



BNY MELLON

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Central Bank UCITS Regulations Consultation  
Markets Policy Division  
Central Bank of Ireland  
PO Box 559  
Dublin 1

29<sup>th</sup> June 2018

**Re: CP119 - Consultation on amendments to (and consolidation of) the Central Bank UCITS Regulations**

Dear Madam/ Sir

BNY Mellon welcomes the opportunity to comment on this Consultation Paper regarding amendments to, and consolidation of, the Central Bank UCITS Regulations.

BNY Mellon is a leading player in the Irish funds industry and service provider to UCITS both as an administration company through BNY Mellon Fund Services (Ireland) DAC and as a depository through BNY Mellon Trust Company (Ireland) Limited.

We have considered the matters set out in Consultation Paper 119 ("CP119") and the questions posed therein. We set out below our responses to the questions relating to each of the four sections of the Consultation Paper.

### **Section I: Amendments arising from a review of the Central Bank UCITS Regulations**

**Question 1: Stakeholders are requested to indicate whether they agree with the changes proposed and to provide any comments and / or observations.**

BNY Mellon has no comments or observations to raise in relation to the changes proposed in Section I.

### **Section II: Amendments to UCITS Share Class Provisions**

**Question 2: Stakeholders are requested to indicate whether they agree with the changes to share class provisions as currently proposed.**

As stated in Section II of the Consultation Paper, it is proposed to amend relevant share class provisions in the Central Bank UCITS Regulations to reflect the Opinion on Share Classes of UCITS issued to NCAs by ESMA in January 2017 ("the ESMA Opinion").

In Section 3.3 paragraph 25 of its Opinion, ESMA sets out some operational principles which, in its view, should be observed to ensure that the derivative overlay used to hedge the currency risk in one share class does not lead to spill-over risk which could disadvantage investors in other share classes of the same fund with no derivative overlay. For example, one of the operational principles cited is as follows:

*“The notional of said derivative should not lead to a payment or delivery obligation with a value exceeding that of the share class. To that end, the maximum potential amount of cash that could be paid to the counterparty or collateral that could be posted to the derivative counterparty should be prudently assessed by the management company and should not exceed the maximum pool of cash and eligible collateral corresponding with the value of the share class”*

In paragraph 26 in the same section of the Opinion, ESMA then goes on to state the following:

*“ESMA is aware that daily subscriptions and redemptions lead to conditions where it is difficult to attain a perfect hedge within a fund or share class. To nonetheless ensure that the above operational principles are met, the UCITS management company should, at the level of the share class with a derivative overlay:*

*.....*  
*b. Ensure that over-hedged positions do not exceed 105% of the net asset value of the share class;*

*c. Ensure that under-hedged positions do not fall short of 95% of the portion of the net asset value of the share class which is to be hedged against currency risk”*

However, Regulation 27(3) of the Amending and Consolidating Central Bank UCITS Regulations (“the Amending Regulations”) reads as follows:

*“Where a UCITS engages in currency hedging at the level of a share class, the responsible person shall do the following:*

*(a) ensure that over-hedged positions do not exceed 105 per cent and under-hedged positions do not fall below 95 per cent of the net asset value of the hedged currency share class;*

*.....*  
*(k) ensure the notional of the derivative transaction does not lead to a payment or delivery obligation with a value exceeding that of the share class”*

Our comment, therefore, is that the distinction drawn in the ESMA Opinion between an operational principle and parameters that can be applied to ensure that the principle is met in practice given the cashflows to/from the fund in the form of subscriptions and redemptions is not apparent in the Amending Regulations. As the proposed Regulation stands, it appears to contain contradictory requirements for the responsible person to ensure that over-hedged positions do not exceed 105% of the value of a share class whilst also ensuring that the notional value of a derivative transaction does not exceed 100% of the value of the share class.

As a further comment, paragraph 22 of Schedule 7 and paragraph 15 of Schedule 8 require that:

*“An up-to-date list of all share classes of the UCITS, identifying whether the relevant share class is hedged”*

is included as additional information in the Annual and Half-Yearly Reports respectively.

We suggest that such a list is limited to include only all launched share classes in order to avoid the provision of unnecessary and unhelpful information to the market.

### **Section III: UCITS Performance Fees**

#### **Question 3: Stakeholders are invited to provide comments and observations on the performance fee provisions being included in the Central Bank UCITS Regulations.**

Regulation 41(1) prescribes that performance fees are only payable by the UCITS on either:

*“(a) achieving a new high net asset value per share over the life of the UCITS, or*

*(b) the out-performance of an index”.*

However, some UCITS provide for the payment of a performance fee only when the “water mark” is exceeded by a certain percentage as opposed to simply when a new high NAV per share is achieved. We suggest that the Regulation is amended to reflect this additional circumstance in which a performance fee can become payable.

**Question 4: Stakeholders are requested to indicate whether further requirements are necessitated to better regulate the charging of performance fees by UCITS.**

Regulation 41(4) details requirements that a performance fee does not crystallise more than once per year and is not paid more than once per year. However, the Regulation does not provide for the crystallisation of a performance fee, and the timing of the payment of a performance fee, relating to a redemption. Typically, a fund prospectus stipulates that a performance fee crystallises and is paid with an annual frequency or, when appropriate, upon a redemption. We suggest, therefore, that this practice is reflected in the Regulation in order that clarity is provided in relation to the treatment of performance fees when a redemption occurs.

On an associated point, Regulation 75 details the prospectus disclosure requirements regarding performance fees. However, no disclosure requirement is specified in relation to the calculation and payment of performance fees following a redemption. We suggest that a requirement to explicitly disclose the fund’s treatment of performance fees following a redemption is added to the Regulation in order to ensure transparency and comparability across funds.

**Section IV: Amendments to UCITS MMF Provisions in light of MMFR**

**Question 5: Stakeholders are requested to indicate whether they agree with the amendments proposed and to provide any observations / comments.**

BNY Mellon has no comments or observations to raise in relation to the changes proposed in Section IV. --

We appreciate the opportunity to contribute to this consultation process. We are happy to discuss our comments further should you wish to do so.

Yours faithfully



**Alan Melia**  
**Country Compliance Officer, Ireland**