

Group Briefing

Central Bank of Ireland
Third Consultation on Fund
Management Company
Effectiveness (CP86)

INTRODUCTION

On 2 June 2016, the Central Bank of Ireland issued its long-awaited consultation on managerial functions and other matters for fund management companies. The consultation is directed at “fund management companies” in Ireland that are authorised by the Central Bank, namely:

- » UCITS management companies;
- » AIFMs;
- » self-managed UCITS investment companies; and
- » internally-managed AIFs.

MANAGERIAL FUNCTIONS GUIDANCE

The Central Bank has identified the following six key managerial functions for fund management companies:

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

The Central Bank requires fund management companies to identify

an individual (a “designated person”) who is responsible for monitoring and overseeing the managerial function assigned to him or her. The draft managerial functions guidance sets out how the Central Bank expects a designated person to carry out his or her role. Some of the key points include:

- » **Designated person’s knowledge of regulatory regime:** Designated persons should know exactly which regulatory obligations fall within their remit and to be up-to-date on developments concerning their managerial function. The Central Bank sets out a detailed framework (running to approximately 60 pages) of how it believes the regulatory obligations set out under AIFMD and the UCITS Directives respectively could be allocated to each managerial function. However, the Central Bank notes that fund management companies may decide that particular regulatory obligations should be attributed differently.
- » **Seniority of designated persons:** Designated persons should be at a sufficient level of seniority such that their challenge of delegates carries weight and they are the appropriate individuals to meet with the Central

Bank as part of its supervisory engagement process.

- » **Obligation of designated persons to act in best interests of investors:** fund management companies are under regulatory obligations to act in the best interests of the investors in the funds under management. The letter of appointment or other contractual arrangements with a designated person will have to specifically provide that the designated person must put the best interests of investors in the relevant funds ahead of any other interests. Given the flexibility introduced by the proposed new location rules for designated persons (see below), we anticipate challenges in reconciling the absolute requirement to put this interest “ahead of any other interests”, particularly where a designated person has multiple roles in a complex group and may owe different duties to different affiliates and different groups of clients. Hopefully, the consultation process might allow the Central Bank to consider clarifying that this requirement is not absolute and should take account of other obligations to which a designated person may be subject provided that

- they adhere to applicable conflicts management policies.
- » **Frequency of monitoring by designated persons:** Designated persons should monitor the tasks for which they are responsible on a “day-to-day” basis. Helpfully, the Central Bank clarifies that this does not necessarily mean that monitoring and oversight has to take place daily – although this might be the case depending on the activities of the fund management company and its investment funds under management.
 - » **Reporting to designated persons:** Reporting received by designated persons from delegates should not be on an exceptions basis. Instead, the reports should include summary information on the activity of each sub-fund over the relevant period, any breaches which occurred or flags raised and underlying trends.
 - » **Meetings with delegates:** Designated persons should hold regular meetings with delegates. These could be in the form of sub-committee meetings, conference calls, physical meetings or a combination of these. These meetings could be less frequent than the frequency of reporting to the designated person but more frequent than the board meeting schedule. Designated persons should also perform on-site visits of delegates.
 - » **Contractual arrangements between fund management companies and service providers:** the Central Bank states that these arrangements should document which service provider is responsible for discharging which regulatory obligations. The Central Bank points out that it should not be assumed that, because a service provider is regulated, it will be carrying out the activities necessary for a fund management company to discharge its regulatory obligations. The draft guidance suggests that a general obligation to perform the contract “in accordance with applicable law and regulation” may not be sufficient to address the Central Bank’s expectations. Few fund management companies would welcome the costs incurred in amending the main contracts they have in place with their service providers and so it is to be hoped that the Central Bank would accept ancillary service level agreements, letters of understanding or similar arrangements as being an adequate way of documenting these matters.
 - » **Reliance on delegates’ or group policies and procedures:** Fund management companies should not rely on the policies and procedures of their delegates or group without considering whether this is appropriate. They should have their own suite of policies and procedures. Where a fund management company intends to rely on a policy or procedure of its delegate or group, its own policy or procedure should document how this has been verified as appropriate and how it will be kept under review.
 - » **Role of designated person in relation to policies and procedures:** Fund management companies are required under law and regulation to have various policies and procedures (“P&Ps”), have particular organisational structures and establish particular limits. Appropriate P&Ps, structures and limits must be (i) designed, (ii) implemented and complied with on an on-going basis and (iii) reviewed periodically. The Central Bank expects that designated persons should have a role in each of these three tasks proportionate to being a key representative of the fund management company in meeting the obligation.
- PROPOSED NEW LOCATION RULES**
- In one of the most significant aspects of the consultation, the Central Bank proposes new minimum requirements governing the location of directors and designated persons. This is a response to representations made by industry on the limitations of the existing Central Bank policy of requiring designated persons (who are not also fund management company directors) to be Irish resident. The proposal is welcome in that it recognises that designated persons can be located outside of Ireland in centres where the appropriate expertise and resources are located. This should enable fund management groups to allocate personnel to managerial functions in a more efficient, cost-effective and integrated approach.
- The applicable requirements will be determined by the PRISM approach to categorising fund management companies. A fund management company with a PRISM impact rating of Medium Low or higher will be required to have at least:
- » three Irish resident directors or at least two Irish resident directors and one designated person based in Ireland; and
 - » two thirds of its directors in the EEA; and
 - » two thirds of its designated persons in the EEA.
- A fund management company with a PRISM impact rating of Low will be required to have at least:
- » two Irish resident directors; and
 - » two thirds of its directors in the EEA; and
 - » two thirds of its designated persons in the EEA.
- A fund management company will be required to satisfy the Central Bank of the appropriateness of any arrangements involving designated persons in different locations and demonstrate that the designated persons can co-ordinate their roles effectively.
- The proposal that a designated person does not have to be Irish resident in all cases is welcome. However, the proposed new location rules are likely to represent a challenge for investment management groups that are primarily located outside of the EEA (e.g. the US). To date, the Central Bank has required that two Irish resident directors be on the board of each fund management

