

Irish Central Bank Updates UCITS Notices, Non-UCITS Notices and Related Guidance Notes

The Central Bank has recently announced that it has amended its [UCITS Notices, Non-UCITS Notices \(“NU Notices”\) and related Guidance Notes](#) effective 23 December 2011 and announced policy changes. While the majority of the amendments are technical in nature, some of the amendments made and policy changes are worth highlighting.

Policy Changes

Borrowing Powers – Foreign Currency – UCITS Notice 11 / NU Notice 3

For both UCITS and Non-UCITS funds that invest across a range of currencies, the borrowing restrictions imposed by the Central Bank did not apply to such funds that borrowed foreign currency by way of a back-to-back loan agreement provided that the offsetting deposit: (a) was denominated in the base currency of the fund; and (b) equalled or exceeded the value of the foreign currency loan outstanding.

The Central Bank has now removed the requirement that the off-setting deposit be denominated in the base currency of the fund.

UCITS – Financial Indices – Guidance Note 2/07

The use of financial indices by UCITS funds has been central to the development of sophisticated UCITS following the introduction of UCITS III.

The Central Bank of Ireland has always been responsive to the evolution of more complex and innovative uses for financial indices within the UCITS framework. In 2007, it introduced

Guidance Note 2/07 which dealt with the circumstances under which a UCITS is required (or not required) to seek clearance from the Central Bank before using a particular index, by way of an index submission. In 2008, Guidance Note 2/07 was amended to permit investments in hedge fund indices.

In general, the Central Bank will not require a financial index to be submitted for clearance if, on a look-through basis, it would be possible for the UCITS to invest directly in the constituents of the index under the “5/10/40” rule and the index constituents are eligible assets. The “5/10/40” rule means that a UCITS may invest no more than 10% of net assets in a single issuer, provided that the total value held in issuers in which it invests more than 5% of net assets may not exceed 40%.

All other financial indices must be submitted for clearance under the index assessment criteria set out in Guidance Note 2/07.

The policy change relates to financial indices where an index submission is not required. Provided that the UCITS confirms, when making an application for authorisation, that the index meets the regulatory requirements (i.e. it is comprised of eligible assets and meets the “5/10/40” rule), an index submission will not be required if the 5/10/40

limits are subsequently exceeded as a result of market movements or other events.

This concession is on the basis that the financial index meets the “20/35” rule, which raises the 10% limit to 20% for investments in shares or debt securities or both and which permits one constituent of the index to have a weighting of up to 35% under certain circumstances.

The ability to avail of the “20/35” rule must be specifically provided for in the constitutive documents of the UCITS.

Closed-ended Collective Investment Schemes – Guidance Note 2/97

Prior to 23 December 2011, Guidance Note 2/97 was entitled “Duration of Closed-Ended Collective Investment Schemes” and dealt only with the duration of closed-ended investment schemes requiring that the fund’s constitutional documents provide for a fixed duration or term and that, depending on the length of such term and whether the fund was a retail fund or a qualifying investor fund (“QIF”), “realistic provision for liquidity” be made. Guidance Note 2/97 set out examples of liquidity provisions.

As closed-ended funds are required to comply with the requirements of the Prospectus Directive (2003/71/EC), the Central Bank provided for other classes of funds with limited liquidity provisions.

The revised Guidance Note 2/97 is now entitled simply “Closed-Ended Collective Investment Schemes” and addresses the additional matters set out below.

Voting Requirements: The amended Guidance Note 2/97 clarifies the requirement for shareholder approval in relation to certain changes to operational matters. Whereas, for open-ended and limited liquidity funds, investors who disagree with a change to the operation of the fund have the opportunity to redeem their units, no such opportunity exists for shareholders of closed-ended funds. Accordingly, the Central Bank requires an enhanced majority of 75% of votes cast for changes to closed-ended funds where there are no realistic liquidity provisions. Where there are realistic liquidity provisions, a simple majority vote will apply. As most closed-ended funds are constituted as QIFs which have no requirement to make provision for liquidity for durations of up to 15 years, it is expected that the enhanced voting requirements will apply to all closed-ended funds constituted as QIFs.

