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Central Bank Consultation on Fund Management Company Effectiveness

by **David Williams**

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The Central Bank has recently published feedback on its Consultation on Fund Management Company Effectiveness, together with proposed guidance on the oversight of delegates, guidance relating to the new role of director responsible for organisational effectiveness, and guidance on directors' time commitments.

In September 2014 the Central Bank of Ireland (the Central Bank) published a consultation paper on Fund Management Company Effectiveness – Delegate Oversight (CP86). "Fund Management Companies" include AIFMs, UCITS Management Companies and self-managed investment funds. CP86 set out a number of proposed initiatives that were primarily aimed at increasing the substantive control which fund management companies have over the activities of their delegates. The suggested initiatives included those listed below.

- The consolidation of the managerial functions applicable to AIFMs and UCITS Management Companies (currently sixteen for AIFMs and nine for UCITS Management Companies) into six managerial functions which would be applicable to all Fund Management Companies. The six managerial functions which were initially proposed were:

1. Risk Management;
2. Investment Management;
3. Regulatory Compliance;
4. Distribution;
5. Capital and Financial Management; and
6. Organisational Effectiveness.

- Introduction of a requirement that Fund Management Companies must document the rationale behind the composition of the board.

Central Bank Paper on Fund Management Company Boards

The Central Bank issued a feedback statement to CP86 on 12 June 2015, as part of the document titled "Fund Management Company Boards". The document was split into five parts as follows;

1. Feedback on CP86;
2. Draft Central Bank Guidance on Fund Management Companies – Delegate Oversight;
3. Central Bank Guidance on Fund Management Companies - Organisational Effectiveness;
4. Central Bank Guidance on Fund Management Companies – Directors' Time Commitments; and
5. Next Steps.

Central Bank Feedback Statement on CP86

The key points of the feedback statement are outlined below.

- Risk Management will be separated into two separate managerial functions: fund risk management and operational risk management. These separate managerial functions may, but do not need to be, conducted by a single person.
- Organisational Effectiveness will not be classified as a managerial function but will be a mandatory function to be carried out by an independent director who cannot be responsible for any of the six managerial functions.
- The six managerial functions do not have to be carried out by a director. Fund Management Companies may appoint other persons to perform the management functions. Where a director is responsible for a managerial function he or she must consider whether consenting to become involved in the management of the company will affect his or her independence.
- The same person may not be responsible for Investment Management and Risk Management (either fund risk management or operational risk management).
- The requirement that two Irish resident directors sit on the board of a Fund Management Company will remain in place. A director will be considered to be Irish resident if he or she is present in Ireland for the whole of 110 working days a year.
- Fund Management Companies must document the rationale for the composition of the Board.
- Fund Management Companies will need to update their business plans or programmes of activity by 30 June 2016.

Draft Central Bank Guidance on Fund Management Companies – Delegate Oversight

The Central Bank has invited comments on its Draft Delegate Oversight Guidance, however as the matters contained in the Draft Delegate Oversight Guidance were already consulted on in CP86, it will be a shortened consultation process with a submission deadline of 24 July 2015.

The Draft Delegate Oversight Guidance focuses on the role of the Fund Management Company's board where significant tasks are delegated and sets out a framework on how delegates should be supervised and overseen by the board. The Central Bank's recommendations regarding good practice for the boards of Fund Management Companies are set out under the following six headings:

1. Investment Management;
2. Distribution;
3. Risk Management;
4. Operation and Administration;
5. Support and Resourcing; and
6. Boards of Externally-Managed Investment Companies.

Central Bank Guidance on Fund Management Companies – Organisational Effectiveness

One of the independent directors of a Fund Management Company, possibly the Chair, will have to take on the "organisational effectiveness" role. The director carrying out this role will be responsible for keeping the effectiveness of the organisational arrangements of the company under ongoing review, with his or her reports being submitted to the board of directors for discussion. He or she will be expected to drive the change agenda and ensure that any agreed actions are being implemented.

