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07 December 2022

Re: Follow up on thematic review of fund management companies' governance, management and effectiveness

Dear Chair,

The Central Bank of Ireland (the "Central Bank") commenced an industry wide review in 2019 to assess compliance with the Central Bank's Fund Management Companies framework (the "framework"), which includes Central Bank requirements[1] and related guidance[2] regarding the organisation of Fund Management Companies ("FMC")[3].

The framework was introduced to ensure sound governance and organisation, effective management and appropriate oversight in FMCs to ensure the protection of investors, the integrity of the market and promote systemic resilience. The framework makes it clear that a FMC can only operate effectively when it has an appropriate level of resources.

Following the completion of the review in 2020, the Central Bank published an industry letter[4] setting out the main findings of the review and the actions expected of FMCs to ensure that they meet the required standards. FMCs were required to critically assess their day-to-day operational, resourcing and governance arrangements against all relevant rules and guidance. In particular, FMCs were asked to assess:

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[1] The requirements are contained in the Central Bank UCITS Regulations and the Central Bank's AIF Rulebook.

[2] The requirements are supported by the Central Bank's Fund Management Companies – Guidance, dated December 2016 ("the Guidance").

[3] "Fund Management Company" refers to a UCITS management company, an authorised Alternative Investment Fund Manager (AIFM), a self-managed UCITS investment company and an internally managed Alternative Investment Fund which is an authorised AIFM.

[4] https://www.centralbank.ie/docs/default-source/regulation/funds/industry-communications/dear-chair-letter---thematic-review-of-fund-management-companies-governance-management-and-effectiveness---20-october-2020.pdf?sfvrsn=78e98b1d_4

- The time commitment, skills and expertise of available resources. The Central Bank's expectation is that the smallest FMCs should have a minimum of 3 FTE resources, each of whom should be suitably qualified and of appropriate seniority to fulfil the role.
- How resources and operational capacity will need to increase to take account of any increase in the nature, scale and complexity of the funds under management and/or to deal with a market and/or operational crisis.

In June 2022, the Central Bank conducted a follow-up industry survey to assess how the governance, structure and resources available to FMCs had evolved as a result of the actions taken on foot of the Central Bank's letter of October 2020. The survey conducted and results set out below do not constitute a review by the Central Bank of the actions taken by FMCs to ensure full and effective embedding of all aspects of the Guidance. Rather, they give an indication of progress achieved in areas such as substance and resources.

Survey Results

Overall, the survey results, outlined below, signal that there has been a notable increase in the resources available to FMCs together with progress in areas such as CEO appointments, director time commitments and resourcing of managerial functions. Over a three-year period, the sector has changed materially in terms of scale, structure and complexity and, while many of these developments are positive, there has been a shift in the risk profile of the sector.

A Changing Landscape

- At the time of our initial review in 2019, there were 358 FMCs in scope. Our most recent survey was completed by 148 FMCs, signalling a significant decrease[5] in the number of FMCs operating in Ireland, despite sizeable growth in assets under management ("AUM").

- There has been a 90% decrease in the total number of Self-Managed Investment Companies ("SMICs") currently operating in Ireland. This has come about due to large-scale restructuring, predominantly as a result of migration of business to third party FMCs and, to a lesser extent, redomiciliations, liquidations and consolidations. In making these

[5] This decrease in the number of FMCs is predominantly made up of SMICs.

decisions, FMCs may have considered the cost implications of the increased FTE requirements.

- The decline in self-managed fund structures has resulted in significant growth in FMCs providing services to third party funds. The scale of firms operating this business model has grown significantly since 2019, with AUM among this group of firms now in the region of €540bn. It is essential that these FMCs have the capacity to take on this additional business without compromising the expected standards set out in the framework or reducing the protection of investors. Therefore, we expect to see corresponding increased resources and expertise as the nature, scale and complexity of third party FMCs grows. This will be a continued area of focus for the Central Bank going forward.

- The results of the survey highlight the growth in the level and extent to which FMCs are providing MiFID services such as individual portfolio management (IPM). In 2019, there was approximately €19bn in assets under management for IPM services; this figure has now increased to €432bn. FMCs are reminded that certain MiFID obligations apply directly to FMCs who provide these services. FMCs must ensure that they are fully aware of and understand these obligations and that these are integrated into their risk and compliance frameworks. This is an area that the Central Bank will examine in more detail in the coming period.

