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Central Bank publishes revised Central Bank UCITS Regulations

Background

Further to the consultation process initiated by it last year, the Central Bank has now published its Revised CBI UCITS Regulations which set down its domestic rules governing the operation of Irish domiciled UCITS and UCITS management companies and impose certain obligations on Irish domiciled depositaries. The Revised CBI UCITS Regulations consolidates amendments made by two previous amending regulations to the CBI UCITS Regulations. In addition, the Central Bank helpfully published a feedback statement on its consultation process as well as a revised edition of its CBI UCITS Q&A which provides additional clarity on a number of the provisions of the Revised CBI UCITS Regulations.

Notably, a number of provisions which were previously set out by the Central Bank in web-based guidance or otherwise have now been incorporated into the Revised CBI UCITS Regulations, the impact of which is that the Central Bank is now empowered to bring enforcement actions for non-compliance.

Below we outline some of the key changes being introduced under the Revised CBI UCITS Regulations.

Performance fees

The Central Bank has incorporated its previous web-based guidance on performance fees into the Revised CBI UCITS Regulations, noting that in so doing, it is provided with a "firmer statutory footing on which to take action against firms for breaches of performance

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fees requirements in the future"¹. This follows on from a thematic review which was conducted by the Central Bank in the past year on UCITS performance fees, reflecting the importance the Central Bank is placing on transparency of fees in the investment funds sector.

The Revised CBI UCITS Regulations now provide statutory provisions which mandate that performance fees payable to management companies or investment managers may only be paid on outperformance of a benchmark or if a new high NAV is achieved over the life of the UCITS. One change introduced by the Central Bank which marks a departure from its previous guidance (and which emanates from an IOSCO paper published in 2016²) is the requirement that performance fees may only crystallise once a year and may only be paid once a year. Helpfully, the Central Bank has confirmed in its UCITS Q&A that performance fees may crystallise upon an investor redemption and will not offend the statutory provisions. While the remainder of the rules relating to performance fees must be complied with immediately, the Central Bank has allowed UCITS management companies with existing UCITS investment funds a transitional period until 27 November 2020 to adjust their methodologies to comply with the annual crystallisation requirement.

Following on from a number of submissions from industry, the Central Bank has also confirmed in its UCITS Q&A that the performance fee rules set down in the Revised CBI UCITS Regulations do not preclude performance fees from being charged at a share class/fund level, as adjusted for subscriptions and redemptions.

While the Revised CBI UCITS Regulations have been issued prior to ESMA finalising its guidance on UCITS performance fees, it is expected that the Central Bank has sought to ensure that its rules are consistent with any such guidance once issued by ESMA which is expected to be later this year.

ESMA Opinion on UCITS Share Classes

As readers will be aware, the Central Bank had previously incorporated the ESMA Opinion on UCITS Share Classes³ into the Irish domestic regime in the form of web-based guidance. However this web-based guidance has now been incorporated into the Revised CBI UCITS Regulations and placed on a statutory footing.

In the Revised CBI UCITS Regulations, the Central Bank has given flexibility as to the type of stress testing which can be conducted by UCITS management companies to quantify the potential impact of share class hedging on other classes within the same UCITS. Marking a departure from the original text proposed under CP119, it also stays faithful to the text of the ESMA Opinion on UCITS Share Classes to allow UCITS to hedge 95% of the portion of the net asset value of the share class which is to be hedged against currency risk.

¹ https://www.centralbank.ie/regulation/markets-update/article/markets-update-issue-5-2019/central-bank-of-ireland/thematic-review-of-ucits-performance-fee-concludes-with-redress-of-1.5-million-paid-to-shareholders

² IOSCO's paper entitled "Good Practice For Fees and Expenses of Collective Investment Schemes is accessible from https://www.iosco.org/library/pubdocs/pdf/IOSCOPD543.pdf

³ ESMA34-43-296 – Opinion to National Competent Authorities on UCITS Share Class Hedging

Other changes

(i) EU Money Market Funds

The Revised CBI UCITS Regulations have been updated to incorporate a number of amendments arising from the implementation of the EU Money Market Fund Regulation, including the disapplication of certain provisions to Irish domiciled money market funds in order to remove any overlap with the MMFR.

(ii) Cash held as ancillary liquidity

To date, the Central Bank imposed different risk spreading rules to UCITS depending on whether a UCITS held cash for investment purposes or ancillary liquidity purposes. Under the Revised CBI UCITS Regulations, when applying the limits on exposure to any one credit institution, UCITS must now aggregate deposits and cash held as ancillary liquidity. This reflects the practice that cash held on deposit with credit institutions is not typically distinguished between cash held for investment purposes and cash held for liquidity management purposes.

(iii) Reporting requirements applicable to UCITS management companies and depositaries

The Revised CBI UCITS Regulations require UCITS management companies and depositaries to file a second set of accounts with the Central Bank which covers the full 12 months of the financial year. This obligation has been imposed on UCITS management companies since December 2016 and had previously provided for a two month filing period. However the Central Bank has reduced the filing period from two months to one month after the year end in the Revised CBI UCITS Regulations. While industry had pushed to retain the existing two-month filing period, the Central Bank noted that the rationale for the shortened filing period is to enable supervisors to obtain information in a "timely manner" so that they can take any necessary supervisory action arising from their review of the accounts filed.

Other existing rules which have been now been codified in the Revised Central Bank UCITS Regulations include the ability of a structured UCITS to be subject to a management fee which is calculated based on the initial offer price rather than being based on the Net Asset Value of the relevant class and the requirement introduced under CP86 that all UCITS maintain an email address for correspondence with the Central Bank which is monitored daily.

Should you have any queries in relation to this article, please contact the author or your usual contact in the Dillon Eustace Asset Management and Investment Funds Team for further information.

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