

Central Bank clarifies certification process following July 2019 guidance on UCITS financial indices

Certification requirements and process clarified

- A UCITS that proposes to use a financial index should assess the index and, at the point of authorisation of the UCITS or approval of a new sub-fund, confirm to the CBI that the index meets the regulatory requirements or provide index certification. A pre-approval submission for an index is required in limited circumstances.
- Updated CBI guidance on UCITS financial indices issued in July 2019 clarifies the circumstances where an index certification is not required.
- If on a “look-through” basis the UCITS could invest directly in the index constituents, or if the index weightings change over time due to market movements, the index will be deemed to meet the CBI’s index criteria and certification is not required.
- Certification is required where the index does not meet the UCITS risk spreading criteria, or for an index comprised of ineligible assets.
- At fund authorisation stage the CBI requires a confirmation where an index is specifically required to be referenced in the UCITS’ prospectus.
- A post-authorisation confirmation will only be required where the index referenced in the UCITS’ prospectus is changed.

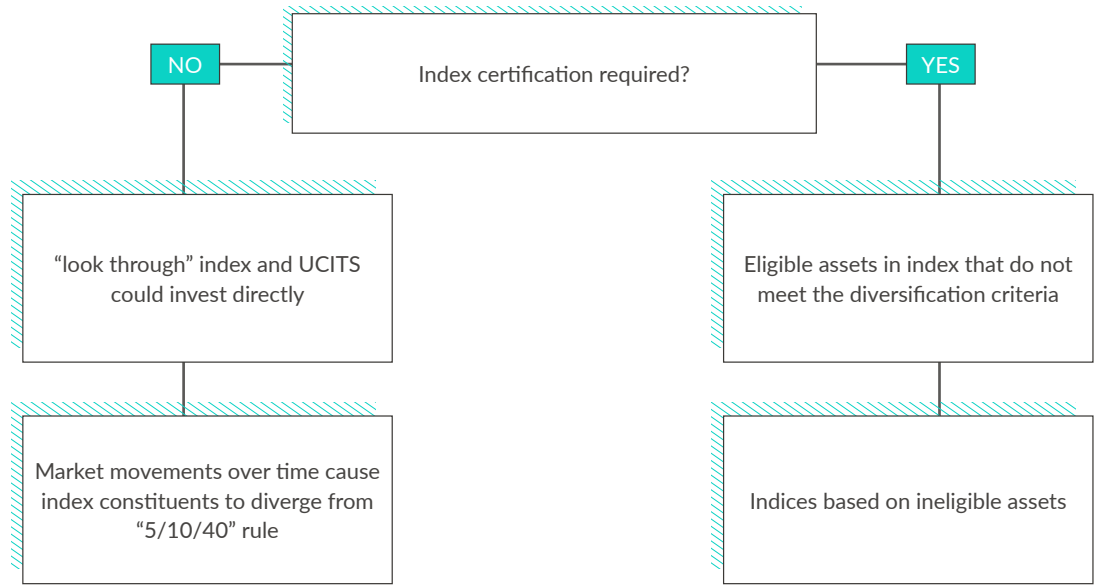
Background

In October 2018, the Central Bank of Ireland (CBI) issued updated guidance permitting UCITS to self-certify most financial indices being used. This was a welcome development. In July 2019 that guidance has been further updated to clarify the circumstances where an index certification is not required. The 2018 guidance meant that UCITS tracking indices even where they were fully diversified and comprised of eligible assets required managers to carry out index reviews for certification and maintain the relevant back up information. The application of the certification requirement to this kind of index investment by UCITS appeared to be disproportionate to the nature of the investment and unintended.

The [July 2019 guidance](#) has been further clarified by the CBI in January 2020 about the certification process at pre- and post-authorisation stage.

Index certification

A responsible person should assess each index that the UCITS intends to use, in order to determine whether the index meets the relevant regulatory requirements. Once determined that this is the case, the responsible person must either state that the index meets the regulatory requirements or provide an index certification when the UCITS seeks authorisation or approval of an additional sub-fund in the case of an umbrella UCITS.



Index certification not required

Look-through

A responsible person that proposes to use a financial index for tracking or replication, investment or EPM purposes for a relevant UCITS is not required to submit an index certification if, on a “look-through” basis, it would be possible for the UCITS to directly invest in the constituents of the index as allowed by the UCITS Regulations. This means satisfying the UCITS eligible assets and risk diversification rules, for example the “5/10/40” rule as applied to equity and debt securities.

