



June 2015

Fund Management Company Boards – Latest Update from Central Bank

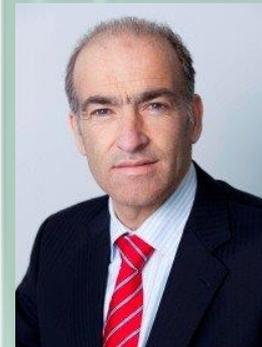
The Central Bank of Ireland (“**Central Bank**”) published on 12 June 2015 a document in relation to “Fund Management Company Boards” which comprised:-

- (i) a Feedback Statement on the Central Bank’s Consultation Paper (“**CP86**”) on “Fund Management Company Effectiveness – Delegate Oversight” which was published in September 2014;
- (ii) a Consultation on Delegate Oversight Guidance;
- (iii) Guidance on Organisational Effectiveness;
- (iv) Guidance on Directors’ Time Commitments; and
- (v) Provisions regarding the next steps of the Central Bank.

As was the case for CP86, the term “**fund management company**” includes a UCITS management company, an authorised AIFM, a self-managed UCITS investment company and an internally managed AIF and the term “**investment company**” refers to an investment company or ICAV which has appointed a UCITS management company or an external AIFM.

The full text of the Central Bank’s document in relation to “Fund Management Company Boards” is available on the Central Bank website at [LINK](#).

For further information on any of the issues discussed in this article please contact:



Brian Kelliher

DD:+ 353 (0)1 673 1721

brian.kelliher@dilloneustace.ie

Introduction

In CP86, the Central Bank suggested certain proposals in order that fund management companies:

- (i) exercise sufficient control over their delegates through close oversight of delegated tasks on a day-to-day basis;
- (ii) exercise effective control over the management company's own operations and activities; and
- (iii) have boards which are composed of the right mix of experience and expertise to achieve, inter alia, the highest standards of oversight of such delegates.

Such proposals included:

- ▣ Guidance on how fund management companies should oversee delegates;
- ▣ Reduction of the number of existing managerial functions and streamlining these functions;
- ▣ Removal of current requirement to have two Irish resident directors (and suggesting replacement provisions); and
- ▣ Introduction of a requirement to provide a rationale for board composition.

Feedback on CP86

Part I of the Central Bank's document in relation to "Fund Management Company Boards" sets out the Central Bank's feedback on CP86. The remaining parts provide consequential guidance as detailed in the sections below.

The principal points from the Central Bank's feedback are as follows:-

- (i) Reduction and Streamlining of the Existing Managerial Functions

In CP86, the Central Bank proposed the reduction and streamlining of the existing managerial functions of fund management companies into six managerial functions. The Central Bank now proposes to proceed largely in the manner proposed in CP86 subject to the following:-

- (a) Complaints handling will be separated into complaints concerning distribution (which will fall within the Distribution managerial function) and all other complaints (which will fall within the Regulatory Compliance managerial function);
- (b) Risk Management will be separated into two separate managerial functions, namely fund risk management and operational risk management. These separate managerial functions may, but do not need to be, conducted by a single person.
- (c) Although one designated person may perform more than one managerial function, the same person may not perform the managerial functions in relation to Fund Risk Management / Operational Risk Management on the one hand and Investment Management on the other hand;

- (d) Organisational Effectiveness will not now be classified as a managerial function given it is considered by the Central Bank as more strategic and inward looking in nature compared to the managerial functions and given the Central Bank has determined that the role must be carried out by an independent director (who may not perform any of the six managerial functions);
- (e) Conflicts of interest and internal audit will be included in the organisational effectiveness role; and
- (f) Existing fund management companies will have to 30 June 2016 to update their business plans / programmes of operation to reflect the revised managerial functions and the organisational effectiveness role.

In conclusion, the existing managerial functions applicable to fund management companies will be reduced and streamlined into the following six managerial functions:-

- ▣ *Fund Risk Management;*
- ▣ *Operational Risk Management;*
- ▣ *Investment Management;*
- ▣ *Regulatory Compliance;*
- ▣ *Distribution; and*
- ▣ *Capital and Financial Management.*

In this regard, the Central Bank intends to provide more information on what it expects in relation to each of the above managerial functions. In addition the Central Bank has advised that the content of the role of each designated person will be proposed in a future consultation on management company guidance.

(ii) Irish Resident Directors Requirement

IN CP86, the Central Bank proposed relaxing the requirement for two Irish resident directors so that there must be two directors who are in Ireland for not less than 110 working days per year but that fund management companies may substitute one of these directors for an individual who:

- ▣ affirms that he/she is available to engage with Central Bank supervisors on request within any 24 hour working day period and is available to attend meetings at the Central Bank at reasonable notice;
- ▣ is unconnected to the depository or a service provider; and
- ▣ is competent in one of the six designated tasks.

