

# A CP86 FLYOVER

FOR IRISH AUTHORISED  
MANCOS AND SMICS



## AQUEST

FOR THE IRISH FUNDS INDUSTRY

Published by:



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**#AQUEST #CP86**

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## What got us here?

CP86 - properly known as **Funds Management Company Effectiveness** is a body of work that the Central Bank of Ireland undertook to better explain to Directors and Designated Persons how the Central Bank expects them to act.

It also sets out the Regulator's expectations around how Irish Authorised fund Management Companies (ManCos) and Self Managed Investment Companies (SMICs) would comply, and demonstrate compliance, with the rules they were subject to under the UCITs and AIFMD regimes.

The work took about 3 years to complete, the final CP86 package was published in December 2016.

There was an 18 month transition period before CP86 came into full effect 1st July 2018. At which time the Regulator flagged that it would carry out a review process to assess how well ManCos and SMICs were complying with the rules. True to its word, the review process began in June 2019 when the Central Bank sent a questionnaire to all fund ManCos and SMICs.

**They upped the ante however in August of 2019, when it sent a letter to a sample of ManCos and SMICs directing them to submit a package of materials to the Regulator for further review.**

Those documents submitted will now form part of the Central Bank's desk based review of how well ManCos and SMICs are complying with CP86.

Firstly the Central Bank will have to review in detail the thousands of pages submitted by the sample of ManCos and SMICs as part of a desk based review. Once that is complete, and it is fair to assume that will take a little bit of time, the Regulator will embark on a number of on-site reviews.

The letter that was sent to the sample firms for the desk based review, did include a provision that they may be visited as part of the review process. It is reasonable to assume that these firms are very much in the cross hairs.

Will other Fund ManCos and SMICs be called for the on-site inspection? Probably not, but this is also not yet certain.


#### What happens at an on-site inspection?

For an on-site inspection, the Regulator will visit the premises of the ManCo or SMIC, whether that is their own office or the premise of their lawyers. They will likely bring a team of 2 to 4 people with them. The Central Bank will look to meet with members of senior management, including directors, and designated persons of the ManCos/SMICs.

The Regulator will interview the individuals they selected, most likely on their own, and they may or may not allow the interviewee to have a note taker with them. The interviewee should expect the interview to include challenging and pointed questions. There will be no point undertaking an on-site review process if the Regulator didn't use it as an opportunity to gather information beyond the written submission.



**What  
happens  
next?**



## Likely Output from CP86 Review?

1 of 2


Any firm that is being inspected should expect to receive a **Risk Mitigation Programme or an RMP**. This is a fairly standard process at the conclusion of a review process carried out by the Central Bank.

The RMP will usually identify the areas of risk that the Central Bank feels merits further attention. It will set out the steps to be taken by the firm to address the risks as well as mitigate them within a set time frame.

The reviewed firm will probably be given the opportunity to comment on the draft before it is finalised, and this may give them a chance to influence the final shape and text of their received RMP.

At an industry level it would be quite normal for the Central Bank to issue a **Dear CEO letter to all ManCos and SMICs** which will set out the review process they have undertaken and identify industry wide actions that they now want completed.

This will specify; industry wide issues, include a list of to dos, and set out time frames for which actions have to be completed. Of course firms will be expected to respond to the Regulator to confirm they have actioned the letter and note any issues that may have arisen.



## Likely Output from CP86 Review?

2 of 2

The Dear CEO letter may also be used by the Regulator to list good practices that they have identified as they have gone through the review process or possibly to set out poor practices where they have seen firms run into difficulties.

It is possible that the Central Bank will look to amend CP86 as a consequence of this review process. They have left this option open and said that it will depend on what they find as they move through the process.

Amending CP86 guidance would probably involve a public consultation process, but the Central Bank may decide further rules are necessary.

The Central Bank has flagged in its desk based review letter, **that all of the powers of the Central Bank are available to its supervisors as they conduct this review. This includes its enforcement powers and its ability to enter into administration sanction procedures.**

So sanctioning of ManCos and SMICs and fining them as a result of the CP86 review is on the table - albeit that it may not be the Regulator's first port of call.



In our experience just over 30 days into the CP86 Letter being issued August 2019, firms are broadly falling into 3 categories in terms of CP86 preparation.

### **1.The A-Team**


Proactive, engaged ManCos expecting to be inspected and preparing for that inspection. They have developed a plan, located areas of weakness, and are now investing sufficient time preparing answers for the questions the Central Bank is likely to be probing into.

