



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

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Feedback Statement on CP 105 – Consultation on amendments to the Central Bank UCITS Regulations



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Introduction

1. On 2 June 2016 the Central Bank of Ireland (the “Central Bank”) published Consultation Paper CP 105 *Consultation on amendments to the Central Bank UCITS Regulations* (“CP105”). The closing date for comments was 25 August 2016 and 3 responses were received.
2. CP105 relates to a number of amendments to the Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Undertakings for Collective Investment in Transferable Securities) Regulations 2015 (the “Central Bank UCITS Regulations”): (a) consequential on the implementation of UCITS V¹; and (b) technical changes, including corrections of typographical errors, identified after the Central Bank UCITS Regulations were published.
3. CP105 raised 3 specific questions for respondents to address. This feedback statement briefly summarises the responses received to each question along with the Central Bank’s comments and decisions.
4. The Central Bank will keep its requirements under review at all times and welcomes on-going discussion on how best to protect investors, while facilitating management of the costs arising.
5. Nothing in this feedback statement should be read with, seen as a clarification of or a supplement to the Central Bank UCITS Regulations. This feedback statement is published to promote understanding of the policy formation process within the Central Bank and is not relevant to assessing compliance with regulatory requirements.

¹ Directive 2014/91/EU

Feedback on amendments consequential to the implementation of UCITS V

Question 1: Stakeholders are requested to indicate whether they agree with the changes as currently proposed and to provide observations. In addition, stakeholders are requested to indicate whether further amendments may be required as a result of the implementation of UCITS V.

6. **Proposal to amend Regulation 11 to reflect the introduction of requirements in UCITS V Level 2 in relation to the holding of cash accounts by UCITS for operational purposes.**

One respondent disagreed with the proposal to replace references to ‘deposits’ with references to ‘cash booked in accounts’. The respondent suggested retaining the reference to deposits and clarifying that it relates to deposits made by the UCITS as investments.

Central Bank: Provisions concerning deposits as investments are set out in Regulation 7. Regulation 11 makes provision in relation to cash booked in accounts at credit institutions for ancillary liquidity purposes rather than deposits as investments. Regulation 11 will be amended to clarify this point.

7. **Proposals to include the Central Bank’s requirements in respect of establishing subsidiaries.**

One respondent submitted a number of comments on the proposals:

- a. The respondent asked if the Central Bank could issue guidance on the circumstances in which it permits the use of subsidiary vehicles by a UCITS;
- b. Regarding the requirement to disclose the name of the subsidiary in the prospectus the respondent indicated it is not practical or efficient for the name of each subsidiary to be disclosed in the prospectus. The respondent proposed inclusion of provision in the prospectus noting that subsidiaries may be established with disclosure of the names of any subsidiaries contained in the annual/semi-annual reports of the UCITS.

Central Bank: The Central Bank has considered these items and advises as follows:

- a. Provisions in relation to establishment/use of subsidiaries are included in the UCITS Regulations - Regulation 74(3) subparagraphs (d) and (e). Similar to the approach taken for alternative investment funds, website guidance will issue in relation to applying to the Central Bank for approval to establish a subsidiary.
- b. The Central Bank agrees that requiring disclosure of the names of subsidiaries in the prospectus may not be practical. The amending Regulations will reflect a revised provision as suggested by the respondent requiring disclosure in the UCITS annual report.

8. **Deletion of Regulations 114(1), 114(7), 114(8), 115, 116(2), 116(3), 118(2) and 118(3) and insertion of new Regulation 114A applying the depositary’s safekeeping obligations where assets of the UCITS are held through subsidiaries.**

One respondent noted that new Regulation 114A did not cross refer to Article 14 of Commission Delegated Regulation 438/2016 of 17 December 2015. That respondent also considered it appropriate to delete Regulation 118(1) as the depositary’s duties regarding valuations are now captured in Article 5 of UCITS V Level 2.

Central Bank: A typographical error in Regulation 114A will be amended to refer to Article 14 (rather than Article 15) of Commission Delegated Regulation 438/2016.

Where assets are held through a subsidiary, the Central Bank considers these as being the UCITS’ assets which should be protected in the same manner as assets held directly by the UCITS. UCITS V Level 2 contains depositary obligations regarding monitoring “all cash of the UCITS”. The Central Bank views this as including the UCITS’ cash held through a subsidiary so that the depositary’s cash flow monitoring duties should apply to UCITS’ cash held through the subsidiary. As drafted in CP105, the proposed new rule applied the depositary safe keeping obligations in relation to assets held through subsidiary vehicles. For clarity Regulation 114A will be further amended to provide that where a UCITS establishes a subsidiary the assets of the subsidiary must be held by the depositary and the depositary’s safekeeping and cash monitoring obligations shall apply.

The Central Bank considers it appropriate to retain Regulation 118(1). This refers to taking into account the level of premium or discount at the date of valuation which is not referenced in the UCITS V level 2.

Feedback on technical amendments including correction of typographical errors

Question 2: Stakeholders are requested to indicate whether they agree with the changes as currently proposed and to provide observations. In addition, stakeholders are requested to indicate whether further amendments may be required as a result of the foregoing proposals.

