

Tel: +353 (0)1 631 6444
Fax: +353 (0)1 667 0042
33 Sir John Rogerson's Quay,
Dublin, Ireland



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

25th August 2016

Dear Sir/Madam,

RE: Response to Consultation on Fund Management Company Effectiveness – Managerial Functions, Operational Issues and Procedural Matters, Consultation Paper 86 – Third Consultation

We welcome the opportunity to provide feedback to the Central Bank's Consultation Paper 86 – Third Consultation. Bridge Consulting offers specialist business regulatory, compliance, risk, governance and fund structuring solutions to the fund management industry. We represent the views of a significant number of stakeholders below.

In summary, we welcome guidance in this area and support regulation designed to enhance the effectiveness of fund management companies to the benefit of investors. We agree with the detailed nature of the guidance and the expectations regarding how the Designated Persons carry out their roles. Guidance to fund management companies is important and can be very useful, but individual fund management companies should be afforded discretion to best fit the guidance to their own circumstances. We have concerns that an overly prescribed governance framework in conjunction with recent 'regulatory fatigue' detracts from the core functions of the boards of fund management companies. There is a danger that boards of fund management companies become distracted by regulatory compliance.

While we agree with the detail included in the Organisational Effectiveness role, our observations are that boards of fund management companies already address all points outlined in the guidance as a function of good governance. Although possibly to late to change, it remains questionable as to whether placing responsibility for Organisational Effectiveness on one Director is necessary to provide good governance. Putting the focus on one director may unintentionally dilute the input from the rest of the board.

The rule which will have the greatest impact on our clients is the location rule. A number of our clients who have carefully considered the composition of their governance arrangements will now be required to change the status quo irrespective of the fact that the arrangements are already working in accordance with best governance practices. The net result is likely to be increased costs to the investors and potentially less investor protection should there be a short term increase in governance risk. We do not take the view that this rule will achieve the desired result of enhanced supervisability and oversight by providing the Central Bank with clearer, more effective channels of communication with fund management companies.

We are broadly supportive of the rules on retrievability of records, but have requested below some further clarifications on the wording of the rule. We are supportive of the dedicated fund email address.

We are disappointed that the Consultation Paper does not provide greater detail of the additional benefit to investors in the work being undertaken. There is an ever increasing cost of regulation which is ultimately borne by the investor. A cost benefit analysis on the impacts of the Consultation Process should be considered.

Consultation Question 1

The detailed nature of the managerial function guidance serves to set out the Central Bank's expectations regarding how designated persons should carry out their roles. It also illustrates the full breadth of responsibility under the designated person's remit. Are there further practices that need to be considered for inclusion in this guidance to assist designated persons in carrying out their roles? If so, please detail.

We recognise the descriptive nature of the managerial functions and the role of the designated persons as a welcome step and have no comments. The draft guidance is extensive and we don't feel there are further practices which should be considered for inclusion.

Consultation Question 2

In the first consultation on CP86 and the feedback statement to the first consultation, the Central Bank advised that the organisational effectiveness role included the previous managerial functions of conflicts of interest, internal audit and supervision of delegates (to the extent that this is not performed by the designated persons). The principal purpose of the organisational effectiveness role is to have someone constantly monitoring how well a fund management company is organised and resourced. By also allocating internal audit to the organisational effectiveness role, there may be a risk that makes it more difficult for the individual performing the organisational effectiveness role to carry out their main purpose. Stakeholders are asked to consider whether responsibility for oversight of internal audit be better placed with the Operational Risk managerial function.

Organisational Effectiveness Role

In our view, ensuring that a company has a sufficient organisational structure and capability to effectively carry out the chosen strategies of the company is one of the key roles of the whole Board. Whilst we still question the CP86 approach to have a single director responsible for Organisational Effectiveness, we welcome the clarification that the director responsible for Organisational Effectiveness can be supported in the role. In fact, we feel the director responsible for Organisational Effectiveness should use all the resources and expertise available to formulate a more appropriate solution. Where the director responsible is using support, this should be reflected in a lower additional time commitment set aside by the director for the role.

Independence

We note that the Organisational Effectiveness rule in CP86 – Third Consultation does not stipulate that the Director responsible should be an independent Director. We recommend that this be clarified. Regulation 100(7)(a) of the Central Bank UCITS

Regulations¹ and the current version of the AIF Rulebook, both effective from November 2015, stipulate that the organisational effectiveness role should be performed by an independent Chair or an independent board member.

Internal Audit

We believe there is a danger that the guidance becomes too descriptive in nature resulting in a 'one size fits all' framework. We find that a particular frustration with the Management Function/Designated Person structure is that it forces fund management companies to appoint a single Designated Person for a management function where it may be more appropriate to split the responsibilities within that function between multiple people.

Whilst the CP86 process has sought to separate the role of a fund director from the day-to-day executive roles of Designated Persons, the detailed description of the organisational effectiveness role could be seen as a backward step forcing the director responsible for OE back in to an executive function. This will be exacerbated further if Internal Audit and Supervision of Delegates are squeezed in to the Organisational Effectiveness role, which will have the knock-on effect of undermining the independence of the director responsible.

