

Detailed Analysis on new UCITS Regulations 2015

On 5 October 2015 the Central Bank of Ireland (**Central Bank**) published new Central Bank UCITS Regulations which will commence on 1 November 2015 (**CB UCITS Regulations**). The CB UCITS Regulations supplement existing legislative requirements, in particular the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (**UCITS Regulations**). For the most part, the rules in the CB UCITS Regulations mirror the conditions set out in the Central Bank's UCITS Notices but a small number of policy changes are included. The Central Bank has also restructured its UCITS guidance to reflect the publication of the CB UCITS Regulations, as detailed below.

Background

Following the implementation of the Alternative Investment Fund ("AIF") Rulebook in July 2013, the Central Bank indicated it would put in place a similar rulebook for UCITS and invited public consultation in its "Consultation on Publication of UCITS Rulebook" (CP77) on the proposed UCITS Rulebook and a number of policy changes such as the removal of the promoter regime, Central Bank approval of regulated markets and semi-annual reporting for UCITS management companies.

Following the consultation, the Central Bank published the UCITS Rulebook in the form of a Central Bank regulation. Publishing the UCITS Rulebook on a statutory basis means that the UCITS rules are now legally binding and provides clarity on the proper and effective regulation of regulated financial service providers. The UCITS Rulebook, together with the updated guidance and the UCITS Q&A, replace the Central Bank UCITS Notices and Guidance Notes from 1 November 2015. The various changes to the UCITS regime are set out below.

Amendments to the UCITS Regime

Removal of Promoter Requirement

Mirroring the recent approach adopted under AIFMD, the Central Bank has eliminated the promoter approval process for UCITS. The Central Bank is now placing reliance on the regulatory regime for UCITS management companies and has elaborated on the obligations of directors when a UCITS gets into difficulties in the Central Bank guidance. This is a welcome change for new asset managers entering the market as they will not have to go through the cumbersome promoter approval process and should lead to more efficient time lines for setting up a new Irish fund.

Guidance on Regulated Markets

The Central Bank is withdrawing Guidance Note 1/96 on permitted market which set out the Central Bank's criteria in determining whether markets were eligible for UCITS investments. In its Feedback Statement on CP 77 the Central Bank noted that there was a degree of overlap between the matters covered by the eligible assets directive and Guidance Note 1/96. As a result the Central Bank will no longer review submissions on proposed regulated markets and will no longer publish a list of permitted markets for UCITS. As a result a UCITS management company or self-managed UCITS can now assess whether a particular market meets the requirements set out in the UCITS Regulations and UCITS Rulebook.

Reporting Requirements for UCITS management companies and depositaries

The Central Bank now requires UCITS management companies and depositaries to submit an additional set of half-yearly management accounts covering the second six months of the financial year. Although many respondents to CP77 challenged this approach on the basis that it would place an additional burden on UCITS management companies and depositaries, in terms of time and costs, the Central Bank disagreed. The Central Bank explained that this will allow the comparison and analysis of reports from the first six months of the year with the second six months, which was not possible before and this should provide better quality and more timely key risk indicators and alerts on PRISM (the Central Bank's risk-based framework for the supervision of regulated firms).

Collateral

The UCITS Rulebook has been updated to reflect the outcome of the recent Consultation on the adoption of ESMA's revised guidelines on ETFs and other UCITS issues (CP84). The ESMA guidelines provided a derogation from the collateral diversification requirement where collateral consisted of securities issued or guaranteed by a Member State, one or more of its local authorities, a third country or a public international body of which one or more Member States belong. This derogation is now available to all UCITS subject to certain disclosure requirements in the prospectus and periodic reports of UCITS.

Depositary Monitory and Reporting

Where a non-material breach is not resolved within 4 weeks the UCITS Rulebook now requires the depositary to notify the Central Bank promptly thereafter. This is a change from current practice where non-material breaches often are not reported (unless they become material with the passage of time). The Central Bank will keep this rule under review to ensure that it is workable and proportionate.

Redemption Gates

Where a redemption gate is in place, redemption requests carried over from a prior dealing day as a result of the application of a gate can no longer receive priority. Up until now a lot of UCITS provided for priority rights of redemption for investors on subsequent dealing days in respect of the balance of redemption requests that had been subject to a gate. The Central Bank believe that applying priority to redemption requests which have been subject to a gate may materially prejudice investors, particularly small investors. This is notwithstanding the fact that the original gate would have had to have been applied pro rata to all investors, large and small, who had submitted redemption requests. One ray of light is that existing UCITS have until 1 November 2016 to implement the change (which will likely require a change to the UCITS' constitutional document).

Disclosure of Short Positions

Where a UCITS proposes to take short positions it must disclose in its prospectus the categories of assets in which it may invest, whether it will take long or short positions or both and disclose the percentage of its assets which it anticipates will be invested in long and short positions. In addressing whether this disclosure should be general or specific in nature, the Central Bank has clarified that the anticipated range for long and short positions can be disclosed.

Updated UCITS Q&A

The Central Bank also published the seventh edition of its UCITS Q&A. Seventeen additional questions were addressed which covered a broad range of topics including maximum fee levels, dealings with connected persons and the information to be included in the annual report of a UCITS relating to the calculation of VaR limits. One other interesting question which was addressed concerned the requirement following CP86 Consultation on Fund Management Company Effectiveness – Delegate Oversight that the rationale for board composition be included in the business plan of the UCITS. The Central Bank has clarified that only new UCITS management companies are subject to this requirements, however, they are of the view that it is good practice for the director performing the Organisational Effectiveness role for each UCITS management company (new or existing) to document the rationale for the board composition as part of developing this role and to include this in the business plan when it is next updated.

Next Steps and Timings

The Central Bank UCITS Regulations commence on 1 November 2015 with the exception of the rules relating to redemption gates set out above which do not have to be in place until 1 November 2016. Clients should consider key points set out below:

■ Derogations

Where a UCITS has a derogation in place from the Central Bank clients will need to assess whether this derogation is covered by the new UCITS Rulebook or if a new derogation should be sought. Any new derogation will need to be in place before 1 November 2015.

■ Redemption Gates

The UCITS offering document will need to be updated to reflect the new requirements. Clients should consider whether the constitutional documents also need to be updated. As this requirement does not come into effect for existing funds until 1 November 2016, clients may take the opportunity to update the constitutional documents at the next AGM.

■ Prospectus Updates

The disclosures in relation to short positions should be included in the next update of the prospectus.

■ Business Plan

The requirement to include the rationale for board composition in the business plan of the UCITS must be incorporated into the business plan at the next update.

We will be working closely with our clients in relation to the impact of these changes. In the meantime, if you have any queries, please contact one of the partners listed or your usual contact at A&L Goodbody.

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