CP86 – Synopsis, Feedback, Guidance & Next Steps

On 12 June, 2015, the Central Bank of Ireland (**the CBI**) published a document entitled "**Fund Management Company Boards**". This document includes feedback on, and consequential changes to the CBI's requirements and guidelines to be issued primarily as a result of, the CBI's Consultation Paper (**CP86**) on Fund Management Company Effectiveness - Delegate Oversight published in September 2014, which set out a number of proposed initiatives designed to enhance fund management effectiveness and delegate oversight.

We set out below a synopsis of the information included in the Fund Management Company Boards document, the requirements that may need to be addressed and the timelines for implementation of changes relevant to:

- UCITS management companies (**UCITS Man Cos**);
- Self-managed UCITS investment companies (**UCITS SMICs**);
- Authorised Alternative Investment Fund Managers (**AIFMs**);
- Internally managed alternative investment funds (**internally managed AIFs**)
- (each referred to as a **Fund Management Company** and collectively **Fund Management Companies**) and, where applicable, to investment companies and ICAVs.

CP86 Feedback and Related Changes - Key elements of the feedback statement include:

Streamlining Existing Managerial Functions

The current CBI requirements specify 9 managerial functions for UCITS Man Cos/SMICs and 15 managerial functions for AIFMs/ internally managed AIFs, which the board of the Fund Management Company are responsible for.

In its feedback statement on CP86, the CBI confirms that the existing managerial functions for all Fund Management Companies will be consolidated into the following 6 managerial functions:

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

Distribution is being added as a managerial function and includes complaints concerning distribution. Other complaints will fall within the regulatory compliance function.

A Fund Management Company which delegates activities will continue to be required to identify a designated director or other designated person who will have responsibility for each managerial function. While the same person may perform more than one managerial function, including both of the risk management functions, a new rule will provide that the same person must not perform managerial functions in relation to risk management and investment management.

New Organisational Effectiveness Role

The CBI has decided that the organisational effectiveness role which it consulted on in CP86 will not now be classified as a managerial function. Instead, the CBI is introducing a requirement for Fund Management Companies to designate an independent director (who could be the chairperson of the board) to undertake the new organisational effectiveness role and who should not perform any of the 6 managerial functions outlined above. This role will, however, include monitoring conflicts of interest and internal audit.

According to the guidance issued by the CBI, the purpose of this role is to ensure that there is an independent director who has the specific task of keeping the effectiveness of the organisational arrangements of the company under review, with his or her reports being submitted to the board for discussion and decision.

The types of matters to be covered under this role include (but are not limited to) reviewing the organisational structure and arrangements of the Fund Management Company, including in relation to the managerial roles and suggesting improvements for consideration by the board; keeping board composition under review and reporting to the board; organising periodic board effectiveness evaluations and overseeing how well the decisions taken by the Fund Management Company and the arrangements for the supervision of delegates are working in the interests of investors; and considering the conflicts of interest affecting the Fund Management Company and its investment funds under management and initiating action, such as escalation to the board, where these are having or are likely in the near future to have an adverse impact.

Rationale for Board Composition

CP86 proposed a new rule to require a Fund Management Company to document specifically how the composition of its board as a whole provides it with sufficient expertise to conduct the tasks expected of the directors and, where relevant, as the designated person for a managerial function. The CBI is implementing this proposal. A Fund Management Company will need to include the rationale for its board composition in its business plan/programme of activity, which will need to be updated any time the board changes.

Clarification of Irish Resident Director

The CBI is retaining the requirement for a Fund Management Company to have two Irish resident directors and has clarified that Irish resident for such purposes means resident in Ireland for the whole of 110 working days per year.

Guidance on Directors' Time Commitments

In parallel with its CP86 consultation, the CBI conducted a thematic review in order to assess the number of directorships held by individuals on boards and any impact on investment fund governance where multiple directorships are held.

Following on from this, the CBI has now published guidance to assist boards and directors in assessing the time commitment of directors in fulfilling their roles and the effectiveness of the board (the **Time Commitment Guidance**). The recommendations in the Time Commitment Guidance will also be used by the Central bank for future reviews of board effectiveness, director time commitments and quality of board operations.

By way of brief overview, the Time Commitment Guidance recommends that:

- Directors and boards should agree a minimum time allocation for board meeting attendance, which should be documented in each director's letter of appointment, as well as additional time for ad hoc issues;
- Additional time should be allocated where a director carries out a chairperson role;
- A designated person role for managerial functions should be considered separately to the role of director and a separate time commitment should be allocated;
- A separate letter of appointment should be issued in respect of designated person roles for managerial functions, which should be subject to annual review;
- Individuals should consider any conflicts of interests; the types and complexity of funds;
- Membership of board committees should be considered as a separate role.

The Time Commitment Guidance does not set a hard limit on the number of board appointments which a director may hold. However, the CBI currently intends to treat in excess of 20 directorships combined with a high aggregate level of annual professional time commitment in excess of 2000 hours as a risk indictor, which may entail additional supervisory attention under the CBI's risk-based approach.

Appointment of Directors

If it is proposed to appoint a director who exceeds the risk indicator thresholds outlined above, the CBI will request a letter from the board which will set out the proposed time commitment for that director; and withdraw from any corporate QIAIF, which proposes that director, the option of the 24 hour authorisation time-frame.

Existing Boards

From 1 January, 2016, previously authorised investment funds with individual directors triggering the risk indicator thresholds outlined above will be given priority consideration for inclusion in CBI thematic reviews where board effectiveness is being assessed. In line with the introduction of the organisational effectiveness role, the CBI expects boards to review their current board composition, taking into account the Time Commitments Guidance.

