CP86

The Central Bank has issued feedback (Feedback) on its “Consultation on Fund Management Company Effectiveness – Delegate Oversight’ (CP86) (the “Consultation”).

It has also issued consequential guidance on related subjects including Guidance on Organisational Effectiveness and Guidance on Directors’ Time Commitments. The original version of CP86 included draft Guidance on Fund Management Companies – Delegate Oversight. The Central Bank of Ireland (CBI) has now re-issued this as a consultation in its own right and is inviting submissions from industry. Each of these developments is considered below in turn.
**i. Feedback statement on CP86**

CP86 proposed amendments to the structure of fund management companies including the reduction and streamlining of managerial functions, director residency requirements and board composition.

**Streamlining managerial functions**

The CBI’s Feedback Statement confirmed that the CBI will proceed to streamline the existing managerial functions from 15 into 6. The responsibilities of each role will be proposed in a future consultation on fund management company guidance.

The six new managerial functions comprise:

- investment risk management
- investment portfolio management
- compliance
- distribution
- capital and financial management
- operational risk

The CBI anticipates that each designated person will be responsible for conducting their assigned managerial function on a day to day basis. They recommend that directors should not assume this role if they believe it could affect their independence. This role will require a stand-alone letter of appointment – separate to the letter appointing the director.

A designated person can perform two roles. For example the same person can perform both the fund risk management and the operational risk management roles; however, the same person cannot perform both risk management and investment management. The individual responsible for ‘organisational effectiveness’ must not perform any of the six managerial functions.

The CBI’s Feedback acknowledges that boards have in recent years been re-organised to incorporate the 15 designated roles. It is therefore allowing a transition period until 30 June 2016 to allow sufficient time for this new re-organisation and to update their business plans/programmes of operation to reflect these changes.

**Directors’ Presidency Requirements**

Irish fund rules have traditionally required boards of funds to have at least two Irish resident directors. CP86 originally proposed two changes to this – reducing the number of Irish resident directors to one, and defining ‘residency’ to mean 110 days per year.

The Feedback to CP86 confirms that funds will continue to require two Irish resident directors. The CBI stated that the main reason to retain this requirement was for funds in distressed circumstances.

The Feedback also confirms that a director must be in Ireland for 110 whole working days per year to be ‘Irish resident’. The CBI confirmed that this number was based on half a working year excluding holidays.

**Rationale for board composition**

The original version of CP86 proposed a new rule, as part of the authorisation process, requiring fund managers to document how a Board’s composition provides it with sufficient expertise to achieve an appropriate balance of skills and competencies on their boards.

The Feedback confirmed that this rule will be adopted. In future, a fund management company must include this rationale in its business plan/programme of operations, and update this plan/programme everytime the board constitutions changes.

The new role of ‘organisational effectiveness’ will include keeping the board composition under review and reporting to the Board on this matter.
ii. Central Bank Guidance on Organisational Effectiveness (Organisational Guidance)

The Organisational Guidance recommends that one independent director of a fund management company (including the Chair if she/he is independent) should undertake a new role dedicated to ‘organisational effectiveness’. This role is to ensure that there is an independent director within the fund management board who takes overall responsibility for its effectiveness. As the CBI considers this a strategic and inward looking role, it decided not to classify this role as one of the six managerial functions – indeed, this person is prohibited from holding one of these managerial functions in order to maintain independence. Instead, it is a task which must be undertaken by one of the independent directors who will report to the board.

The responsibilities assigned to this person includes being on alert for organisational issues and escalating these to the board. The CBI views this person as a ‘change leader’, who proposes improvements in effectiveness to the board and drives the implementation of any agreed actions, including replacing outdated or inappropriate organisational arrangements such as:

- monitoring the adequacy of a fund management company’s internal resources against its day-to-day managerial roles;
- reviewing the organisational structure of the fund management company and considering whether it remains fit for purpose;

When all sections of the CBI’s Fund Management Company Guidance have been finalised, the CBI will amend the AIF Rulebook and include in its forthcoming UCITS Regulations a rule that the organisational effectiveness role must be performed by an independent director.
iii. Central Bank Guidance on Directors’ Time Commitments

In parallel with their review into the Fund management company delegate oversight under CP86, the CBI also conducted a thematic review to assess the number of directorships held by individuals on the boards of corporate investment funds, fund management companies and AIF management companies. The aim of this review was to determine the impact on governance where directors hold multiple directorships. The Irish funds industry has 2,057 active directors, and the CBI review discovered that 13 of those individuals hold 652 directorships within the Irish funds industry, along with what they described as an ‘extensive level of aggregate professional time commitments’. The CBI also noted that several directors hold employments outside their directorships.

