

The (Irish) Financial Regulator (“TFR”) has deemed that the UCITS III Management Company Directive requires that:

- **“Substance”** exists in the operation of the management company and it isn’t just a “letterbox entity”. At least two “Named Individuals” are responsible for conducting the day-to-day business of the management company specifically with regard to the **eight key managerial functions** (substance test – see below).
- **Mind and management** of the management company must be substantially carried out in Ireland
- **Adequate management resources and systems** exist to control strategic and day-to-day activities so that such persons who conduct the business of the company can monitor effectively at any time the activities of the company

TFR has interpreted the Management Company Directive substance test to mean that eight key management functions must be controlled by at least two named individuals. Those Eight Key Managerial Functions being

- **Decision Making;** Must have clear responsibility and competence in relation to all material decisions affecting the operation and conduct of business of the management company or self-managed fund.
- **Monitoring Compliance;** Must ensure compliance with all applicable legal and regulatory requirements.
- **Risk Management;** Must be in a position at all times to identify, monitor and manage all applicable risks pertaining to the UCITS under management.
- **Monitoring of Investment Performance;** Must ensure availability of up to date information on portfolio performance.
- **Financial Control;** Must ensure that all relevant accounting records are properly maintained and are readily available, including production of annual and semi-annual financial statements.
- **Monitoring of Capital;** Must ensure compliance with applicable capital adequacy requirements.
- **Internal Audit;** Must ensure effective internal audit process.
- **Supervision of Delegates;** Must have clear structures in place for the ongoing monitoring of work delegated to third parties.

There is no stipulation that the eight activities must be undertaken by employees of the Management Company or that they be located in Ireland. However the responsibility remains with the Board members located in Ireland.

The most common corporate structure for the Irish Mutual Funds industry includes the outsourcing of all activities, including investment management, administration and marketing functions. Third Party providers of administration services are located in Ireland, whereas the investment management and marketing activities are not usually located in Ireland.

TFR has placed greater emphasis on the Management Company directors obtaining and fully understanding information received from the outsourced activity providers

In order for the Management Company Board to have a more detailed understanding of the Fund’s activities, additional reporting is required from Third Party Administrators. Third Party Administrators consider this to be a greater intrusion and there has been a general ‘push back’. However, in some cases, the Management Company are appointing a representative of the Third Party Administrator as the Named Individual to provide the Management Company Board with sufficient monthly information on the relevant key controls.

TFR requires that information on the relevant key control functions is provided on a regular basis (deemed by TFR to be monthly but not prescribed in the regulation). The larger industry participants have internal and external resources that can provide information with regard to the eight key managerial functions and have 'suitably qualified' directors. These resources are usually both within and located outside Ireland.

In order for information from the outsourced activities to be understood by the existing Management Company Board, **FMConsult** also provide a facilitator role between the third party providers and the Management Company. i.e. to receive, review, interpret and report on the information. This has proved to be a cost efficient approach in the development of existing Management Company's procedures in order for the Board to obtain and understand such information.

The number of UCITS III funds that are sophisticated users of derivatives has been limited to date. However, more sophisticated funds are applying for authorisation; including Alternative Funds.

Under the new Management Company Directive, a Business Plan/Programme of Activity is required to be submitted by the Management Company which includes a clear demonstration of substance. The Management Company must submit adequate documentation to satisfy TFR that, on an ongoing basis, it will be able to comply with the operational and corporate governance requirements. The Business Plan/Programme of Activity is required to be very detailed. However the specific details and content will depend on the approach taken with regard to the substance test. TFR has issued a draft guidance note and supplemental letter on what should be in a typical business plan.

Management Companies must convert UCITs I funds to UCIT III funds and some of the UCITS III funds will take advantage of the wider investment powers. In doing so, the Management Company will be required to monitor the investment risk within the Funds portfolio (being one of the eight key control functions). In this particular situation there will be a need for greater sophistication and knowledge on the Board of the Management Company, or from the 'Named Individual.

As noted above, the key control functions do not necessarily have to be undertaken within Ireland. The infrastructure of many existing Management Companies provides for the key control functions to be undertaken by existing individuals within different jurisdictions.

The large well established asset management groups may have appropriate employees within their group to undertake the Named Individual role for the key control functions and their Board of Directors may have the appropriate experience to satisfy TFR that reports provided on the outsourced activities are understood and appropriate action is taken as necessary. However, new entrants into the Irish market, such as Alternative Asset Managers, and UCITS III funds that use the additional investment powers available to them will require sophisticated investment risk systems and may require an independent facilitator, such as **FMConsult**.

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