

UCITS – Organisation of Management Companies

Matheson

Introduction and background

This note highlights the key organisational requirements which apply to UCITS management companies and the means by which compliance should be documented.

The primary documentary means of describing and demonstrating compliance with the requirements is through the management company's business plan. Business plans are essentially governance documents or regulatory compliance plans, setting out how management companies will be run day-to-day. The Central Bank of Ireland (the “**Central Bank**”) has confirmed that, whilst management companies must maintain detailed operating procedures covering the large number of areas identified in their published guidance, the business plan is not required to include or incorporate detailed operating procedures manuals. The business plan should, however, include a description of the policy in relation to those areas, with cross references to the relevant procedures.

Key Management Functions

In accordance with good corporate governance principles, the Central Bank considers that the board of a management company is responsible as a whole for the following managerial functions, each of which must be specifically addressed in its business plan.

Each management company is required to review the regulatory obligations placed on it and should identify precisely under which managerial function each regulatory obligation falls. The Central Bank's guidance sets out a suggested framework for the allocation of regulatory obligations to the different managerial functions. Each management company may however attribute specific regulatory obligations to the managerial function deemed most appropriate.

The managerial functions and related procedures are as follows:

- **Capital and Financial Management:** procedures to ensure it meets its capitalisation requirements, to ensure all relevant accounting records of the management company and those of the funds it manages are properly maintained and are readily available, including production of annual and half-yearly financial statements; and that the board adequately oversees the proper and accurate valuation of the assets and liabilities of the funds it manages;
- **Operational Risk Management:** the monitoring of the business of delegates to ensure they are effectively managed and controlled, and that appropriate operational risk policies and procedures of the delegates are in place;
- **Fund Risk Management:** procedures to ensure that all applicable fund risks pertaining to the board and to the funds it manages are identified, monitored and managed at all times;
- **Investment Management:** procedures to review and approve the proposed investment approach of any new fund, and, on an ongoing basis, to oversee the investment manager's compliance with the approved investment approach, and developments affecting the investment manager(s), the investment process and strategies, the investment team and progress and performance;
- **Distribution:** the approval of proposed distribution strategies of the funds it manages, and ongoing monitoring of patterns of distribution, sales flows and any local compliance issues connected to the funds' distribution;
- **Regulatory Compliance:** procedures and an organisational structure which specify reporting lines and allocates functions and responsibilities to ensure compliance with all regulatory obligations.



UCITS – Organisation of Management Companies

Matheson

One director of the management company is additionally required to perform an organisational effectiveness role. This director must be independent and may not carry out any of the managerial functions. The role is to keep the effectiveness of the company's organisational arrangements under ongoing review. The director is required to bring proposals to the board to improve effectiveness, champion these proposals and ensure that agreed actions are implemented. Responsibility, Delegation and Review

Responsibility, Delegation and Review

Responsibility

Although the boards of management companies have collective responsibility for managing its affairs, individual "designated persons" must be identified for each of the above managerial functions. A designated person is responsible for monitoring and overseeing the managerial function assigned to him or her. Designated persons may be directors or employees of the management company, or may be seconded to the management company from another firm (eg, the investment manager) or from a third party firm which specialises in the provision of designated persons. Designated persons may be located globally, provided at least 3 of the managerial functions are performed by at least 2 designated persons resident in the EEA (or such other jurisdictions as the Central Bank may determine).

Delegation

Management companies are entitled to delegate functions, provided that adequate measures are put in place which enable it to monitor effectively, at any time, the activity of the undertaking to which the function in question has been delegated. Such measures are intended to ensure that management companies do not become mere "letter box entities". In addition, it should be noted that, notwithstanding delegation, responsibility for the key managerial functions will remain at all times with the relevant designated person (and ultimately with the board as a whole).

Furthermore, it should be noted that the Central Bank requires the board of the management company to take all major strategic and operational decisions affecting the fund management company and any investment funds it manages (subject always to any matters reserved to its shareholders). Examples of key responsibilities that should be retained by the board include the following:

- approval and periodic review of the business plan and compliance with it;
- its own internal governance, including the appointment and retention of directors and conflict of interest policies;
- adoption and review of a comprehensive suite of policies and procedures and, to the extent that reliance is placed on the policies and procedures of delegates, periodic review of the appropriateness of such reliance;
- satisfying itself that arrangements are in place to enable compliance with applicable legal and regulatory requirements;
- appointment, oversight and removal of delegates;
- the investment approach;
- launches or closures of sub-funds and share classes; and
- distribution strategies including the jurisdictions into which the funds are marketed.

Additionally, where a management company has responsibility for the following obligations, they must similarly be retained by the board of the management company:

- issue of the prospectus;
- review and approval of financial accounts and investment fund documentation; and
- temporary suspension of redemptions, or other measures taken in response to adverse financial developments.



UCITS – Organisation of Management Companies

Matheson

These retained obligations are generally understood to be obligations of oversight and review of functions, rather than requirements to undertake the functions directly and it is assumed that the management company may delegate the performance of the underlying functions.

One of the key controls which management companies have over their delegates is the requirement for them to report regularly on their areas of responsibility. The business plan must set out the reporting frequencies and lines between the delegates and the relevant designated person, which shall include but not be limited to exception reports, in line with thresholds and triggers determined by the board from time to time and specified in the business plan. The business plan must also specify the procedures to be adopted by the board on receipt of reports.

