ICI Global
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IDC
INDEPENDENT DIRECTORS COUNCIL
Committed to Strong Fund Governance

25 August 2016

Submitted electronically to
fundspolicy@centralbank.ie

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

Re: Fund Management Company Effectiveness – Third Consultation

Dear Sir/Madam,

ICI Global[1] and the Independent Directors Council ("IDC")[2] appreciate the opportunity to comment on the Central Bank of Ireland's Consultation on Fund Management Company Effectiveness – Managerial Functions, Operational Issues and Procedural Matters (Consultation Paper CP 86 – Third Consultation).[3] Our comments specifically respond to Question 3 in the Consultation.[4]

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[1] The international arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US$19.4 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC.

[2] IDC serves the U.S.-registered fund independent director community by advancing the education, communication, and policy positions of fund independent directors, and promoting public understanding of their role. IDC's activities are led by a Governing Council of independent directors of Investment Company Institute member funds. The views expressed by IDC in this letter do not purport to reflect the views of all fund independent directors.

[3] The Consultation is available at:
https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&ved=0ahUKEwjNlpPJksvOAhVDlR4KHZDSBZsQFggjMAE&url=https%3A%2F%2Fwww.centralbank.ie%2Fregulation%2Fmarketsupdate%2FDocuments%2F160602_CONSULTATION%2520PAPER%2520-%2520CP86_THIRD%2520CONSUL_FINAL%2520VERSION.pdf&usg=AFQjCNEQVfAEaZKbs7iKrk7JxwpllTVAxw&sig2=8SI6GasHqwN9IpU0EIeejQ&bvm=bv.129759880,d.dmo.

[4] Question 3 of the Consultation reads as follows: 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.

ICI Global's members are regulated funds that are publicly offered to investors in jurisdictions around the world, including Irish-domiciled UCITS. Since the adoption of the UCITS Directive more than 30 years ago, UCITS, domiciled in Ireland as well as elsewhere in the European Union ("EU"), have been recognized as the only truly globally distributed investment fund product in the world. The UCITS Directives provide a robust regulatory framework. Consequently, a substantial number of our members have established UCITS funds, including in Ireland, with global investment and distribution strategies.

The IDC has long supported the highest standards of governance for regulated funds for the benefit and protection of fund shareholders. Given its deep experience and primary focus on independent directors, IDC is in a unique position to comment on the proposed residency requirements as they relate to directors. IDC focuses its work on continuously improving the effectiveness of directors, principally through education, for the benefit of fund shareholders.

ICI Global and IDC fully support efforts to enhance governance and fund management company effectiveness that are designed to promote and protect the interests of fund investors. As described more fully below, we firmly believe that the Central Bank of Ireland's ("CBI's") proposal to require that 2/3 of directors and designated persons be resident in the European Economic Area ("EEA") (hereafter referred to as the "ratio requirement") is neither an effective way to achieve the CBI's intended goals, nor in the best interest of investors. Specifically, the proposed ratio requirement:

- is contrary to the continued growth of a global product and industry;
- ignores technological advances and legitimate, better means of accomplishing supervision;
- could be harmful to investors by constraining the selection of the best personnel;
- is a protectionist measure that is inconsistent with efforts to reduce barriers to cross-border trade in services; and
- is untimely, given the uncertainty surrounding the Brexit vote and the upcoming review of the Alternative Investment Fund Manager Directive ("AIFMD").

We urge the CBI to not adopt the ratio requirement as proposed, and further recommend that the CBI not impose (formally or informally) any residency restrictions on designated persons, provided that they otherwise meet the CBI's approval standards. To ensure that the CBI has adequate access to personnel, the CBI could require the fund management company, or directors and designated persons individually, to provide an undertaking to such effect.