Time allocation

Following both these reviews, the CBI decided to prepare this Guidance on Directors’ Time Commitments to assist directors and fund managers in complying with requirements. They consider that 2000 hours per director provides a reasonable number of working hours per year. This time allocation should be considered by individuals when taking on new directorships and should include all professional commitments including other directorships and employments held. The CBI also recommends that directors and boards agree how much time to devote to particular funds, and additional time should be set aside for additional responsibilities and as a ‘buffer’ for unexpected ad hoc queries. The chart below summarises the CBI’s recommendations.

<table>
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<tr>
<th>2000 hours per director</th>
<th>• based on a 9 hour day and 230 working days per annum.</th>
<th>• This ‘total’ time allocation should include all professional commitments including other directorships and employments held.</th>
<th>• Directors must satisfy themselves, and their boards, that they have sufficient time to fully discharge their duties.</th>
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<tr>
<td>Minimum time allocation for board meeting attendance</td>
<td>• Boards and directors must agree this and record it in the director’s appointment letter</td>
<td>• Must incorporate sufficient time to allow for preparation, document review and travel time</td>
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<td>Additional time requirements — in addition to the normal time allocated to each director role</td>
<td>• ‘Buffer’ — incorporate this to allow for ad-hoc queries which arise occasionally</td>
<td>• Chairperson – extra responsibilities and work require additional time be set aside. This extra time allocation should be agreed with the board.</td>
<td>• Sub-funds – these each require extra time; cannot just account for the umbrella fund alone</td>
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<td>• Type of fund and investment complexity – must consider whether these require extra time</td>
<td>• Different client relationships – consider the number of such relationships when assessing time commitments</td>
<td>• Board committees – membership should be regarded as a separate role; must be included in assessing time commitment and availability</td>
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<td>• Designated person role – this is a separate role to that of director and must be considered separately. A separate time commitment should be allocated for each such role, and must be commensurate with any additional work the role requires and remuneration received. Allocated time must incorporate an ongoing oversight role, daily availability, report review and onsite visits to delegates.</td>
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| Letters of appointment | • Directors - require a letter of appointment. | • Designated person role for managerial functions – this requires a separate letter of appointment. | • Both letters must:  
> include a written contract outlining job specifications; time expectations; fee arrangements  
> be subject to annual review by the board and made available to the CBI upon request |
| Conflicts | • In cases of multiple directorships, directors must consider:  
> any potential conflicts  
> ‘corporate interconnectivity’  
> Where individuals have full-time positions in a service provider to the board, any potential conflicts must be considered and appropriate action taken |
| Expertise | • Must consider the type and complexity of individual funds and sub-funds when assessing the time commitment and necessary expertise to oversee that fund |
| Regulatory and legal obligations | • of differing types of boards and legal structures – consider before appointment |
Central Bank supervision of the time allocation

The CBI intends to treat high levels of directorships combined with high aggregate levels of annual professional time commitments as a risk indicator. Where any risk indicator is triggered, additional supervisory attention is appropriate under the CBI’s risk based approach to supervision. The CBI is initially setting that risk indicator in terms of a joint test of (a) holding more than 20 directorships and (b) having an aggregate professional time commitment exceeding 2,000 hours.