### **2.Team Confused.com**

They know action is required, and they are keen to engage - but they don't know where to begin. The challenge is to understand better and more clearly what the Central Bank expects, what the review process entails and how to approach it. The risk is they spend too much time figuring out the starting line so that they have insufficient time to prepare for an onsite inspection.

### **3.Team LastMinute.com**

This group are not alive to the complexity of a Central Bank review process. They are perhaps sitting back and waiting until the letter arrives notifying them that they are going to be the recipient of an onsite inspection. While they will get advance notice of an onsite inspection, it will not give them sufficient time to prepare fully for the Central Bank's visit to your office. The other risk, is that the external advisors that they may like to call up on to assist them will probably be otherwise engaged with firms who are ahead of the curve, making it more difficult for them to prepare at all, never mind prepare sufficiently.



**Reactions to  
CP86 so far?**



For ManCos authorised within the last 18 months, or older ManCos that have office premises and full time staff, the key challenges they are likely to face when the Regulator arrives onsite include:

**1. Governance** - the Regulator will probably inquire into and test their governance arrangements. They will be interested to see: how the board of directors acts and how effective they are at putting into place the recommendations and suggested approaches set out from cp86 guidance; how you approve new fund authorisation applications; how good are they at overseeing and challenging the investment manager; how good are they at identifying and testing risks and drawing these out in board minutes.

**2. Organisational Effectiveness Role (OER)**- the Central Bank has flagged since day one that it intended to look at how the OER is being performed and how for example recommendations made by the OER are being implemented by a ManCo/SMIC in practice. While the Central Bank's desk based review letter did not go into this topic in detail, it is fair to assume that their onsite review team will be very interested in how they OER is: getting on in practice; where time is going and how much is being dedicated to the role; how they can demonstrate value. These are all questions firms must have answers for in anticipation of the Regulator addressing these issues.

**3. Operations** - Many of the docs required to be submitted under the desk based review letter, relate to the performance of the investment management and fund management roles, so fund ManCos should expect a lot of questions from the on-site team on these two areas. ManCos should be very familiar with how roles are performed in practice and how they can be improved.



## Key CP86 Challenges for ManCos?

For SMICs and Legacy ManCos that have resourcing models based on secondments such as:

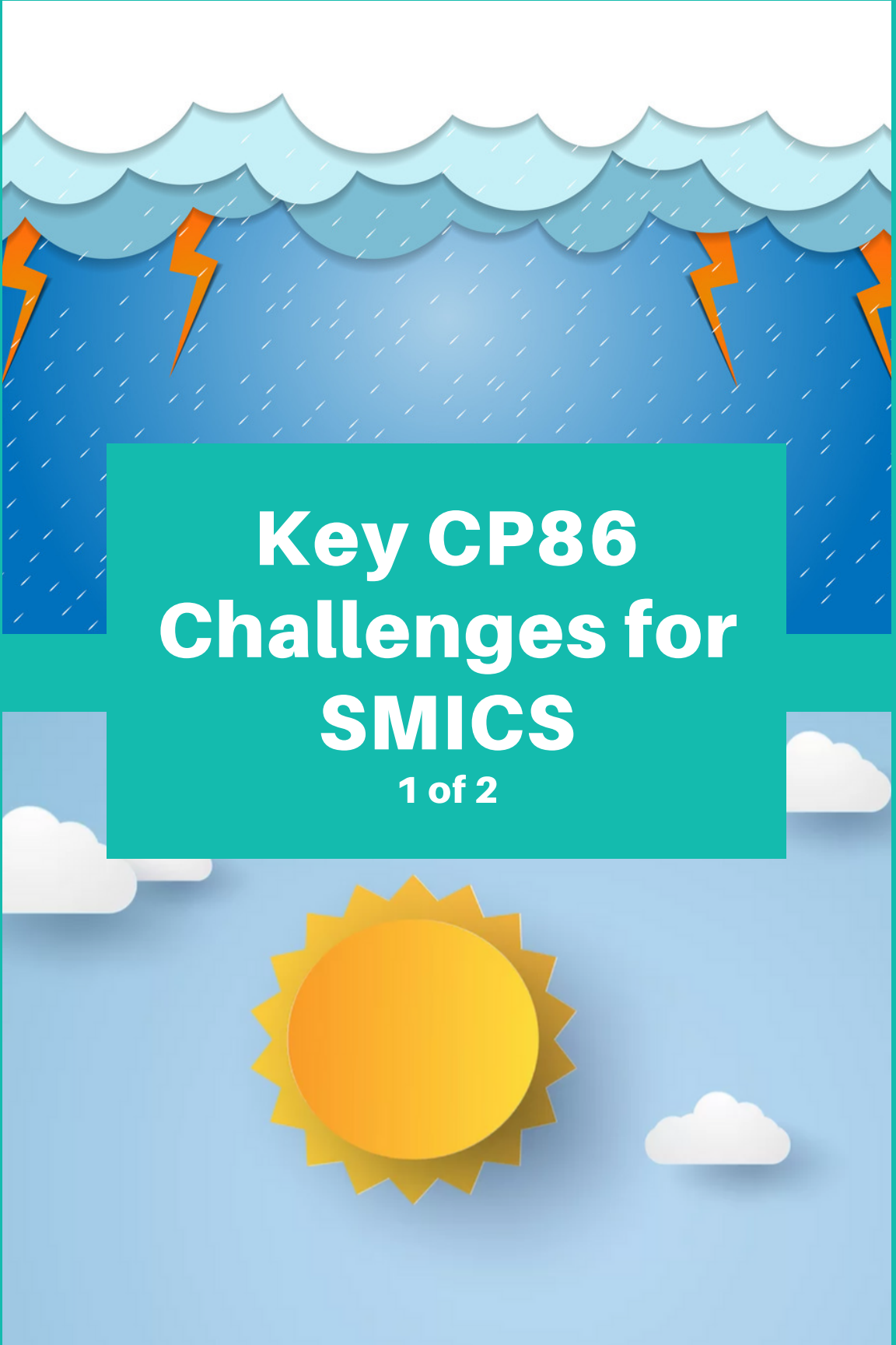
1. third party investment managers
2. third party specialist service providers

