Dear Sirs

Thank you for the opportunity to comment on the consultation paper. I have worked in the investment fund industry in Ireland since 1993 in a number of different roles, including as a member of and an adviser to boards of investment funds and management companies over this period. Based on my experience, I have one general comment to make, and a number of other comments on specific aspects of the proposals set out in the paper.

General

In general, I believe regulation should be reserved for situations where there is some evidence of market failure to produce a socially desirable outcome in an area where society has a legitimate interest. I think it is readily accepted that financial services, and the particular area of investment funds, is such an area. I would also suggest that the socially desirable outcome is clear - for example, it might be stated as facilitating savings and mobilisation of capital by delivering products that have an appropriate return/investment risk profile at a reasonable cost and with minimal non-investment risks.

Viewed against this yardstick, what concerns me about the general tenor of CP86 is that it is not obvious that there is evidence of market failure in the fund governance area. Market in this context means more than just financial motivations - for example, it is my experience that most fund directors are keenly aware of their legal and moral obligations to the fund and its investors, and that as a result, they will attempt to drive change where they see a positive benefit available to investors where it comes at a reasonable cost. Over time, provided matters are not allowed to stagnate, this will produce a continuous stream of gradual, but steady, improvement in governance standards.

Fund promoters, while they also have an obvious financial incentive in maximising their fee revenue from managing an investment vehicle, are also in my experience motivated by the potentially long term nature of a relationship with a fund investor to ensure the long term value of their brand and reputation are not damaged by short term opportunism, but rather enhanced by steady improvement in the governance structures of the funds they promote.

There has been a great deal of change in the funds area in Ireland over the last few years, including both regime-changing developments such as UCITS III, UCITS IV, the introduction of the IFIA Corporate Governance code and most recently AIFMD, as well as a continuing flow of less dramatic, but still significant regulatory changes such as the fitness and probity requirements. The effect of these changes is still bedding in, and will be for some time to come, so there is no sign of stagnation in the industry, but on the other hand, there has been a very great increase in cost.

This brings me to the central point of my concerns with CP86, which is that there does not appear to be any clear cost-benefit analysis to some of the proposed measures. A number could be said to be cost-neutral, but I do not believe this on its own is sufficient justification - there should be some clear, readily identifiable benefit to any measure which attempts to divert or interfere with the normal evolutionary processes referred to above. Other proposals potentially involve significant cost, which should set the bar for their introduction even higher.

In considering any cost-benefit analysis, I think it also fair to ask how much of the cost will be borne by the investors, and whether they will receive any clear benefit for this cost. For example, is there a real failure of standards that is currently costing investors, such that its correction will confer on the investors a real benefit?

I would therefore suggest that if the proposals in CP86 are to proceed, each specific proposal should be costed in terms of its impact on a typical fund, both in money terms and in qualitative terms, and assessed against the benefits the proposal is expected to deliver.

Specific comments

1. Simplification of the management functions:

In general, I believe any movement to simplify the process of operating a fund should be welcome. I have two concerns here though - the first is that merely reclassifying and combining a number of functions under a smaller number of functions will not necessarily result in a simpler process. there would need to be a more thorough review of the content of each function, and a willingness to accept that there is more than one operational model that should be acceptable. My experience with the management functions, which I believe is common to most practitioners in the area, is that the regulatory approval process is more inflexible than it should be, and that funds and management companies are forced to adopt procedures which are more rigid and often more complicated than they need to be. Unless this can be addressed, my concern would be that the changes proposed here, which should on the face of it be an improvement, may end up being largely cosmetic, or even worse, a source of additional requirements and more complexity.

My second concern is the very real issue of cost. UCITS funds and management companies have had to go through two significant rewritings of the regulatory regime in the last 10 years, with UCITS III and UCITS IV, with lesser revisions at the end of the transitional period for UCITS IV and the implementation of what turned out to be compulsory guidance from CESR, then ESMA. AIF and AIFM structures have barely completed the work required following the implementation of the AIFMD. These involve large one off costs for amending documents and regulatory applications, and significant additional ongoing charges. These costs are paid by the investors in the funds concerned, and they reduce their investment returns on a permanent basis.

Having made the (in some cases, several) transition(s) to the existing regime, I believe there is no appetite in the industry at the moment for additional cost of this nature, and if a change is to be introduced in this area, I suggest the transition period for it be on a 'no compulsion' basis for existing funds and management companies, which could then decide to adopt the new model at a time which is convenient. If the simplification proposed is also going to include genuine flexibility, it ought to be capable of accommodating two streams of operating model for as long as it takes the industry to evolve naturally from one to the other.