company. Under the new rules, at least two thirds of the directors and two thirds of its designated persons must be located in the EEA. This puts non-EEA firms at a distinct disadvantage as they will have less flexibility to source directors and designated persons from their home jurisdiction. The proposed new rules requiring the location of directors or designated persons in the EEA are likely to present significant challenges for non-EEA firms without a presence in the EU.

The Central Bank states that its proposal on the location of directors and designated persons will assist with “supervisability” (i.e. “the capacity to carry out the Central Bank’s engagement model without undue constraint and the ability to react in a crisis”). In this regard, the Central Bank wants to ensure that it has access to a fund management company’s people (directors and designated persons) and that there are clear, effective channels of communication with fund management companies. If the concern of the Central Bank is around “supervisability”, it is difficult to understand how the Central Bank is less able to communicate with a designated person located in Boston or New York versus a designated person in an EEA member state that is a similar distance away. In an age of instant communication and air travel we fail to see how proximity to Dublin should make any difference on governance matters generally and the ability to implement the Central Bank’s engagement model specifically. This issue will need to be addressed as part of the consultation process and we intend to make these points in our response to the Central Bank’s consultation.

OTHER POINTS TO NOTE FROM THE CONSULTATION

- » **Organisational effectiveness:** The Central Bank notes that it has already published its full guidance on the director performing the “organisational effectiveness” role. The Central Bank highlights that fund management companies authorised from 1 November 2015 onwards should not be delaying their

implementation of that guidance in the expectation of further Central Bank guidance.

- » **Document retention:** Fund management companies will be required to keep all of their records in a way that makes them immediately retrievable in or from Ireland. When the Central Bank meets representatives of a fund management company in Ireland and asks them to produce a record of the fund management company (such as board minutes, policies and procedures, letters of engagement, contracts with delegates, reports to designated persons), they should be able to produce this record immediately. In this regard, the fund management company will be required to adopt a detailed document retention policy.
- » **Dedicated email address of fund management company:** The Central Bank will require fund management companies to maintain a dedicated and monitored email address for the purpose of complying with information requests from the Central Bank.
- » **Procedural matters:** The procedural matters chapter of the consultation reflects existing Central Bank guidance titled “Organisation of UCITS management companies”. It deals with the application process for authorisation of fund management companies and the information which the Central Bank will require where a fund management company proposes to use its management company passport. The existing guidance has been amended to cover both UCITS management companies and AIFMs.

TIMING

Responses to the consultation must be submitted no later than 25 August 2016. There will be a transitional period of one year following the completion of the consultation process for fund management companies to comply

with the new rules and guidance. This transitional period is welcome, as previously the Central Bank had indicated that it would be allowing for a 6 month transitional period only. Assuming that the Central Bank publishes final rules by the end of 2016, fund management companies would have until late 2017 to implement these rules.

KEY CONTACTS

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