Corporate Governance in Fund Management Companies

New developments on corporate governance in fund management companies active in Ireland

Corporate governance, as it applies to fund management companies, is firmly on the regulatory agenda following the completion of a consultation process put into place by the Central Bank of Ireland in September 2014.

The resulting consultation paper, Consultation on Fund Management Company Effectiveness - Delegate Oversight (CP 86), was also accompanied by a review by the Central Bank of the number of directorships held by individuals in fund management companies. Following these reviews, the CBI has been engaged in dialogue with a cross-section of fund management companies in Ireland on the issue.

The Central Bank has recently published feedback it received from the consultation process, as well as proposed guidance on the oversight of delegates, guidance on fund management companies' organisational effectiveness, and also guidance on the time commitments required of fund management company directors.

Fund management companies include:

- UCITS management companies
- Alternative Investment Fund Managers (AIFMs)
- Self-managed UCITS investment companies, and
- Internally-managed alternative investment funds.

What the CP 86 feedback generated

Delegate Oversight

Following the consultation process, draft guidance on delegate oversight has now been published by the Central Bank, largely based on the good governance practices outlined in the consultation. Submissions on the draft guidance are requested by 24 July 2015.

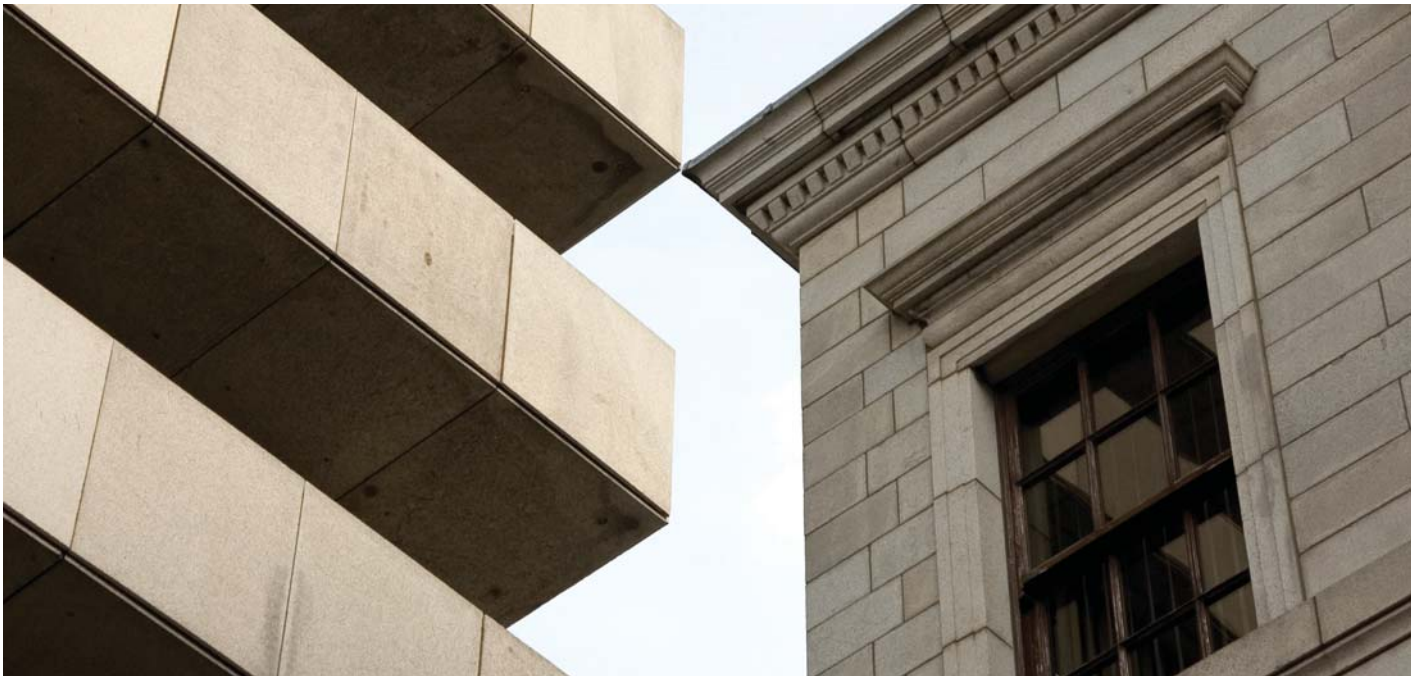
This guidance focuses on the role of the fund management company's board, where significant tasks are delegated and sets out a framework on how delegates should be supervised and overseen by the board. These delegated tasks include:

- Investment management
- Distribution
- Risk management
- Investment operations, and
- Administration.