These firms will likely find that the Regulator's focus is very much on resources.

Consider that new ManCos coming through the Irish authorisation process over the last 2 years have certainly seen higher levels of resources being required leaving a significant gap in how legacy firms would be operating in comparison to newly authorised firms.

It is reasonable to expect that Legacy ManCos and SMICs are expected to close the gap on their level of resourcing so all Irish authorised firms are operating at similar standards and doing so in time for the Regulator's on-site inspection. Resourcing in particular should be given high priority while preparing for the CP86 review process.

2. TIMING - SMICS might expect that they will be given a transition period following a CP86 review allowing them to revisit and increase their resources, however, it may not play out like this.

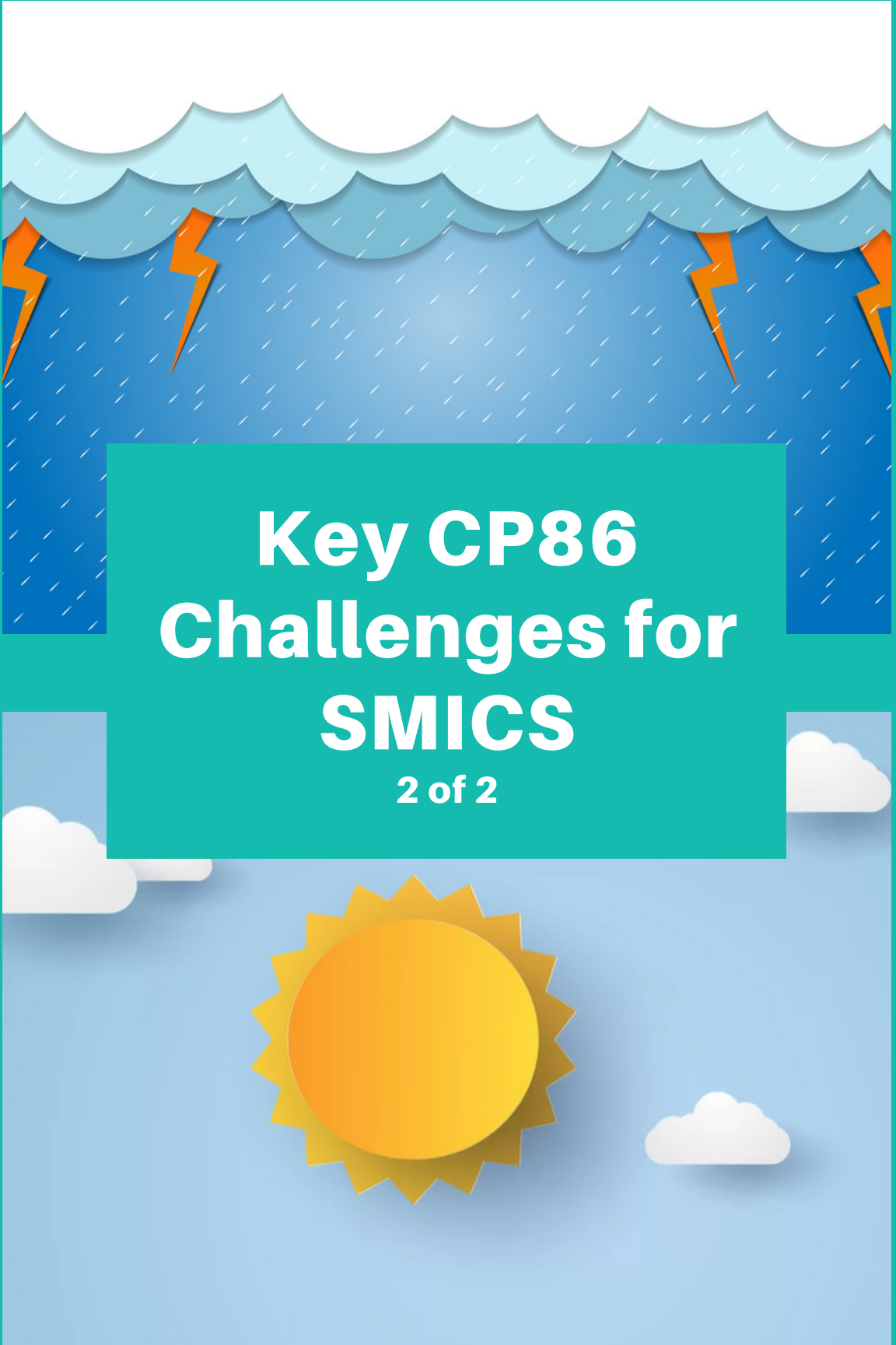


## Key CP86 Challenges for SMICS

1 of 2

SMICs might expect that they will be given a transition period following a CP86 review allowing them sufficient time to revisit and increase their resources. However, it may not play out like this. Instead of setting a line in the sand and giving all SMICs a timeframe by which they must increase their resources, it is possible that the Central Bank will approach this in a more phased basis. In practice this could mean, when an existing SMIC approaches the CB with their request for fitness and probity clearance for a new director to replace one going on mat leave, or about to retire - this could prompt a review of resources. In turn, that could set the clock ticking for the SMIC to have to decide, and thus implement, a new stronger resourcing model that meets the Regulator's expectations. This would likely impact the SMIC's degree of control

The above scenario would likely take timing out of the SMIC's control and possibly make things awkward for the SMIC. While a SMIC may think this requirement is years down the track, for example a director resigning, could prompt the process to commence far more quickly.