9. **Proposal to amend Regulation 2(1) and Schedule 9 to align the definition of “own Funds’ with the requirements in CRD IV.**

No comments were received on this proposal but our own review identified that the provisions regarding the calculation of the minimum capital requirement and the own funds requirements in Regulation 111 and schedule 9 of the Central Bank UCITS Regulations are no longer necessary. This is because of the depositary capital rules introduced by UCITS V and reflected in Regulation 34 of the EC (UCITS) Regulations 2011². Regulation 111 and schedule 9 of the Central Bank UCITS Regulations will be amended to delete those provisions.

10. **Proposed amendments to Regulation 23 and 61 to correct inconsistencies between the text and the ESMA Guidelines on ETFs and other UCITS Issues (ref. ESMA 2014/937)**

One respondent questioned whether it was appropriate to delete the reference to ‘instruments’ in Regulation 23(1) on the basis that this would be inconsistent with paragraph 25 of ESMA’s Guidelines on ETFs and other UCITS Issues.

11. **Proposal to amend Regulation 36 to reflect the fact that valuation of a particular asset type of a UCITS may be mandated by legislative requirements other than those in the Central Bank UCITS Regulations (e.g. valuation of OTC derivatives not cleared by a CCP in accordance with Regulation (EU) No 648/2012 (EMIR))**

One respondent noted that the proposed amendment in Schedule 5 relating to valuation of OTC derivative contracts did provide for all OTC derivative contracts. The respondent noted the provisions of Regulation 68(1)(g)(iii) and section 25 of Schedule 9 of the UCITS Regulations. The respondent suggested amending Schedule 5 to provide for all of these in relation to valuing OTC derivatives to avoid any potential for these requirements to be overlooked.

12. **Proposal to amend Regulation 53(2)(b) to permit a responsible person more flexibility in providing disclosure for long and short positions.**

One respondent welcomed the additional flexibility but suggested that the prescribed terms for the disclosure remained difficult to adhere to. The respondent proposed deleting Regulation 53(2)(b) and replacing it with a requirement to include “a description of the extent to which the UCITS anticipates taking such short positions, relative to the overall

² S.I. No. 352 of 2011.

value of the Fund”.

13. **Proposal to amend Regulation 78(1) to clarify timing for submission of UCITS periodic reports.**

One respondent suggested that the proposed inclusion of ‘within two working days’ should be excluded on the basis that Regulation 88 of the UCITS Regulations already specifies the timeframe for publication of the annual and half yearly reports. Inclusion of ‘within two working days’ would increase difficulty in compliance monitoring without the addition of any benefit to the parties involved and its regulation.

Central Bank: The Central Bank has considered these items and advises as follows:

10. Reference to ‘instruments’ will be retained in Regulation 23(1).
11. Regulation 36/Schedule 5 is not being amended. However, the Central Bank will issue a Q&A to clarify that valuation of a particular asset type of a UCITS may be mandated by legislative requirements other than those in the Central Bank UCITS Regulations. In such circumstances those particular assets should be valued in accordance with the relevant legislative requirements.
12. The Central Bank intends to amend Regulation 53(2)(b) to give the responsible person more flexibility to provide for disclosure of long and short positions. The new provision will permit disclosure on the basis of the anticipated maximum percentage or anticipated ratio of long positions to short positions.
13. Reference to ‘within two working days’ will not be included in Regulation 78(1).

Question 3: The Central Bank is considering whether the requirements in relation to disclosure of open derivative positions in annual and half-yearly reports might be amended, particularly in circumstances where the disclosure can be lengthy and technical in nature. The Central Bank would welcome proposals from stakeholders for an alternative approach for disclosure which is both proportionate and which achieves sufficient, meaningful disclosure.

14. Respondents agreed that the current requirement in relation to disclosure of open financial derivative positions can lead to excessively long reports diluting the relevance of such information for investors and contributing little to the readers understanding of overall risk exposures.
15. Two respondents made suggestions. Both suggested that UCITS be given the option to present either a full portfolio statement listing each open financial derivative position or a condensed portfolio statement listing open financial positions representing a certain percentage or more of assets, distinguishing between the different types of financial derivatives positions and analysed in accordance with the most appropriate underlying exposure type in light of the investment objective of the UCITS. Open positions representing less than the specified percentage of net assets should be aggregated in so far as open derivatives in an asset and liability position are not offset and in the case of OTC derivatives they are held with the same counterparty. One respondent suggested condensing on the basis of positions representing 1% or more; the other suggested condensing on the basis of positions representing 5% or more.

Both these respondents suggested that where a condensed portfolio statement is presented, the UCITS must then make the full portfolio statement available to investors on demand free of charge.

Central Bank: The Central Bank welcomes the proposals put forward. The Central Bank will amend the Central Bank UCITS Regulations to include a new provision incorporating the proposed option to present either a full portfolio statement listing each open financial derivative position or a condensed portfolio statement listing open positions representing 5% or more of assets.