However the Central Bank decided to retain the requirement for two Irish resident directors but confirmed in this regard that Irish resident means resident in Ireland for the whole of 110 working days per year (which is based on half a working year excluding vacation and public holidays). The Central Bank advised that the argument it found most persuasive on this issue was in relation to the

important role of Irish resident directors in circumstances where an investment fund or fund management company becomes distressed.

(iii) Board Composition of Fund Management Companies

In order to ensure that fund management companies pay sufficient attention to achieving a balance of skills and competencies on their boards, the Central Bank proposed in CP86 to introduce a new rule to require each of these companies to document as part of the authorisation process specifically how the composition of its board as a whole provides it with sufficient expertise to conduct the tasks expected of the directors and, where relevant, as the designated person for a managerial function.

The Central Bank has decided to implement this proposal and is incorporating the suggestion that this matter be included in a fund management company's business plan / programme of operations. This would also mean that the rationale for board composition would need to be revised any time the board changes and reflected in a revised business plan / programme of operations (which must be kept up to date).

Consultation on Delegate Oversight Guidance

In CP86, the Central Bank proposed issuing guidance regarding what it considered to be good practice for directors of fund management companies in their oversight role. The Central Bank sought the views of a committee of investment professionals which it established in January 2014 (the "Committee on Collective Investment Governance" or "**CCIG**") and a document setting out principles that boards of fund management companies might follow, and identifying a number of tasks that should be retained by boards, was included in CP86.

Part II of the Central Bank's document in relation to "Fund Management Company Boards" contains draft guidance on Fund Management Companies - Delegate Oversight (the "**Delegate Oversight Guidance**"). This guidance focuses on the matters covered in the CCIG report but has been revised as Central Bank guidance.

The Central Bank is inviting comment on its draft Delegate Oversight Guidance. However, given that the CCIG report was consulted on in CP86, the Central Bank is undertaking a shortened process on the draft Delegate Oversight Guidance. The deadline for submissions is 24 July 2015.

Guidance on Organisational Effectiveness

In CP86, the Central Bank proposed the introduction of a management function titled "Organisational Effectiveness" comprising the current managerial functions of conflicts of interests and to a certain extent supervision of delegates.

A number of respondents to CP86 asked for more clarity around the organisational effectiveness role and as a result, the Central Bank has issued guidance on the role which is set out in Part III of the Central Bank's document in relation to "Fund Management Company Boards".

According to this guidance, the purpose of this role is to ensure that there is an independent director within the fund management company who has the specific task of keeping the effectiveness of the organisational arrangements of the company under ongoing review, with his or her reports being submitted to the board for discussion and decision.

In the guidance, the Central Bank gives some non-exhaustive examples of the types of matters which the independent director undertaking the organisational effectiveness role will be involved in:

- ▣ monitoring the adequacy of a fund management company's internal resources to its day-to-day managerial roles;
- ▣ reviewing the organisational structure of the fund management company and considering whether it remains fit for purpose;
- ▣ considering the conflicts of interest affecting the fund management company and its investment funds under management and initiating action, such as escalation to the board, where these are having or are likely in the near future to have an adverse impact;
- ▣ reviewing the board composition and reporting on this to the board;
- ▣ organising periodic board effectiveness evaluations; and
- ▣ overseeing how well the decision taking by the fund management company and the arrangements for the supervision of delegates are working in the interests of investors.

Guidance on Directors' Time Commitments

In parallel with its CP86 consultation, the Central Bank conducted a thematic review in order to assess the number of directorships held by individuals on the boards of corporate investment funds, fund management companies and AIF management companies. The objective was to assess the impact on investment fund governance where multiple directorships are held by individuals in the industry.

As a result of the feedback received on CP86 and the findings of the Central Bank based on the thematic review, the Central Bank has introduced guidance to assist Chairs, boards and individual directors in assessing the time commitment of individual directors in fulfilling their roles (the "**Directors' Time Commitments Guidance**"). This guidance is set out in Part IV of the Central Bank's document in relation to "Fund Management Company Boards". The Central Bank has advised that it will use the recommendations in Part IV as a guide for future reviews of board effectiveness, director time commitments and quality of board operations.

