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29 June 2018

BY EMAIL: fundspolicy@centralbank.ie

Central Bank UCITS Regulations Consultation
Markets Policy Division
Central Bank of Ireland
PO Box 556
Dublin 1

Re: Consultation on amendments to (and consolidation of) the Central Bank UCITS Regulations ("CP 119")

Dear Sir/Madam,

We welcome the opportunity to respond to CP 119 on amendments to (and consolidation of) the Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Undertakings for Collective Investment in Transferable Securities) Regulations 2015 (the **"CBI UCITS Regulations")**.

Arthur Cox is one of Ireland's largest law firms. Our Asset Management and Investment Funds Group is a market leader, advising on all aspects of investment management issues and the establishment and ongoing operation of investment funds in Ireland.

We have contributed to the response that Irish Funds has made to CP 119 and support the submissions made therein, particularly those regarding the accrual, crystallisation and payment of performance fees.

Performance Fees

Setting a minimum frequency for the crystallisation of a performance fee may not always be in the best interest of investors. As recognised by IOSCO in its Good Practices on CIS Fees and Expenses, where a fund applies a "fulcrum fee model" it is not required to adhere to a minimum annual frequency for crystallisation and payment of the performance fee. This method of calculation provides a fee averaged over a specified period that increases or decreases proportionately with the investment performance of the fund in relation to the returns from an appropriate securities index. Therefore, if the Central Bank's intention is to align its requirements with those of IOSCO, the CBI UCITS Regulations should include provision for these circumstances. Provision should be made to permit accrual of performance fees at each valuation point and for a redemption of shares to be considered a crystallisation event.

Accounts

As the second set of half-yearly accounts which management companies and depositaries must file with the Central Bank will cover the full financial year, reducing the filing timeframe from two months to one may present operational challenges for these parties. We would ask the Central Bank to consider retaining the two month period for submission of the second set of accounts covering the full financial year. This would be consistent with the timeframe allowed for the first set of half-yearly accounts.

Other Observations

In addition to endorsing the comments which Irish Funds has raised, we also have the following general observations on the CBI UCITS Regulations. As the Central Bank is reviewing its CBI UCITS Regulations, we would ask that it consider addressing the points below, which have caused confusion and/or challenges for market participants.

Anti-Dilution Levy

The term "anti-dilution levy" as defined in the CBI UCITS Regulations and referred to in Regulations 39 and 63(2) provides that an anti-dilution levy (ADL) must be applied on a net subscription or net redemption basis. The application of an anti-dilution levy is one of a variety of tools which a fund may employ to protect investors in a fund from the effects of dilution. Dilution is the adverse effect which existing investors may suffer where a fund's net asset value may be reduced due to the costs of buying and selling fund assets on foot of subscriptions and/or redemptions.

Other tools employed to mitigate the impact of dilution include:

- the application of duties and charges to the NAV per share to arrive at a subscription price and redemption price;
- the use of swing pricing (with a possible dilution adjustment at the level of the NAV);
- valuing assets of a fund on an offer basis to arrive at an offer/subscription price, while also valuing the assets on a bid basis to arrive at net bid/redemption price.

Each of these tools has its advantages and disadvantages and no one tool provides a complete solution to mitigate the impact of dilution.

Given the variety of tools available to mitigate against the effects of dilution, we would ask that the Central Bank consider removing reference to this one tool or if retaining it, we would ask that the definition and the conditions relating to its application be amended.

As noted above, as currently defined/applied an ADL may only be applied on a net dealing basis. We would argue that an ADL should also be permitted to be applied on an individual deal basis i.e. not on a net subscription and/or net redemption basis but on the basis of individual deals. Applying an ADL on a net dealing basis may not always result in all investors being treated fairly. For example, on a dealing day where a fund experiences net subscriptions, and an ADL is applied to increase the subscription price, an investor who placed a small subscription which did not trigger a dilution effect would bear the costs of the ADL and a higher subscription price. We ask the Central Bank therefore to consider its requirements on the application of an ADL and provide that it may also be applied on an individual deal basis. In support of this, we would refer to the final report issued by IOSCO in February 2018 entitled "Open ended fund liquidity in risk management – good practice and issues for consideration" where the application of an ADL on an individual deal basis is recognised.

Collateral Requirements – Regulations 25(3)(a) and (b)

It would be helpful if the Central Bank could clarify the interaction between Regulation 25(3)(b) of the draft amending and consolidating CBI UCITS Regulations which refers to UCITS receiving collateral on any basis other than a title transfer basis and Regulation 34(7)(d) of the UCITS

Regulations. Regulation 34(7)(d) of the UCITS Regulations 2011 which provides that assets held in custody by a depositary may only be reused by the UCITS provided the transaction is covered by collateral received by the UCITS under title transfer arrangements. There appears to be some confusion as to how these provisions are to be applied, particularly in the context of securities lending transactions, following remarks from Gerry Cross at an ISLA roundtable in Dublin last year where he stated the following:

"It appears that there may be an impression amongst some market participants of a regulatory preference for title transfer arrangements to apply to securities lending collateral arrangements. Title transfer arrangements are of course optimal from the perspective of collateral receivers to protect against counterparty failure and the Central Bank requires that collateral received should be capable of being fully enforced by the UCITS at any time without reference to or approval from the counterparty. However, title transfer arrangements are not mandated by the ESMA guidelines or indeed by the Central Bank. Rather, the guidelines (and the Central Bank UCITS Regulations) provide for the possibility of pledge arrangements with the proviso that the collateral be held by a third party custodian who is unrelated to the collateral provider and is subject to prudential supervision. As this pledge model is already being used in the context of derivatives clearing through CCPs, it is not clear from where this uncertainty originates."

It would be helpful if the Central Bank could clarify its position.

Yours sincerely

Arthur Cox

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