Review

Management companies are obliged periodically and on an ongoing basis to assess and review the effectiveness of the policies, arrangements and procedures which have been put in place to comply with their regulatory obligations and to take appropriate measures to address any deficiencies. This requirement applies to the management company's own policies but also to the policies and procedures of delegates. More specifically, the Central Bank requires that business plans mandate service level agreements and KPI reporting, a detailed annual review of each delegate and mechanisms for reporting material issues to the board, with subsequent review to ensure controls are in place to prevent recurrence and the imposition on delegates of an obligation to attend board meetings of the management companies where material issues arise.

Risk management

The management company must establish, implement and maintain an adequate and proportionate risk management policy which:

- identifies and addresses all of the material risks which have been identified for each fund it manages, with a particular emphasis on market, liquidity and counterparty risks and collateral management;
- confirms the risk appetite;
- addresses the tools and techniques used for the management of the risks;
- allocates responsibilities within the management company for risk management;
- addresses reporting requirements of the risk management function; and
- provides for regular reviews and assessment of its adequacy and effectiveness and that of the statement of risk management procedures, the compliance of the funds with the policy and the effectiveness of measures taken to address deficiencies in the policy.

A hierarchically and functionally independent “permanent risk management function” must be established by the management company with the requisite authority and access to fulfil its role. The risk management function may be provided by a third party, although this delegation will itself be subject to the review, resourcing and reporting requirements described above. The primary role of the risk management function is the implementation of the management company's risk management policy but additional tasks may include ensuring funds' compliance with risk limits, advising on the risk profile of funds and supporting the valuation of over-the-counter financial derivative instruments.



UCITS – Organisation of Management Companies

Conduct of Business Rules

Management companies are required to put in place formal conduct of business rules that must be observed at all times, although some of the rules can be considered in terms of proportionality. These obligations are derived directly from provisions of the Irish legislation implementing the UCITS Directive or are conditions imposed by the Central Bank, and include the following:

General Principles

- Duty to act in the best interests of UCITS and their unit-holders
- Due diligence requirements

Handling of Subscription and Redemption Order

- Reporting obligations in respect of execution of subscription and redemption orders

Best Execution

- Execution of decisions to deal on behalf of the UCITS
- Placing of orders to deal on behalf of UCITS with other entities for execution

Handling of Orders

- Procedures and arrangements which provide for the prompt, fair and expeditious execution of portfolio transactions
- Aggregation and allocation of trading orders

Administrative Procedures and Control Mechanism

- Safeguarding best interests of UCITS

Internal Control Mechanisms

- Control by senior management and supervisory function
- Permanent compliance function
- Permanent internal audit function
- Permanent risk management function
- Personal transactions
- Recording of portfolio transactions
- Recording of subscription and redemption orders
- Record-keeping requirements

Administrative and Accounting Procedures

- Electronic data processing
- Accounting procedures

Conflicts of Interest

- Criteria for the identification of conflicts of interest
- Conflicts of interest policy
- Independence in conflicts management
- Management of activities giving rise to detrimental conflicts of interest

Inducements

- Safeguarding best interests of UCITS

Strategies for Exercise of Voting Rights

Proportionality principle

Management companies may avail of the concept of proportionality with respect to certain management functions discussed above. This enables a management company to take into account the nature, scale and complexity of its business and the nature and range of services and activities undertaken in the course of that business (eg, the number, size and investment strategies of the funds that it manages) in determining how certain key management functions (including compliance, internal audit, risk management and conflicts of interest) will be addressed both operationally and in the business plan. Where a management company also provides services to third party funds (ie, it is not acting as management company), these activities must also be considered when assessing the nature, scale and complexity of its business.

UCITS – Organisation of Management Companies

Matheson

Please get in touch with your usual Asset Management and Investment Funds Group contact or any of the contacts listed in this publication should you require further information in relation to the material referred to in this briefing note.

Full details of the Asset Management and Investment Funds Group, together with further updates, articles and briefing notes written by members of the Asset Management and Investment Funds team, can be accessed at www.matheson.com.

Contacts



Tara Doyle

PARTNER

D +353 1 232 2221

E tara.doyle@matheson.com



Michael Jackson

PARTNER

D +353 1 232 2219

E michael.jackson@matheson.com



Dualta Counihan

PARTNER

D +353 1 232 2451

E dualta.counihan@matheson.com



Joe Beashel

PARTNER

D +353 1 232 2101

E joe.beashel@matheson.com



Anne-Marie Bohan

PARTNER

D +353 1 232 2212

E anne-marie.bohan@matheson.com



Shay Lydon

PARTNER

D +353 1 232 2735

E shay.lydon@matheson.com



Liam Collins

PARTNER

T +353 1 232 2195

E liam.collins@matheson.com



Philip Lovegrove

PARTNER

D +353 1 232 2538

E philip.lovegrove@matheson.com



Elizabeth Grace

PARTNER

D +353 1 232 2104

E elizabeth.grace@matheson.com



Oisín McClenaghan

PARTNER

T +353 1 232 2227

E oisin.mcclenaghan@matheson.com



Michelle Ridge

PARTNER

T +353 1 232 2758

E michelle.ridge@matheson.com



Barry O'Connor

PARTNER

T +353 1 232 2488

E barry.oconnor@matheson.com

29.09.17 The material is provided for general information purposes only and does not purport to cover every aspect of the themes and subject matter discussed, nor is it intended to provide, and does not constitute, legal or any other advice on any particular matter. The information in this document is provided subject to the Legal Terms and Liability Disclaimer contained on the Matheson website.

Copyright © Matheson

Dublin London New York Palo Alto San Francisco

www.matheson.com