designated persons and records.

Development of CP 86

Following the third consultation the CP86 work was complete. The final package consisted of:

- the rules mentioned earlier on managerial functions;
- the introduction of the organisational effectiveness role;
- new rules on location of directors and designated persons;
- a new rule that records be immediately retrievable in or from the State; and
- a composite set of guidance in a single document called “Fund Management Companies – Guidance”. This includes the guidance mentioned earlier on boards and time commitments. It also includes:
 - Guidance on the managerial functions. This sets out the Central Bank’s expectations on how persons who conduct these functions should carry out their roles;
 - Guidance on operational issues – specifically on record retention and the need for a designated and monitored email address; and
 - Guidance on procedural matters including applications for authorisation; relationship with the Central Bank and use of the fund management company passport.

It is evident therefore that for the most part CP86 has led to a substantial set of guidance material and some, but not too many, additional rules. That was consistent with our aim from the outset which was to ensure good levels and high quality application of the rules already in place and to make clear how compliance with these rules can be demonstrated.

At the time some commentators referred to the guidance as being issued on a “comply or explain” basis meaning that fund management companies could choose whether or not to act in accordance with it. However I would caution against viewing our guidance too much in that light. While guidance is not enforceable in its own right or viewed by supervisors as creating legal obligations, it does set out how fund management companies should act in order to comply with

their legal obligations. If they do not act in that way they run the risk that they are not complying with their obligations and breaches of their obligations are enforceable. On the other hand I also caution against approaching the guidance as a compliance manual covering all of the obligations of the fund management company.

This is best illustrated by looking in more detail at Part IV of the Fund Management Company Guidance document which addresses the managerial functions. It explains that the designated persons who conduct managerial functions are the line of management that lies between the board and delegates and they ensure that the strategies, policies and directions issued by the board are acted upon and complied with. They are responsible for the day-to-day management of the company and, while they will not necessarily be the persons who are carrying out all of the tasks which fall within their scope of responsibility, they will manage employees or oversee delegates who do carry out the tasks. They should have the capability to review delegates on a continuous basis and to be available on a day-to-day basis.

Fund management companies are expected to specify, in the letters of appointment, that a designated person must put the best interests of investors in the investment funds under management ahead of any other interest. Designated persons should have experience and expertise and be sufficiently senior in their role such that their challenge of delegates carries weight and authority. Where regulatory obligations involve an exercise of judgement the designated person should have sufficient expertise to assess whether the position adopted is reasonable and document that for future reference.

A fund management company's contracts with delegates should be sufficiently prescriptive to ensure that the delegate knows exactly what is being delegated to them. There should be no assumption that because a delegate is authorised, it will discharge the regulatory obligations of the fund management company. The Central Bank expects that the contract includes provisions to ensure the delegate carries out its tasks in a manner consistent with AIFMD or UCITS requirements as appropriate.

Another important matter is guidance on the policies and procedures which a fund management company is required to maintain. A fund management company should be able to demonstrate compliance with policies and procedures at all times. It cannot rely on a delegate's written policies and procedures to satisfy the obligations in AIFMD and UCITS to have its own written policies and procedures. Where it is intended to rely on the substance of its delegates' policies and procedures the Central Bank expects that the fund management companies own policies and procedures should document that this is the case; the basis for that reliance, (which will

require a mapping exercise), how it will test and review the delegates policies and procedures and the role of the relevant designated person. Moreover, the Central Bank guidance sets out that designated persons should be involved in the design, the implementation and the review of all the policies and procedures required of the fund management company.

The Central Bank guidance also sets out that each fund management company should review the obligations to which it is subject and identify precisely under which managerial function each obligation will fall. This approach will ensure that all obligations are monitored and that designated persons understand the expectations placed on them. The Central Bank illustrates how this could be allocated in the context of obligations from AIFMD and UCITS. A similar approach could be taken to obligations from the Central Bank's domestic Rulebooks for UCITS and AIFs or obligations from the cross sectoral legislation mentioned earlier such as EMIR, Market Abuse Regulation and so on. Obligations under the MMF Regulation will now be appropriate for some fund management companies.