Ratio Requirement is Contrary to a Growing Global Industry and Product

Over the past twenty-plus years, UCITS have emerged as the only truly global fund platform. Consequently, it is expected that regulation and supervision of UCITS will be informed by, and reflective of, this important characteristic. By imposing a requirement that is so clearly contrary to the global nature of Irish-domiciled funds and management companies, the CBI risks pushing away fund managers with global strategies that rely on access to the best expertise available, as well as the strong

but sensible regulatory UCITS framework heretofore in place in Ireland. A flourishing global industry will be transformed into a limited, local one to the detriment of fund management companies, funds, and investors. We seriously question why the CBI is taking these actions that will harm, rather than enhance, the strength and effectiveness of funds and their management companies. No compelling evidence was presented for these proposals.

Today, Irish-domiciled UCITS with a variety of investment objectives and strategies are sold to investors in numerous jurisdictions around the world. According to research from Morningstar, as of March 2016, 65.4% of Irish-domiciled UCITS (representing 80.5% of UCITS assets) are available for sale in at least three countries. An additional 11.2% (17.2% of UCITS assets) are available for sale in either Ireland and an additional country, or just one country excluding Ireland.

A core strength of the Irish fund management companies, which are often part of global investment management firms, is that they draw talent and expertise from around the world to implement the investment objective and strategy of a particular fund. For example, to accommodate different investors in multiple jurisdictions while availing all investors of the firm's best talent, a global fund manager may sponsor "mirror funds" – an Irish UCITS and a U.S. mutual fund or a Japanese investment trust. These funds will essentially use the same investment portfolio personnel and other experts for the day-to-day management of the funds. The relationship of an investor is with the fund promoter or provider – based on the expertise of the firm and its personnel – and not specific to location of Irish or EEA residents that are selected as directors and designated persons.

The proposed restrictions on the composition of the fund management company's board of directors and designated persons to require 2/3 be based in the EEA would be challenging and in some cases fundamentally disruptive to fund management and operations and not to the benefit of investors. In addition, such an approach would ultimately hinder the continued global expansion and growth of the Irish fund industry. As described below, appropriate supervision and compliance can be ensured without resorting to a ratio requirement.

<u>Supervisability and Accessability of Personnel Can be Ensured through Other Means</u>

In the Consultation, the CBI explains that, in order to maintain effective oversight of fund management companies, the CBI must ensure that it has access to a fund management company's people and records and that there are clear, effective channels of communication with fund management companies. The proposed ratio requirement, however, is a blunt and ineffective tool for achieving this goal. The supervisability and accessability of personnel that the CBI desires can be ensured through other means. Indeed, regulators in other leading jurisdictions such as the United States, Canada, and Hong Kong (and in the EEA) have not found it necessary to take measures as drastic as those proposed by the CBI to achieve their supervisory goals.

Ease of Communication and Travel. We understand the CBI's desire to ensure that it has reasonable access to relevant, responsible personnel of an Irish fund management company, along with access to records as needed. In today's environment, however, the physical presence of directors or designated persons in an EEA country, rather than in another jurisdiction outside the EEA, does not actually make

such personnel or records any more accessible to the CBI. Normal, everyday business interactions take place through a variety of media. Directors and designated officers of fund management companies, wherever located, can be contacted and engaged with through a variety of means – such as by phone (landline and mobile), email, or video conference – just as easily as those located within the EEA. If requested to meet with the CBI in person, a person located outside the EEA may, in many cases, be able to do so quicker and with more ease than a person located within the EEA, and even in Ireland.

The approach proposed by the CBI in this Consultation does not adequately take into account the level of technology currently available whereby persons located around the world can be in constant contact on essentially a real-time basis. We note that the CBI itself previously remarked that work practices are increasingly flexible and there is ease of travel.[5] Further, the CBI has not included in the Consultation any discussion on, or evidence of, difficulty engaging with directors or other fund management company personnel located outside of Ireland or the EEA, and we are not otherwise aware of any issues. These factors should be acknowledged and reflected in the CBI's regulations.