From our experience there is significant overlap in Operational Risk and Internal Audit for fund management companies. It will be appropriate for many fund management companies to amalgamate Internal Audit in to the Operational Risk management function. For fund management companies with greater scale and complexity it may be more appropriate to set up a separate fully independent internal audit function which can undertake unbiased audits of the Operational Risk function.

We recommend that it be left to individual management companies to decide where Internal Audit best sits. There will be oversight by the director responsible for organisational effectiveness in either case.

Consultation Question 3

The location rule balances the need for sufficient expertise against the need to be able to access persons and supervise fund management companies. Please provide any factual analysis you have on the impact of this.

General Comments

Whilst recognising that the Consultation was published pre-'Brexit', we see the proposed stipulations on EEA resident directors as having the most significant negative impact for our clients. We also note that this rule appears to completely reverse the initial approach suggested in the first iteration of CP86, which looked to relax stipulations on residency by reducing the requirement for Irish resident Directors.

Much work has been done in recent times in the area of good governance for fund management companies, including but not limited to (i) the introduction of the Fitness and Probity regime; (ii) introduction of the industry standard corporate governance code; (iii) inclusion of the rationale for board composition in the authorisation process. In our view, further restrictions on the residency of board directors and designated persons only serves to undermine this work.

¹ The Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Undertakings for Collective Investment in Transferable Securities) Regulations 2015

We note that the proposed rules fall under the 'Supervisability' section of the consultation paper. Whilst appreciating that the Central Bank must have adequate and quick access to the right people in order to supervise, it is questionable if the proposed location rules will enhance Central Bank access to the appropriate people to a greater extent than is already in place through the requirement for two Irish resident directors. Our views consider:

- Ease of travel – the Directors and Designated Persons can be in Dublin for face-to-face meetings in a short period of time. In fact, travel to Dublin from the US can be as quick/if not quicker than travel to Dublin from a number of EEA countries.
- Advances in communication technology – enhanced global communication channels, including video conferencing, are increasingly being used as a substitute for face-to-face meetings, particularly as companies become more aware of corporate social responsibilities.
- Directors Responsibilities – We see a greater understanding and willingness from all directors to make themselves available to the Central Bank at short notice, not just the Irish resident directors.

Increase in Irish Residency Requirement

We do not see how supervisability is enhanced by having an additional Irish resident Director or Designated Person for fund management companies which are PRISM rated Medium Low or above. Our view is that this rule will impede fund management companies from formulating the most optimal and effective governance solution. The addition of a third Irish resident in order to meet the quota will result in an undue expense which will be borne by investors.

Rules on EEA Directors

In our analysis, the EEA rules will either undermine effective governance or increase expense of effective governance. A significant number of our clients fund management companies are set up with the stipulated 2 Irish directors and a further 2 non-EEA resident directors (or 2 UK resident directors). The net impact on these boards is that they either (i) remove one non-EEA director, which results in substance being removed and a dilution of governance; or (ii) add 2 more EEA resident (Irish resident) directors, which will not significantly enhance a governance structure which has already been carefully constructed, and will add significant expense to be borne by investors.

Should the UK, post-'Brexit' cease to be an EEA country, the impact of the proposed rules will be significantly exacerbated.

In our view, rules on residency are a restrictive measure when considering board composition and as much as possible, should be discouraged. We do not see any benefit to the end investor in introducing the proposed rules. As per the above, much work has been done in the area of good governance in fund management companies in recent years which does benefit the protection of the end investor.

We recommend the EEA location restrictions be dropped and the current position of 2 Irish resident directors be left in place.

Consultation Question 4

The proposed rule and guidance on retrievability of records focus on the outcomes to be achieved rather the IT systems to be used to achieve those outcomes. Is this the right approach?

Retrievability of Records Rule

Whilst agreeing that it is the right approach to focus on the outcomes to be achieved and not the IT systems, we would request that the rule be further clarified. In our experience, good governance in retrievability of records in management companies operating a delegated model involves the maintenance of a Record Keeping policy of the Management Company that details who is responsible for maintaining the particular record type.

Good oversight of the delegates by the Management Company will ensure that the Management Company is comfortable that delegates can produce the records within a reasonable timeframe when requested. Whilst noting it is important for management companies to be able to produce records on request from the Central Bank, making the records 'immediately' available is not, in our view, practical where management companies are using delegated models. Fund management companies should be able to demonstrate control of the records, but given that different records may sit with different delegates there should be a reasonable timeframe given to deliver the records upon request.

We note the wording of the guidance appears to take a more practical view than the wording of the rule, which suggests our comments above may be in line with the intentions of CP86 in this respect.

We recommend the rule be clarified further.

Monitored Email Addresses

We recognise the difficulty in maintaining sufficiently up to date contacts for the relevant parties in fund management companies and are in agreement with the requirement that fund management companies should maintain a dedicated and monitored email address for the purposes of improving communication with the Central Bank.

Yours faithfully,

Patrick Robinson

Bridge Consulting