According to the guidance, the Central Bank intends to treat in excess of twenty directorships combined with a high aggregate level of annual professional time commitment in excess of 2000 hours as a risk indicator. Where any risk indicator is triggered, additional supervisory attention will

arise under the Central Banks risk-based approach to supervision and the following examples were highlighted by the Central Bank:-

- (i) In the rare case of the proposed appointment of such a director, the Central Bank will:
 - (a) Request a letter from each board which will set out the proposed time commitment for that director; and
 - (b) Withdraw from any corporate QIAIF, which proposes that director, the option of the 24 hour authorisation time-frame.

- (ii) Previously authorised investment funds which continue to have such a director after 1st January 2016 will be given priority consideration for inclusion in Central Bank thematic reviews where board effectiveness is being tested in any respect.

The Central Bank expects boards to review their current board composition, taking into account the Directors' Time Commitments Guidance, to ensure that each director appointed has sufficient time allocated to his /her role and that directorship numbers are kept at an acceptable and manageable level.

Next Steps of the Central Bank

Part V of the Central Bank's document in relation to "Fund Management Company Boards" sets out next steps and details immediate rule changes and authorisation process changes which are being made as a result of the outcome of CP86.

Immediate rule changes relate to the definition of Irish resident. This has already been addressed in the Central Bank's AIF Rulebook. A similar definition is to be included in new Central Bank UCITS Regulations to be published shortly and which will replace the Central Bank's UCITS Notices.

Immediate authorisation process changes for fund management companies include the requirements that

-  A copy of each designated person's letter of appointment be submitted to the Central Bank as part of the authorisation process; and
-  The rationale for the board composition be included in the business plan / programme of operations.

Part V of the Central Bank's document in relation to "Fund Management Company Boards" also sets out the Central Bank's intention to publish later in 2015 the following further fund management company guidance in relation to fund management companies:-.

▣ Managerial Functions Guidance

This guidance will set out, inter alia, the Central Bank's views on the tasks involved in each of the managerial functions, how designated persons should oversee each of the regulatory obligations which fall within their managerial function and guidance on the time commitments for designated persons. Although this guidance will issue in draft form and be subject to public consultation, the Central Bank expects this guidance to be finalised by the end of 2015;

▣ Operational Guidance

This guidance will cover policies and procedures (in particular where a fund management company relies on the policies and procedures of its delegates) and recordkeeping. Although this guidance will issue in draft form and be subject to public consultation, the Central Bank expects this guidance to be finalised by the end of 2015; and

▣ Procedures Guidance

This guidance will deal with the procedures relevant to authorisation applications and fund management company passport applications. Given that this guidance will be procedural in nature and based largely on current guidance, the Central Bank does not believe that public consultation on this guidance will be necessary.

In conjunction with the Central Bank's publication of its fund management company guidance, the Central Bank intends to amend its AIF Rulebook and forthcoming Central Bank UCITS Regulations to address other proposed changes as a result of the feedback on CP86 (as detailed above).

Impact for Existing Fund Management Companies

Boards should review their current board composition, taking into account the Directors' Time Commitments Guidance, to ensure that each director appointed has sufficient time allocated to his /her role and that directorship numbers are kept at an acceptable and manageable level.

Fund management companies will have to 30 June 2016 to update their business plans / programmes of operation to reflect the revised managerial functions and the organisational effectiveness role.

Once the Central Bank's fund management company guidance is published, it would also be prudent for existing fund management companies to review their business plans / programmes of operation and policies and procedures as although divergence from the Central Bank's fund management company guidance will not be a regulatory breach, the Central Bank's supervisors will have reference to this guidance when forming a view as to whether a fund management company has complied with its regulatory obligations.

DILLON  EUSTACE

Dublin

33 Sir John Rogerson's Quay, Dublin 2, Ireland. Tel: +353 1 667 0022 Fax: +353 1 667 0042.

Cayman Islands

Landmark Square, West Bay Road, PO Box 775, Grand Cayman KY1-9006, Cayman Islands. Tel: +1 345 949 0022 Fax: +1 345 945 0042.

Hong Kong

604 6/F Printing House, 6 Duddell Street, Central, Hong Kong. Tel: +852 352 10352.

New York

245 Park Avenue, 39th Floor, New York, NY 10167, U.S.A. Tel: +1 212 792 4166 Fax: +1 212 792 4167.

Tokyo

12th Floor, Yurakucho Itocia Building, 2-7-1 Yurakucho, Chiyoda-ku, Tokyo 100-0006, Japan. Tel: +813 6860 4885 Fax: +813 6860 4501.

DISCLAIMER:

This document is for information purposes only and does not purport to represent legal advice. If you have any queries or would like further information relating to any of the above matters, please refer to the contacts above or your usual contact in Dillon Eustace.

Copyright Notice:

© 2015 Dillon Eustace. All rights reserved.