A Responsible Person of a UCITS is a director of the UCITS management company or of the UCITS self- managed investment company

Market events and weighting

Over time, market movements or other events may cause the weightings of a financial index to change so that it no longer complies with the “5/10/40” rule. Where this happens and on the basis that the UCITS confirms as part of its authorization, approval or post-authorisation process that the index is comprised of eligible

assets and complies with the “5/10/40” rule, the financial index will be deemed to meet index criteria set out in the section of the CBI guidance “Summary of Financial Index Assessment Criteria”.

CBI confirmation

A UCITS that proposes to use a financial index for which there is no requirement to submit an index certification should state, when making the application for authorisation or approval to the CBI, that such indices meet the regulatory requirements. The guidance states that the absence of such a statement will result in the CBI querying the use of the index, and requesting the relevant certification, which will delay the authorisation or approval process.

Index certification required

Eligible assets not satisfying the diversification rules

If it would not be possible for a UCITS to invest directly in assets comprising an index without transgressing the risk-spreading limits of the UCITS Regulations, an index certification should be submitted to the CBI. This does not apply to UCITS applying the “look-through” approach or where the “5/10/40” rule is exceeded over time due to market movements.

Ineligible assets

An index certification should be submitted to the CBI if it is not possible for a UCITS to invest directly in the underlying assets comprised in the index.

Financial Index assessment and other requirements

No change has been made since the October 2018 guidance to:

- the pre-approval submission to the CBI where the financial index to be used has one constituent with a weighting in excess of 20% up to a maximum of 35%
- the financial index assessment criteria
- disclosure requirements
- CBI quality assessment procedure.

The updated guidance continues to state that:

- no confirmation or certification is required where a UCITS uses an index solely as a performance benchmark
- non-financial indices are not eligible assets for UCITS.

January 2020 clarification

On 9 January 2020 Irish Funds issued a regulatory update with the following information from the Central Bank:

At the fund authorisation stage the CBI require a confirmation where an index is required to be referenced specifically within the fund's Prospectus (and certification of the index is not required). The Responsible Person must determine whether a confirmation or a certification is relevant to the index in question.

In addition, a post-authorisation confirmation will only be required where an index that required confirmation as part of the initial authorisation process (i.e. an index referenced directly in the fund's Prospectus) is changed.

For the avoidance of doubt, where an index requires certification, the UCITS, at all times, may only gain exposure to that index after the relevant certification has been submitted to the CBI.

A&L Goodbody understands this to mean

- If a UCITS is using an index for investment purposes, for example using FDIs which give return on that index, and details are to be disclosed in the prospectus, the UCITS must provide to the CBI either
 - » written confirmation in application for authorization of UCITS or sub-fund approval but NO certification required if UCITS could invest directly in the underlyings of the index in the same proportion as in the index and, in so doing, comply with the UCITS diversification requirements (for example the 5/10/40 rule) or
 - » a certification if UCITS could NOT invest directly in the underlyings of the index or comply with diversification rules, either because of ineligible assets in the index or insufficient diversification.
- An updated confirmation is only required, post authorisation, where the UCITS intends to seek exposure to a new index for investment purposes that must be disclosed in the prospectus.
- If the index is being used for EPM only then there is NO need to disclose the names of indices in prospectus other than general reference to gaining exposure to UCITS compliant indices. However the UCITS should provide a certification if UCITS could NOT invest directly in the underlyings or comply with diversification rules.

"Certification" is always required (in advance of a particular investment) if the UCITS could NOT invest directly in the underlyings of the index or, in so doing, comply with diversification rules. This is the case whether the indices are used for investment purposes or EPM and whether envisaged at outset of fund or to be used later.

Conclusion

Irish UCITS which use financial indices welcomed the clarification and reduced burden of self-certification requirements in the CBI's July 2019 updated guidance. Those UCITS who have not already done so should revisit their compliance with the provisions of the October 2018 CBI guidance on UCITS use of financial indices and consider what implications the changes in the July 2019 updated guidance may have. The consideration should also take into account the January 2020 clarification which explains when confirmation or certification should be provided to the CBI at pre- and post-authorisation stages.

You can contact a member of the A&L Goodbody Asset Management & Investment Funds team for further information and advice

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