## **Key CP86 Challenges for SMICS**

**2 of 2**

Firms are proactively preparing for the CP86 review process are investing resources, time and energy in 4 key areas:

1. Lay of the Land: Strengths, Weaknesses
2. Document Submission Review
3. Mock Interviews 1-on-1 with each member of the Leadership Team
4. Full day workshopping the CP86 Inspection Preparation Timeline

The Central Bank Regulators will be very well prepared. They will have spent months behind the scenes preparing for your on-site review.

Fund ManCos that don't take preparation equally seriously run the risk of an onsite inspection process that is far more difficult and time consuming than it needs to be. You also run the risk that your on-site review outcome goes beyond receipt of an RPM.

**Formal & deliberate preparation would be well advised for two reasons:**

1. Being efficient and effective in working with Regulators on site, demonstrating you know your business well; strengths and weaknesses.
2. Building a relationship with the Regulator that demonstrates you are a ManCo or SMIC that takes its regulatory obligations seriously and are one that can be trusted to act in the best interest of your investors at all times.



**How are Firms  
Preparing?**



For more information on CP86, CP86 podcasts, Aquest newsletters and to inquire about Aquest's [CP86 Inspection Preparation Advisory](#), go here:

**Aquest.ie/FixMyCP86**



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**As the former head of the Central Bank of Ireland's Funds Policy Team and the Central Bank's Project Lead on CP86, Daniel was involved in designing, drafting & implementing regulatory initiatives affecting the funds industry from 2010 to 2017.**

With an intimate knowledge of CP86 coupled with the perspective of an ex-regulator, Daniel is in a unique position to help firms improve their relationship with the financial regulator by becoming Regulator Intelligent.

Before joining the Central Bank, Daniel worked as an investment funds lawyer for 9 years at William Fry, one of Ireland's leading law firms.

Today, Daniel Lawlor is MD of Aquest; a boutique firm dedicated to improving your experience with the financial regulator.