The consequences of holding such time commitments include:

- The director being contacted by the CBI to ensure their legal obligations and responsibilities are being met.
- The CBI will monitor director’s commitments to prevent any risk of weakening of governance standards.
- Treat this as a ‘risk indicator’, which triggers additional CBI supervision as appropriate under the CBI’s risk based approach.
- Where a fund is considering appointing a director with such time commitments (including non-Irish fund-directorships and non-fund directorships), the CBI will (i) request a letter from each board setting out the proposed time commitment (IFIA Code para 4.5) and (ii) dis-allow the 24 hour guaranteed corporate QIAIF approval time
- Any previously authorised funds with directors holding such time commitments after 1 January 2016 will be given priority consideration for CBI thematic review where board effectiveness is already being considered.
The Draft Delegate Guidance sets out recommendations regarding good practice for boards of investment companies, UCITS management companies, AIFMs and AIF management companies incorporated and authorised in Ireland.

The focus of this document is on the role of boards where significant tasks are delegated externally. Delegation does not dilute the board’s ultimate responsibility and it must at all times retain and exercise control over the relevant delegate’s management.

The CBI issued this as part of CP86 originally and has now re-issued it as a stand-alone consultation in its own right. The CBI is accepting submissions on the draft Delegate Guidance until 24 July 2015.

### Investment Management
The Board of the Fund Manager should seek a report or presentation from the investment manager prior to the issue of the prospectus and launch of the investment fund or sub-fund, and should approve the investment approach which the investment manager proposes to take. Following the (sub)fund launch, the board should oversee the investment manager’s compliance with this approach. The Board is also asked to seek comprehensive annual presentations from the investment manager regarding the investment manager’s performance and investment team. The directors are required to have a good understanding of the investment manager’s business, which may necessitate due diligence visits to their premises.

### Distribution
The Board are required to review and approve the proposed distribution strategy prior to a (sub) funds’ launch, and to receive regular updates on distribution including patterns of distribution, sales flow and any legal, regulatory or tax issues.

### Risk management
Although a management company may delegate (internally or externally) many day to day risk management tasks, its board retains ultimate responsibility for risk management. It should adopt a risk management framework, including identifying risks and risk mitigants, confirming the risk appetite, and incorporating appropriate policies for measurement and management of risk. It sets out specific requirements for each of investment risk, operational risk and enterprise risk and business continuity.

### Operation and administration
When appointing a delegate to undertake operational and administrative tasks, a board should establish that the delegate has sufficient capacity and flexibility to manage varying levels of business, operational resilience and suitable procedures for confidentiality and data protection. It should regularly receive reports on operational matters including depositary reports, administrator reports, performance, and operation of anti-money laundering procedures. The Board should adopt an appropriate valuation policy and a budget for payment exceeding the investment management fee.

### Support and resourcing
Management companies must have sufficient resources to enable them to carry out their functions properly, taking into account the nature, scale and complexity of their business. The Guidance suggests that matters which may require support include proactive monitoring of developments between board meetings, management of board meetings, a regular review of the management company’s suite of policies and procedures. It also suggests that individual directors may be designated with particular roles in the oversight of certain functions. In that case, the board should ensure that that person is sufficiently experienced and qualified for the role, s/he has sufficient resources to enable them to undertake that role and their nomination for that role does not comprise either their or the board’s independence.

### Boards of externally-managed companies
This section of the Guidance caters for externally managed investment companies (EMIC) which are not regulated as management companies. It emphasises that the board of an EMIC retains ultimate responsibility for its management including the appointment and oversight of the management company which is its principal delegate. The EMIC Board also remains responsible for issuing the prospectus and publishing audited annual financial statements. It should receive regular reports from the management company describing its compliance with the sections 1 (investment management), 3 (risk management) and 4 (administrative tasks) of the Guidance, developments in the distribution of the funds, and the extent of its delegation of any tasks and its control framework for oversight of the delegates’ performance. The Guidance asks the Board to consider whether it considers it appropriate to receive reports from any of the delegates of the management company.

The Guidance acknowledges that some AIF management companies (AMC) may appoint external AIFMs. These AMCs are not regulated as AIFMs, however, they remain responsible for the AIFs under management, the oversight of the AIFM, issuing the prospectus and publishing audited financial statements. The AMB’s Board is also required to apply the same principles to the oversight of the AIFMD as described above for EMICs. To avoid doubt, the Guidance clarifies that this section (6) is limited to EMICs, to AMCs with external AIFMs, and that it does not apply to other forms of investment fund or management company.