Central Bank Guidance on Fund Management Companies – Directors' Time Commitments

The Central Bank carried out a thematic review, in conjunction with CP86, in order to assess the impact of directors' time commitments on investment fund governance. The key points of the resulting guidance are as follows;

- 2,000 hours a year is considered a reasonable number of working hours available for each individual. Accordingly, where a director has committed less than 2,000 hours a year to professional commitments, including employment and directorships, no further action need be taken.
- If directors have committed more than 2,000 hours a year to professional commitments and hold more than 20 directorships, including both fund and non-fund directorships, then the Central Bank will consider that a risk indicator has been triggered. The Central Bank will engage with the director directly to ensure he or she is meeting his or her obligations and responsibilities. The companies which he or she is a director of will be targeted for thematic reviews by the Central Bank.
- When a risk indicator is triggered by a director, additional scrutiny may be applied to the companies which he or she is a director of, and in the case of a QIAIF the standard 24-hour timeframe for authorisation will not be possible.
- The boards of directors of relevant companies should carry out a review of their current board composition, taking into account the directors' time commitment guidance, to ensure that each director has sufficient time to allocate to the role and the number of directorships which each director holds are at an acceptable and manageable level.
- The appropriateness of the time commitments given by directors should be reviewed. Additional time should be allocated where a director carries out the chairperson role or sits on a sub-committee of the Board, and the number of sub-funds within an investment fund should be taken into account.
- The role of designated person for managerial functions should be considered separately to the role of director. A separate time commitment should be agreed and a separate letter of engagement should be issued.

Next Steps

The Central Bank will amend the AIF Rulebook and the forthcoming UCITS Regulations to reflect the changes outlined above.

The Central Bank will also issue the finalised "Managerial Functions" and "Operational" sections of the Fund Management Company guidance prior to the end of 2015.

Implications for Fund Management Companies

Immediate Implications

The Central Bank guidance on Directors' Time Commitments has been finalised and so the boards of Fund Management Companies should carry out a review of board composition and directors' time commitments at the earliest opportunity. The Central Bank will use the guidance as guide for future thematic reviews of board effectiveness, director time commitments and quality of board operations.

Fund Management Companies who have individual directors who hold more than 20 directorships a year and have professional time commitments amounting to more than 2,000 hours a year will be given priority for inclusion in such thematic reviews.

Boards of Fund Management Companies should also get confirmation from their Irish resident directors that they are present in Ireland for the whole of at least 110 working days a year.

Rule changes expected by December 2015

As outlined above, the Central Bank has committed to publishing further guidance for Fund Management Companies by the end of 2015. The Central Bank will also include in its forthcoming UCITS Regulations, and will amend its AIF Rulebook to include, provisions relating to the revised management functions and the organisational effectiveness role.

Accordingly, the boards of Fund Management Companies should start considering who will take responsibility for each of the six management functions and for the role of organisational effectiveness.

Boards of Fund Management Companies should consider whether it is more appropriate for a director to take on each of the managerial functions or whether the function would be better carried out by an employee of one of its delegates such as the Investment Manager or a third party compliance consultant.

If it is decided that a director is the appropriate person to take responsibility for a particular management function, consideration will need to be given to whether the independence of that director will be affected by the performance of that function.

Actions necessary by June 2016

The Central Bank has given Fund Management Companies 12 months within which to update their Business Plans or Programme of Activities to reflect the revised managerial functions and the organisational effectiveness role. The length of the transitional period is reflective of the fact that the Central Bank expects Fund Management Companies to take time to consider how to revise their managerial functions to best suit their needs rather than rushing to amend documentation.

The revisions to Business Plans and Programmes of Activities will also need to take into account the forthcoming guidance on Fund Management Companies once it has been issued. The necessary revisions may be significant and so Fund Management Companies should begin the process of revising their documents well in advance of the June 2016 deadline to flush out any issues that may arise.

For more information please contact David Williams at dwilliams@lkshields.ie.

About the Author

David Williams
Managing Partner

David advises on all aspects of financial services law and regulation.
T: +353 1 637 1542 **E:** dwilliams@lkshields.ie