Undertaking to Respond in a Timely Manner. Even recognizing that communicating through existing technology may not be difficult, we understand that the CBI may maintain concerns about whether directors and/or designated persons – particularly those located in distant time zones – can be reached by the CBI in a timely manner, particularly in an emergency situation. Such concerns, and they should not be limited to non-EEA persons, could be addressed by either (1) requiring an undertaking by the fund management company to respond to an inquiry from the CBI on a timely basis, including a request to interact with a particular director or designated person, or alternatively by (2) requiring directors and designated persons to individually represent that they will make themselves available on a timely basis to the CBI and, in crisis circumstances, as soon as practicable.[6] Such an undertaking would underscore the importance of the fund management company's and the individual's (whether within or outside the EEA) responsibilities and would greatly mitigate any perceived risk that relevant personnel would not be responsive to the CBI's requests.

Regulatory Cooperation. We understand that the CBI may also be concerned about the level of regulatory cooperation that it may receive from non-Irish regulators if needed in handling an issue with a non-Irish director or designated person. We understand that regulators within the EEA frequently work with one another and therefore there may be more confidence in the responsiveness of those

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[5] Central Bank of Ireland Consultation on Fund Management Company Effectiveness – Delegate Oversight (CP86), September 2014 ("2014 Consultation"), at 5.

[6] In the 2014 Consultation, for example, the CBI proposed to substitute for one of the required Irish resident directors an individual who, among other requirements, "affirms that they are available to engage with Central Bank supervisors on request within any 24 hour working day period and is available to attend meetings at the Central Bank at reasonable notice."

regulatory peers. We do not believe, however, that the level of regulatory cooperation with EEA regulators compared to those outside the EEA should be markedly different.

There is an abundance of information sharing and enforcement agreements between regulators from all around the world. More than 100 regulators are signatories of the IOSCO Multilateral Memorandum of Understanding and additional agreements continue to be entered into on a bilateral and multilateral basis.[7] Additionally, in 2010, the Technical Committee of the International Organization of Securities Commissions released a final report on principles regarding cross-border supervisory cooperation that offers suggestions as to how regulators can enhance cross-border cooperation to better supervise the entities they regulate and describes different types of collaborative mechanisms that can foster greater supervisory cooperation.[8] Existing and future agreements, as well as more informal established relationships, should be helpful in alleviating the CBI's concerns.

Experience of Other Leading Jurisdictions. We recommend that the CBI consider that other leading jurisdictions, including within the EU, have not found it necessary to impose a ratio requirement to achieve effective supervision. While certain jurisdictions have some requirements regarding the residency of directors or designated persons, these requirements are not percentage based and are collectively less disruptive and detrimental to operations than those proposed by CBI. Such jurisdictions have been able to still effectively supervise funds and management companies.

Under the U.S. federal securities laws, for example, there is no residency requirement for directors (either independent or interested) or management personnel of a registered investment company or for registered investment advisers.[9] Skills and qualifications are the driving force behind the selection of directors on a mutual fund board, as funds are required to disclose in the registration statement the specific experience, qualifications, attributes, or skills that led to the conclusion that the person should serve as a director. In addition, there is no requirement that an investment adviser registered with the U.S. Securities and Exchange Commission be domiciled in the U.S. or that its personnel be resident in the United States.

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[7] We support the development of increased cooperation agreement and networks among securities regulators, which would help raise the standards for funds and their management companies, as well as bring consistency and predictability in their supervision.

[8] The Report is available at http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEwiT9vCWu8vOAhXCdR4KHbONB7MQFggcMAA&url=http%3A%2F%2Fwww.iosco.org%2Flibrary%2Fpubdocs%2Fpdf%2FIOSCOPD322.pdf&usg=AFQjCNH13U4mcXnWii8Vggfoku4Jjy-8rQ&sig2=08zemGw8TTv4pZlLoK8dlg&bvm=bv.129759880,d.dmo.

[9] The Investment Company Act of 1940 ("1940 Act") requires that at least 40 percent of directors be independent of the adviser, and current SEC rules require that funds relying on common exemptive rules have boards with a majority of independent directors. In practice, however, independent directors make up 75 percent of fund boards at over 80 percent of fund complexes.