Consultation on Delegate Oversight Guidance

The CBI is currently consulting on the proposed guidance it published for directors of investment companies, ICAVs, Fund Management Companies and AIF management companies incorporated and authorised in Ireland on delegate oversight (the **Delegate Oversight Guidance**), which is largely based on the good governance practices outlined in CP86.

The draft Delegate Oversight Guidance focuses on the role of boards where significant tasks are delegated externally and sets out a framework for good practice in relation to the monitoring and oversight of delegates, delegated tasks and tasks to be retained. Specific guidelines on the supervision of delegates in relation to investment management, distribution, risk management and investment operations and administration are included. The Delegate Oversight Guidance also considers support and resourcing and matters to be considered by boards of externally managed investment companies and ICAVs.

Further Consultation and Guidance for Fund Management Companies in 2015

The CBI has indicated that it intends to publish additional guidance for Fund Management Companies during 2015 to cover the following matters:

Managerial Functions and Ongoing Control - this guidance will set out the CBI's views on the tasks involved in each of the managerial functions and deal with how designated persons should oversee each of the regulatory obligations which fall within their managerial function. Guidance on time commitments and letters of appointment for designated persons will also be included.

Operational - this guidance will cover policies, procedures, including the CBI's expectations where a Fund Management Company relies on the policies and procedures of its delegates, and the CBI's views on how a Fund Management Company's records should be kept.

Procedures - this guidance will deal with the procedures relevant to authorisation applications and Fund Management Company passport applications.

The CBI will consult with industry in relation to the guidance proposed on managerial functions and ongoing control and operational matters and expects to issue the final guidance before the end of 2015. The CBI does not believe that public consultation on procedural guidance will be necessary, as the guidance will be procedural in nature and based largely on current guidance.

The CBI has noted that divergence from its guidance will not be a regulatory breach. However, the CBI's supervisors will have reference to its guidance when forming a view as to whether a Fund Management Company has complied with its regulatory obligations.

Impact for Fund Management Companies and the Timeline for Implementation of the Changes

12/06/2015	New Fund Management Company authorisation applications to include: (i) letters of appointment for each designated person; and (ii) a documented rationale for board composition within the business plan/programme of activity. Rule changes to the definition of Irish resident director.
24/07/2015	Responses due to consultation on Delegate Oversight Guidance.
End 2015	CBI expects to reflect the changes to the managerial functions and organisational effectiveness role outlined above in the AIF Rulebook and UCITS Regulations. CBI expects to publish guidance on managerial functions and ongoing control and operational matters after consultation with industry.
01/01/2016	Authorised investment funds with individual directors triggering the directors' time commitment risk indicator will receive priority consideration for inclusion in CBI thematic reviews where board effectiveness is being assessed.
30/06/2016	Fund Management Companies are required to update business plans/programmes of activity to reflect the revised managerial functions and the organisational effectiveness role.

Key points to be addressed:

- Fund Management Companies will need to consider and update their business plans/programme of activity to reflect the revised managerial functions and the organisational effectiveness role. The business plans/ programme of activity should also be reviewed in light of the further guidance to be issued by the CBI in 2015.
- Boards should consider their current board composition, taking into account the directors' Time Commitments Guidance. Boards should also be mindful of the fact that under the Irish Funds Corporate Governance Code (**the CGC**), the chairperson, board membership and the performance of individual members and the board must be reviewed formally every three years. As the CGC was adopted by most boards in 2012, the three year review is approaching in many cases.

We will be working closely with our clients in relation to the impact of these changes. In the meantime, if you have any queries, please contact one of the partners listed below or your usual contact at A&L Goodbody.

Article written by Deirdre Ryan, Associate, A&L Goodbody.

KEY CONTACTS

Brian McDermott
Partner
+353 1 649 2307
bmcdermott@algoodbody.com

Michael Barr
Partner
+353 1 649 2327
mbarr@algoodbody.com

Mary McKenna
Partner
+353 1 649 2344
mmckenna@algoodbody.com

Niamh Ryan
Partner
+44 20 73 820 820
nryan@algoodbody.com

Elaine Keane
Partner
+353 1 649 2544
elkeane@algoodbody.com

Stephen Carson
Partner
+353 1 649 2317
scarson@algoodbody.com

Nollaig Greene
Professional Support Lawyer
+353 1 649 2359
ngreene@algoodbody.com

Deirdre Ryan
Associate
+353 1 649 2728
dryan@algoodbody.com

DUBLIN
IFSC,
North Wall Quay,
Dublin 1
E: dublin@algoodbody.com
T: +353 1 649 2000
F: +353 1 649 2649

BELFAST
42/46 Fountain Street,
Belfast BT1 5EF
E: belfast@algoodbody.
com
T: +44 28 9031 4466
F: +44 28 9031 4477

LONDON
Augustine House,
Austin Friars,
London EC2N 2HA
E: london@algoodbody.
com
T: +44 20 7382 0800
F: +44 20 7382 0810

NEW YORK
The Chrysler Building,
405 Lexington Avenue,
New York, NY 10174
E: newyork@algoodbody.
com
T: +1 212 582 4499
F: +1 212 333 5126

SAN FRANCISCO
The Shell Building,
100 Bush Street,
San Francisco, CA 94104
sanfrancisco@algoodbody.
com
+1 650 922 2074
F: +1 415 830 5925

PALO ALTO
228 Hamilton Avenue
Palo Alto, CA 94301
E: paloalto@algoodbody.
com
T: +1 650 798 5183
F: +1 650 798 5001