The frequency of the monitoring and oversight over each regulatory obligation should be determined by the fund management company taking into account various factors such as the complexity of the investment strategies of the individual funds, the types of instruments they invest in and where traded, frequency of trading and of investor dealing. Time needed for this will grow as the company grows and activities increase. Guidance is provided on the engagement between designated persons and delegates, which should be regular and include on-site visits. Evidence of constructive challenge by designated persons and interrogation by them of information received from employees and delegates is likely to point towards a fund management company which is well managed and takes compliance with its obligations seriously.

Implementation issues:

The new rules and related guidance applied to new applicants from July last year and to existing firms from 1 July 2018. Every management company should have critically assessed their operations against the new requirements and the guidance and made necessary changes, including to the time committed to carrying out of the designated person roles. We will now and particularly in 2019 focus our supervisory approach towards existing firms, in order to assess how they have implemented CP86. However due to Brexit we are seeing a substantial increase in new applicants. Our work in relation to these new applications is providing us with a significant amount of information on the organisation of fund management companies and on the time required of designated persons in order to carry out their tasks. To be clear, this is

material. I have touched upon many aspects of the designated person roles and all of that is necessary to ensure the fund management company is meeting with all of its obligations.

Brexit has also led to a focus on relocating entities by EU authorities and the Central Bank participates in the ESMA Supervisory Coordination Network (SCN) designed to foster supervisory convergence in that context. The SCN continues to be a very welcome initiative as it allows supervisors to debate on what should be an appropriate level of substance for different categories of firms. It raises the same questions on substance that we ask applicant firms.

The SCN engagement and our authorisation processes informs our determination of new applications and in particular what we believe is an appropriate amount of time the designated persons will dedicate to their roles. It has led to useful interactions where a number of applicant firms are being required to increase the time committed to designated person roles. But this is a natural part of the evolution that CP86 is bringing about and is a reflection of the Central Bank's ongoing work in ensuring we have an appropriate regulatory framework for all industries we supervise, including the funds industry.

As I mentioned, we will carry out a more detailed assessment on how existing firms have implemented CP86 in 2019. That will influence our position on whether further changes or additional guidance is needed. It would of course be wise for fund management companies to be taking into consideration what is required of new entrants as they make their assessments and prepare for expected visits from the Central Bank in the future. The organisational effectiveness role holder should also be carrying out a detailed review of the arrangements and satisfying him or herself that all obligations of the company are being met by the designated persons on a day to day basis.

Finally I would like to reflect a little on the organisational effectiveness role introduced early in the CP86 process. While this is generally welcomed and regarded as a very good initiative, particularly for fund management companies given their business models, there have been some debates about what this role does and does not involve. The role is a continuous one to ensure that there is an independent director, who does not carry out any designated person role, who is tasked with keeping the effectiveness of the organisational arrangements of the company under ongoing review and to report on this to the Board for discussion and decision. The frequency of reporting is not specified at this time but the Central Bank will expect that matters arising from the monitoring process will be escalated without delay and as necessary.

The Central Bank's guidance document provides some examples of matters which will be involved in the role but does not provide any further detail on how they might be addressed in practice.

Looking at those briefly: the Central Bank expects that the role holder will monitor the adequacy of the fund management company's resources and so this is clearly linked to the roles of the designated persons. The role holder will consider if the organisational structure remains fit for purpose – this will be an important matter as the fund management company increases its activities or for example takes on new types of funds. An important element of the role is that related to consideration of potential conflicts of interest and to ensuring that these are appropriately addressed, most likely through escalation to the board. With regard to the board itself, the role holder will continuously evaluate its composition and so this is very much linked to ensuring there is a robust structure which is fit for purpose in the context of delegated activities.

It is intended to develop the Central Bank's guidance in this area particularly by taking into account the experiences of those who carry out this role and by engaging with industry experts. There has been some work already within the industry which we very much welcome. We have heard some very different views expressed regarding the pros and cons of this role ranging from how it could be particularly important for smaller entities to concerns that it could become a tick the box exercise. My impression is that as fund management companies have applied CP86 they are positively disposed towards the organisational effectiveness approach and are identifying many benefits as this requirement is applied. I expect our work on this to develop over the coming months.

Let me stop there and thank you for your attention.

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