Canada similarly does not have residency requirements for fund or management company personnel. In Canada most regulated funds are common law trusts. The management company (which can be both the trustee and the fund manager) does not need to be domiciled in Canada. While a certain number of personnel that perform specified functions need to be "fit and proper" and vetted and approved by the relevant regulator, there is no requirement that such personnel reside in Canada. In addition, there is no residency requirement for the persons that sit on a fund's independent review committee.[10]

In Hong Kong, the trustee of a Hong Kong-domiciled open-end mutual fund, which is established as a unit trust, must appoint a management company that is domiciled in a jurisdiction with an inspection regime which is acceptable to the Securities and Futures Commission ("SFC"). There is no Hong Kong residency requirement for the directors of the management company if it is not domiciled in Hong Kong, although there are other eligibility requirements including being of good repute and possessing, in the opinion of the SFC, the necessary experience for the performance of their duties. If the management company is domiciled in Hong Kong, it must be separately licensed and regulated by the SFC. Such a management company must have at least two responsible officers who satisfy the SFC's eligibility requirements, with at least one of these responsible officers being an executive director of the management company, and at least one of the responsible officers being resident in Hong Kong.

Similar to the United States, Canada and Hong Kong, other leading EU jurisdictions may require that a minimum number of directors or management personnel be resident in that Member State. We are unaware, however, of any similar ratio requirement.

These jurisdictions, as well as numerous others, have recognized that it is possible to achieve adequate accessibility and supervisability with either no residency requirement, or a minimum number that is substantially less than the ratio requirement proposed by the CBI. The CBI can achieve its goals without the harmful consequences that would stem from the ratio requirement, such as limiting the selection of the best candidates while also undermining the global nature of these funds and their management, as discussed more fully below.

Ratio Requirement Would Constrain the Selection of the Best Personnel

The primary consideration for directors and designated personnel, in all cases, should be the selection of the best qualified personnel, and the CBI's regulatory framework should not constrain or undermine such selection.

Directors. The CBI's work on delegate oversight guidance for directors, as well as the guidance on organizational effectiveness and directors' time commitments, has strengthened governance by providing clarification and guidance regarding the active engagement that is expected of directors. We support this work and believe that it ultimately can benefit investors. We are deeply concerned,

[10] The members of the independent review committee must be unrelated to the management company.

however, because the proposed ratio requirement's geographic limitation on the residence of directors unnecessarily hampers the selection of directors that will best serve the interests of fund investors, and instead forces an inappropriate focus on residence. Given the high expectations placed upon directors and the wide range of jurisdictions in which they may be resident, unduly limiting the pool of individuals available for appointment as directors does not serve investors' interests.

In the 2014 consultation that considered loosening the two Irish director requirement, the CBI stated that it was particularly concerned about encouraging a broad range of relevant skills and competencies on fund management company boards, and that the Irish residency requirement could unduly limit the pool of individuals (particularly those with portfolio management and risk management experience) available for appointment as directors. This current proposal is in stark contrast to the 2014 proposal, and seems to have lost sight of those important concerns. While there may be justification for having at least one Irish resident director, a requirement that 2/3 of directors be resident in the EEA arbitrarily dictates the composition of a board of directors in a way that may not serve the interest of the fund or its investors. For global fund managers, in particular, individuals best suited to serve as directors may be based in a variety of non-EEA jurisdictions. As noted above, we are unaware of any evidence that would suggest that current arrangements are inadequate to the needs of regulatory supervision or in any way disserving the interests of funds and their investors.

Designated Persons. The CBI recently revised its rules to require that designated persons be assigned to six specific managerial functions and now proposes managerial functions guidance that describes its expectations of designated persons and sets out in detail the measures that should be employed by fund management companies to ensure compliance with regulatory obligations. These measures place upon designated persons broader and more demanding obligations than previously articulated. We generally support the change to six managerial functions and the managerial functions guidance proposed by the CBI; however, we emphasize that these measures will benefit investors only if a fund management company can select the best person, whether resident in Ireland or otherwise, to serve in that capacity.