However, where a condensed portfolio statement is provided the Central Bank considers that the introduction of an additional leverage metric could improve disclosure in terms of making it more informative. The leverage metric should be consistent with the leverage measure as used by the UCITS (i.e. sum-of-the-notionals or commitment methodologies) per its Risk-Management-Process. However, for the purposes of the condensed portfolio statement the leverage is to be analysed (delineated) within each of the following headings: each derivative type, each derivative type by currency and maturity, each derivative type by industry sector and each derivative type by geographic region.

Other feedback

16. Pursuant to question 2 (technical amendments), the Central Bank invited respondents to indicate whether further amendments might be required. A number of suggestions were received. Those comments which were especially noteworthy, particularly issues which were raised by a number of different respondents, are summarised below.
- a. A respondent queried whether the Central Bank intended to amend Chapter 4, Efficient Portfolio Management to reflect the requirements of the Securities Financing Transactions Regulation³ ('SFTR').
 - b. A respondent suggested an amendment to Regulation 33(2) to indicate that a responsible person shall 'normally' pay redemption proceeds within ten business days. The purpose of this would be to reflect cases where payment within ten business days may not be practicable, for example, where the investor has not complied with anti-money laundering requirements. The respondent suggested that the proposal to include 'normally' was consistent with section 2.14.15 of the Central Bank's UCITS application form.
 - c. A respondent proposed that Regulation 47(1) should be adjusted to provide for circumstances when it is proposed to replace the management company i.e. the UCITS investment company and not the management company itself should assume the obligations.
 - d. One respondent suggested amending the risk warning disclosure in Regulation 64(3) to delete 'should not constitute a substantial proportion of an investment portfolio' on the basis that it is for each investor to determine the portion of its portfolio to invest. The respondent also asked for clarity on whether there is an ongoing obligation to monitor the limits in Regulation 64(3) over the life of the fund.
 - e. Some respondents suggested the addition of a materiality threshold to the requirement in Regulation 103(2)(a) to notify the Central Bank of any breaches of the UCITS Regulations or of the Central Bank's requirements.
 - f. Some respondents proposed that Regulation 103(2)(c) should be amended to provide that the UCITS management companies would only notify the Bank of 'significant' rather than 'all' legal proceedings involving the UCITS management company or UCITS under its management.
 - g. One respondent suggested a number of amendments to Regulation 78(2) to clarify the reporting provisions.
 - h. One respondent suggested the provisions in Schedule 3, Section 3 in relation to issuer credit quality should be amended to refer to 'collateral credit quality'. The respondent suggested that the existing provision would also be supplemented with a criterion for equity collateral.

³ Regulation (EU) 2015/2365

Central Bank: The Central Bank has considered these items and advises as follows:

- a. SFTR is a European Union regulation and has direct effect under Irish law. The Central Bank UCITS Regulations only contains those rules which the Central Bank is imposing on UCITS, UCITS management companies and depositaries. It does not repeat legislative requirements.
- b. The requirement in section 2.14.15 of the Central Bank’s application form is clear. It requires that there should be provision in the prospectus for the period within which redemption proceeds will normally be paid or discharged to investors. It clarifies that the period between the dealing deadline for redemption requests and payment of the UCITS to investors should reflect the frequency of dealing i.e. daily, weekly. The period must be within 10 business days of the relevant dealing deadline.
- c. The existing definition of ‘responsible person’ contained in the Central Bank UCITS Regulations provides: “... in the case of Regulation 47, the responsible person means the UCITS investment company where the designated management company is being replaced.”
- d. The risk warning required pursuant to Regulation 64(3) is being retained as this is a long standing protection notification for retail investors. The risk warning is required where the UCITS has an investment objective or investment policy that involves an intention to invest in excess of specified percentages in emerging markets or bonds/warrants that are below investment grade. In such instances relevant disclose of the intentions and the risk warning should be included in the UCITS prospectus.
- e. This is not being amended at this time. The Central Bank may review its requirements in relation to notification of breaches of the UCITS Regulations or the Central Bank’s UCITS Regulations at later date.
- f. The provision around notification of any legal proceedings was given consideration when the UCITS Rulebook was being drafted. The Central Bank indicated that guidance would issue and this was included in ID 1027 of the UCITS Q&A. The intention is that a UCITS management company is required to notify the Central Bank of any and all legal proceedings involving the UCITS management company or UCITS under its management.
- g. Amendments clarifying the provisions of Regulation 78(2) were included in the first set of amendments to the Central Bank UCITS Regulations – S.I. 307 of 2016.
- h. As the provisions in Schedule 3 reflect the ESMA guidance on ETFs and other UCITS issues the Central Bank does not propose to make the suggested amendments.

Next steps

17. The Central Bank will proceed to amend the Central Bank UCITS Regulations to give effect to the changes described in this feedback statement. Changes resulting from the consultation process on fund management company effectiveness (CP86) will also be reflected in the amending regulations. It is anticipated that the Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1))(Undertakings for Collective Investment in Transferable Securities) (Amendment) Regulations 2017 will issue in Quarter 1 2017.

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