2. Residency/need to encourage investment management-knowledgeable board representation:

I have no real comments to make on the proposed definition of residency, or the possible partial relaxation of the residency requirement, although I am aware this area has excited much debate. Instead, I would make the observation that there is nothing to stop a fund board right now from appointing additional directors specifically with investment management expertise if they want to do so. There is an often repeated view that there is a shortage of investment expertise in Ireland - I am not sure this is actually true, and if it ever was, it is undoubtedly changing, but in any event, there is nothing in the regulatory regime to stop a board appointing as many investment management candidates from abroad, of which there are a very great many, as it might want to.

For that reason, I do not believe that changing the residency requirement will suddenly result in a substantial increase in investment management experience on boards. If this is really a desirable outcome, and I am not expressing any opinion on that point, I suggest it would be more instructive to look at the reasons why an appointment to an Irish fund board might be seen as unattractive to a candidate based outside Ireland and to see if they can be improved.

For example, the effect of the tax system on directors' fees means a non-resident director will always pay tax on those fees at the higher of the Irish tax rate and the rate in the country where he or she is based. This is a clear disincentive to anyone living in a country with a lower rate of income tax than Ireland, which given our recent economic history, is many of them. It would be admittedly difficult to change this, for very many reasons, but another disincentive which it is much more difficult to understand is the view of the Revenue Commissioners that effectively says that directors travelling to Ireland to attend board meetings must either pay tax on the costs of travelling to the meeting or pay the costs themselves. Essentially, we are saying as a country that we are going to charge you for the privilege of attending board meetings, which seems directly contrary to the objectives of encouraging

physical attendance at board meetings and participation by non-resident investment manager candidates.

Leaving aside the clear disincentives created by the tax system, a repeated criticism I hear at board meetings from directors based outside the country is that the regulatory regime itself, insofar as it relates to directors, seems to be overly complicated and unrealistic in its expectations of fund boards relative to that of service providers. CP86 in some ways seems to be an example of this in that it seems to suggest that if there is a problem with how funds governance operates, which I believe would not be accepted by many people, the answer is to impose more requirements on fund boards, rather than looking for example, and the balance of power between fund boards and the service providers for example.

3. Documenting the rationale for the composition of the board:

This appears to be a relatively innocuous proposal, but on consideration, it is difficult to see how it would work in practice or what real benefit would result. If a board has to justify its composition to someone outside the board (other than implicitly to investors by disclosing the make up of the board in the prospectus), to whom will this be? If it is to the Central Bank, on what criteria will the composition be judged? Are we them to be in a situation where a board will be required to have its quota of a lawyer, an accountant, an investment manager and so on? If the criteria are to be more subjective, such as perceived ability to contribute, objectivity, decision-making, is it being suggested that this kind of criteria are not being used at the moment, and how do you document that to a third party?

Another issue which hopefully would never arise, but which might still be relevant is whether this is creating an opportunity for litigation, either from disgruntled candidates for selection, or later on, if a fund fails to perform, when it might be asked why there was not more investment managers on the board for example.

The suggestion is also apparently made in the paper (question 5 of the questions for consideration) that existing fund boards would need to alter their board composition to reflect some standard that will emerge from this proposal. It is hard to imagine how this could work without resulting in some relatively crude quota system-type approach, which seems to me more likely to be detrimental to the objective of good governance than to be helpful. Cost seems particularly relevant here - both in terms of the expense in changing a board and appointing new directors, but there is no consideration of this aspect of the proposal apparent from the paper.

It also seems a poor reward for a board member that may have worked diligently and been a valuable contributor to a board for many years to be dismissed because of failing to meet some externally-imposed and formulaic selection criteria.

My suggestion would be to drop this proposal, unless it is possible to demonstrate a real benefit to be achieved from its introduction that would outweigh the costs to those concerned.

4. Publishing a delegate oversight good practice document:

Publishing a document of itself cannot do any harm as an encouragement to work in a particular direction, and I have no difficulty with this proposal, or anything contained in the Appendix to CP86, as long as it remains entirely voluntary. However, there have been suggestions in the follow-up presentations to the consultation that the Appendix might in effect become part of the regulatory code by being used as a measure of what is considered acceptable practice in enforcement actions. This is a very different approach to that suggested in the paper and if it is to be followed through on, it would seem fair that the appendix get a more thorough review than is suggested in CP86, to the extent perhaps of having its own dedicated consultation paper.

As an aside, it might also not be particularly fair to the authors of the Appendix to use it in this fashion, if that was not the intention with which they produced it.

On a cost-benefit basis, I also believe there is an obvious cost in any attempt to impose externally measured performance criteria after the fact on a decision making body, such as a board, that requires a commensurate benefit to justify it. The cost will be significantly higher if the criteria are not focused and clearly defined, but consist of generalised principles and aspirations. It would also incidentally be an example of how Irish regulatory standards differ from those applied elsewhere in the context of the point above on the attractiveness or otherwise of serving on an Irish fund board as perceived by a director based in another country.

Yours faithfully

David Hammond