The overriding principle in the guidance is that the board must retain and exercise overall control over the delegates

Requirements of Irish Resident Directors

The current requirement is that fund management companies must have two Irish resident directors. Despite initially suggesting that this requirement would be relaxed to one Irish resident director plus another director available at 24 hours notice, the Central Bank has decided to retain the status quo because of the importance of resident directors in the event that a fund becomes distressed.



But what defines "resident" in this context? Residency has been defined as 110 working days per year spent in Ireland and this updated guidance is already reflected in the AIF Rulebook and will also be included in the forthcoming Central Bank UCITS Regulations.

Board Composition

A proposal that requires fund management companies to publish a rationale for the composition of its board in its business plan has been adopted. The company's business plan will also need to be updated to include the rationale behind any proposed changes to the composition of the board.

Designated Person Role

The feedback makes a clear distinction between the roles of directors and designated persons – directors control and direct the fund management company, while designated persons carry out managerial functions to which they have been assigned. Directors themselves can carry out the functions of designated persons, but in this situation they will need two separate letters of appointment, one as a director and the other as a designated person.

Streamlining Managerial Functions

Current Central Bank regulations require fund management companies to identify designated persons responsible for nine specified managerial functions, referred to above, in the case of UCITS management companies and 15 managerial functions in the case of AIFMs.

Concerned that there could be overlap between such a large number of functions, the Central Bank has now adopted a proposal that emerged from CP 86 that the numbers of distinct managerial functions be reduced to six. The six managerial functions are:

1. Investment portfolio management
2. Investment risk management
3. Distribution
4. Operational risk
5. Capital and financial management
6. Compliance.

The investment portfolio management and investment risk management functions must be performed by different designated persons. Further guidance on managerial functions will be issued later this year.

Fund Management Companies - Organisational Effectiveness

The Central Bank has decided that the organisational effectiveness role should be separate from the managerial functions on the grounds that it is predominantly a strategic function.

The role must be performed by an independent director of the fund management company - either the Chair or a board member - and will involve monitoring:

- The fund management company's ability to manage its day-to-day operations
- Its organisational structure

- Any potential conflicts of interest that might emerge
- Board composition
- Board effectiveness
- The arrangements in place to oversee delegates.

The independent director responsible for organisational effectiveness cannot perform any of the six managerial functions detailed above.

Fund management companies must update, by 30 June 2016, their business plans or programmes of operation to reflect the revised managerial functions and the organisational effectiveness role.

Directors' Time Commitments

The Central Bank has indicated that there are more than 2,000 directors of fund management companies in Ireland who have a broad range of experience and expertise. But within this grouping there is a significant number of directors who hold multiple directorships with significant time commitments

Feedback in CP 86 indicated that guidance on directors' time commitments would be welcomed by the fund management industry and would have a positive impact on a board's ability to act effectively.

As a result the Central Bank has issued guidance to the effect that a reasonable time commitment for a director is in the order of 2,000 hours a year – based on a 9-hour day and 230 working days a year. This benchmark should be considered by individuals taking on new directorships and employments. Overall the Central Bank has recommended that directors should hold no more than 20 directorships, otherwise their ability to act effectively may be compromised.

While these are benchmarks and not firm limits, the Central Bank has indicated that it will look on multiple directorships with excessive time commitments as a risk indicator. In this situation where a risk indicator is triggered, additional supervisory scrutiny may be applied, and in the case of a QIAIF the standard 24-hour timeframe for authorisation will not be possible.

Further Guidance to be Issued

The Central Bank has committed to producing guidance on managerial functions, as well as the operational aspects of fund management companies' business and a final guidance note on procedures, all of which will be issued before the end of 2015.

The managerial functions guidance will clarify the Central Bank's expectations about the tasks involved in each of the six functions, and the breakdown of responsibilities within each function. The operational guidance will cover policies, procedures and recordkeeping, while the procedures

guidance will cover authorisation applications and passport applications which will be based on existing practice, and so the Central Bank does not intend to consult on this guidance.

Conclusion

By the end of 2015, the Central Bank will have put guidance in place covering the following matters:

- Delegate Oversight
- Organisational Effectiveness
- Directors Time Commitments
- Managerial Functions
- Operational
- Procedures

Corporate governance standards for fund management companies are now far more prescriptive that they were previously. It is clear that the Central Bank expects the requirements detailed in the various guidance notes will result in more effective management of fund management companies with due regard given to the interests of both investors and market participants.

While there will be no statutory obligation on fund management companies to comply with the guidance, it is a yardstick that the Central Bank will use when it assesses companies' compliance with regulatory obligations.

Compliance with the requirements will have a significant impact on how fund management companies run their business and they will have to look closely at how the new requirements affect their existing arrangements. If you need more clarity around any of these issues, we have extensive experience in advising fund management companies across a range of areas. Please feel free to contact one of our senior team.

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