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ESMA Guidelines on Repurchase and Reverse Repurchase Agreements

Introduction

On 25 July 2012, the European and Securities Markets Authority (**ESMA**) published guidelines for certain types of Undertakings for Collective Investment in Transferable Securities (**UCITS**), including UCITS Exchange-Traded Funds (**ETFs**), and other UCITS-related issues, referred to as the Guidelines on ETFs and Other UCITS Issues (the **ETF Guidelines**). The ETF Guidelines can be found here. The ETF Guidelines included a consultation paper on the recallability of repurchase and reverse repurchase agreements (the **Consultation Paper**).

Following a review of responses to the Consultation Paper from stakeholders including the Irish Funds Industry Association, ESMA published guidelines on repurchase and reverse repurchase agreements (the **Repo Guidelines**) on 4 December 2012. The Repo Guidelines can be found here. The aim of the Repo Guidelines is to protect investors by introducing requirements on the use of repurchase and reverse repurchase agreements by UCITS.

Repo Guidelines

The Repo Guidelines provide that a UCITS should enter into repurchase and reverse repurchase agreements on terms that allow the UCITS to recall any assets or the full amount of cash at any time. For UCITS entering into reverse repo agreements, the Repo Guidelines leave the possibility for the cash to be recalled on an accrued basis or on a mark-to-market basis (each of which are described in brief below). However, if cash is recallable on a mark-to-market basis, the UCITS should also value the reverse repo on a

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mark-to-market basis. Fixed-term repurchase and reverse repurchase agreements that do not exceed seven days should be considered as arrangements on terms that allow the assets to be recalled at any time by the UCITS.

Application Date

The Repo Guidelines are to be incorporated into the ETF Guidelines (together the **Guidelines**) and will apply from two months after the date of official publication of the Guidelines on the ESMA website (the **Application Date**). We do not have any indication currently as to when the Guidelines will be officially published but the Central Bank has indicated that it intends to introduce the Guidelines through amended UCITS Notices and that it intends to issue the UCITS Notices before the Application Date.

All new UCITS created <u>after</u> the Application Date will have to comply with the Guidelines immediately.

Existing UCITS will benefit from transitional provisions giving them in certain circumstances up to 12 months from the Application Date to comply. Amendments to the fund rules/instrument of incorporation, prospectus, key investor information document (**KIID**) and marketing communications that issued prior to the Application Date will not be required until the earlier of (i) the first occasion after the Application Date on which the relevant document (having been revised or replaced for another purpose) is published, or (ii) 12 months after the Application Date. Requirements to publish information in the annual report do not apply in respect of any accounting period that has ended before the Application Date.

Commentary

The Repo Guidelines introduce express requirements in relation to recallability, which aim to protect investors by limiting the possibility of repurchase and reverse repurchase arrangements compromising the ability of a UCITS to meet redemption requests.

<u>Existing Regime</u>

This change should enhance the existing UCITS Notice 12 regime for repurchase/reverse repurchase agreements and stock lending which does not deal with recallability but focuses on quality and diversification of collateral and the reinvestment of cash collateral received by a UCITS, all of which have a bearing on the recallability of repurchase/reverse repurchase agreements.

<u>New Regime</u>

The Repo Guidelines clarify that a UCITS can enter into both overnight and fixed-term transactions of up to 7 days provided that it is entitled to the return of its full amount of cash due to be returned under the transaction, which may be adjusted to account for the (i) unused portion of the duration of the transaction (the accrued basis); or (ii) cost of unwinding the transactions taking into account matters such as collateral profile, FX rates, funding cost and maturity date (mark-to-market basis). If the mark-to-market basis is used to value the unwinding of a reverse repo that value must also be used in the calculation of the net asset value of the UCITS.

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