Corporate Governance and Resourcing

While the most recent survey results indicate progress made within FMCs, it has also highlighted areas that require further improvement.

- **Chief Executive Officer (CEO) -** The review evidenced a significant uplift in the number of FMCs with a dedicated CEO. Our most recent survey found that 67% of FMCs now have a dedicated CEO, representing a 50% increase since our first survey in 2019.

  The Central Bank notes the clear benefits this change has had in its engagement with FMCs and it is positive to see that the number of FMCs appointing a dedicated CEO continues to increase. As per our 2020 industry letter, the Central Bank expects that all but the smallest FMCs have a CEO appointed.

- **Director time commitments -** On average, time committed by directors has almost doubled since 2019, reflecting another positive move. We continue to monitor the number of directorships held by individual directors to ensure this is sustainable, particularly given the increased time committed to individual directorships. Where we deem the number of directorships to be excessive, these will be challenged through our supervisory and gatekeeper engagement.

- **Designated Persons & Support Staff -** The results have also shown positive changes in the organisation of FMCs. When we consider the level of resources within all Designated Person and related support roles since 2019, the average FTE[6] increase per firm is three-fold, rising from 3.2 in 2019 to 10 in 2022.

  If we focus on the top ten FMCs in terms of AUM, we have seen an increase of approximately 200% in resourcing of Managerial Functions. Furthermore, for firms currently within the Medium-High/Medium-Low PRISM Impact category[7], the average headcount per firm is approximately 23 FTE. The Central Bank has consistently communicated our expectation that the level of FMC resourcing must be continuously monitored and should grow in line with the nature, scale and complexity of the business.

- **Independent Non-Executive Director (INED) Tenure -** The number of INEDs with a tenure of greater than ten years has decreased by 7%, from 25% in 2019 to 18% in 2022. While this signals a move in the right direction, it still reflects a sizeable number of directors who continue to be classified as independent but have been in situ for 10 years or more. Directors should be mindful that tenure is a factor that can impact their ability to act independently and this should be continually assessed.

  The Central Bank expects that tenure and independence continue to be considered as part of the Organisational Effectiveness Director's ("OED's") review of Board composition and forms part of related reporting to the Board. In this regard, OED reviews need to consider

[6] FTE refers to full time employee or equivalent to full time employee
[7] Typically, Medium-High Impact firms are large firms with considerable potential to cause prudential harm or customer loss. They are, however, not systemically important institutions but firms whose failure (if managed properly) should not derail the financial system or wider economy. Medium-Low Impact firms are medium-sized and non-dominant "players" in their respective industries. The amount of prudential harm or consumer loss is limited in the event of failure.

the appropriateness of the continued use of the INED designation where the INED is in place for a prolonged period of time. This review should set out an approach for FMCs to ensure a regular rotation of Board members. The review should be available to the Central Bank upon request.

- **Board Diversity -**The results of the survey indicate a marginal increase in the number of directorships held by women from 16% in 2019 to 20% in 2022.

  A significant gender imbalance still exists at Board level within FMCs. We expect that FMCs continue to consider diversity as part of ongoing internal governance reviews including due consideration of factors such as skills, age, gender, culture and ethnicity.

Looking to the Future

While the Central Bank recognises the progress made over the past number of years, FMCs should remain mindful that there is more work to be done. FMCs will be challenged on all aspects of their compliance with the framework as part of ongoing firm engagement and, in particular, as and when their operations grow.

FMCs established in Ireland manage a significant number of investment funds that are distributed with a wide footprint, not only at a domestic level but also on a European and Global scale. As such, Irish FMCs must perform their duties to a high standard so that there is a high degree of confidence in the manner in which FMCs discharge these duties and thereby protect the interests of investors in host jurisdictions.

The findings from the FMC review will inform the Central Bank's policy development. Work will continue within the Central Bank on identification of necessary changes to enhance and clarify certain aspects of the existing FMC requirements and Guidance.

Conclusion

The Central Bank expects that this letter will be discussed by the Board and that any areas requiring improvement that directly relate to a firm are given due consideration to ensure robust and appropriate governance arrangements are in place.

Please direct any queries you may have regarding the contents of this letter to cp86queries@centralbank.ie.

Yours sincerely,

Patricia Dunne

Director of Securities and Markets Supervision