As is the case with the appointment of directors, but perhaps even more so due to the nature of the day-to-day responsibility placed upon designated persons, we stress the importance of allowing firms the ability and discretion to select the personnel that have the most appropriate skills and expertise to perform those functions. Given the global nature of investment managers that sponsor Irish funds, personnel meeting these standards are unsurprisingly based around the world. Accordingly, it is imperative that to best serve investors, funds and fund management companies be able to hire and utilize the best personnel, wherever located. With that in mind measures can be taken to, as described above, ensure that the CBI has adequate supervisability of a fund management company. Ultimately, the fund management company and fund investors will lose if a firm is forced to appoint a second best, or even third best, option simply due to geographical location.

<u>The Proposed Ratio Requirement is Protectionist and Inconsistent with Increasing Market Access</u>

The CBI has failed to provide adequate justification for the proposed ratio requirement, which clearly places an unfair burden on firms that are based outside of Ireland or the EEA. As such, this proposal

can be understood as simply a protectionist measure seeking to secure the location of director and designated person jobs within the EEA, to the exclusion of others. This approach is contrary to the direction of industry growth, which is becoming increasingly global, and ignores the reality of technological advances and modern modes of business communication. It is also contrary to ongoing regulatory efforts to improve cross border business, to the benefit of industry and investors. As we argue against this proposal, we underscore what a detrimental result it would be for the global fund industry if other key fund jurisdictions took a similar position.

Like many developed nations, Ireland is a party to various trade agreements and independently, or through the EU, is in the process of negotiating others. A fundamental objective of such agreements is to encourage trade in services and goods through trade liberalization, accomplished primarily by commitments to market access and national treatment and otherwise removing the effects of measures that prevent firms from operating on equal footing in a country. A ratio requirement disadvantages non-EEA firms as compared to EEA-headquartered firms. Protectionism, as appears to be the case with the proposed ratio requirement, is squarely inconsistent with open trade.

Other Considerations Support Not Proceeding with Ratio Requirement

Brexit Uncertainty. We also encourage the CBI to consider how the uncertainty regarding the future relationship between the United Kingdom and the EU following the Brexit vote impacts the effect of the ratio requirement. The exact status of the relationship between the United Kingdom and the rest of the EEA is unlikely to be settled for some number of years. During this murky period, and even once a path forward has been announced, a significant number of investment management firms – both those that are based in the EU and those that are not – will be implementing changes to their business, including potentially the relocation of personnel, which will in some cases be quite significant. Proceeding with the 2/3 EEA requirement for directors and designated persons, without clarity regarding the result of the implementation of the Brexit vote, creates a significant additional challenge for Irish fund management companies. Given these concerns and the absence of any pressing evidence of problems with the current arrangements, it would be sensible for the CBI not to proceed with the proposed ratio requirement.

AIFMD Review. A further consideration for not proceeding with the proposed ratio requirement at this time is the upcoming review of the AIFMD by the European Commission in 2017, which is expected to cover issues such as substance, delegation, and other related matters. These questions will be considered in the context of a review of the European market, rather than on a country-by-country basis, which risks inconsistency and suboptimal solutions from a pan-European perspective. While the results of this review ultimately may necessitate further consideration of the CBI's regulation of alternative investment funds and UCITS, taking action at this point is, in our view, premature.

Conclusion

For the reasons described above, we urge the CBI to not adopt the ratio requirement as proposed, and further recommend that the CBI not impose (formally or informally) any residency restrictions on

designated persons, provided that they otherwise meet the CBI's approval standards. The CBI can ensure strong governance and fund management company effectiveness through other measures that would not have the harmful consequences about which we are concerned.

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We greatly appreciate your consideration of these issues. If you have any questions, please contact Dan Waters at +44-203-009-3101 or dan.waters@iciglobal.org or Susan Olson, Chief Counsel, ICI Global, at +1 (202) 326-5813 or solson@iciglobal.org.

Sincerely,

/s/ Dan Waters

Dan Waters
Managing Director
ICI Global

/s/ Amy Lancellotta

Amy Lancellotta
Managing Director
IDC