As revised, Guidance Note 2/97 requires that the following changes be submitted to shareholders for approval: (i) changes to the duration/term; (ii) changes to investment objectives; (iii) material changes to investment policies; and (iii) an increase in the maximum redemption charge / maximum annual fee charged by the management company of the fund.

In line with the current position, non-material changes to investment policies only require notification, which can be provided by means of appropriate disclosure in the next periodic report of the fund.

Furthermore, the Central Bank may impose the enhanced voting requirements in relation to other proposed changes, depending on the potential impact of the changes on investors. Circumstances where this approach is likely to be required include changes to the distribution policies of the fund or changes to its valuation policies. Guidance Note 2/97 states that proposed changes will be considered by the Central Bank on a case-by-case basis. Given that most QIFs are not likely to provide for realistic liquidity provisions, it is not clear whether the requirement for Central Bank consideration relates only to a question of whether a simple majority or a 75% majority is required for the measure or whether the requirement for Central Bank consideration might also apply to changes that would not ordinarily require a unitholder vote.

These changes are significant, as existing closed-ended funds will need to review (and update as appropriate) their fund prospectuses in line with these changes. Notification in the next periodic report of the fund may suffice.

In addition, any proposed changes to a closed-ended fund will need to be considered in detail to ensure compliance with the provisions of Guidance Note 2/97.

Collective Investment Schemes with Limited Liquidity: funds which are not closed-ended, but which do not provide redemption facilities on a monthly basis (in the case of retail funds) or on a quarterly basis (in the case of QIFs) are classified as limited liquidity funds.

Guidance Note 2/97 provides that the Central Bank may also apply the enhanced voting requirements to limited liquidity funds; the extent to which such requirements will be applied will be determined by the Central Bank on a case-by-case basis and will depend on the liquidity arrangements which are provided for in the fund.

Guidance Note 2/97 gives an example of a fund with very few exit mechanisms. Such a fund will be subject to the enhanced voting requirements.

Most, if not all, limited liquidity funds, will be established based on the simple majority voting requirement and the fund prospectus will refer to this.

For existing funds, consideration will need to be given as to what restrictions on liquidity arrangements/exit mechanisms will cause enhanced voting requirements of Guidance Note 2/97 to apply, engagement with the Central Bank on this issue will probably be necessary.

For new funds, it will also probably be necessary to consult with the Central Bank at the time of establishment so that the fund prospectus can provide for the simple majority or enhanced majority, as appropriate. This will need to be taken into consideration in terms of timing when establishing QIFs.

It may also be the case that the limitations on liquidity may become apparent only during the lifetime of the fund, in which case, it may be prudent to make provision for both options.

Other Significant Changes

UCITS – Organisation of Management Companies – Guidance Note 4/07

Guidance Note 4/07 in relation to the Organisation of Management Companies has been revised to address the omission of the ability of UCITS management companies to maintain client asset accounts for processing subscription and salespersons' moneys. In such circumstances, the management company shall be required to comply with the client asset requirements ("CAR") issued by the Central Bank under the Markets in Financial Instruments Directive ("MiFID").

It is worth noting that the Central Bank is undertaking a view of the application to CAR to financial services firms generally and this includes fund administrators and custodians.

UCITS – Electronic Document Requirements – UCITS Notice 15

UCITS Notice 15, which deals with cross-border notifications for UCITS has been amended to outline the requirement in relation to the availability of documents on a website. UCITS Notice 15 now

clearly states that the offering documents, Key Investor Information Document and the constitutional documents of the fund must be made available on either the website of the fund or its manager (or another website if the original notification letter to the Central Bank is updated). In addition, the UCITS must ensure that the UCITS host Member State has access to this website.

Dealings by Promoter, Manager, Partner, Trustee, Investment Adviser and Group Companies ("Connected Parties") – UCITS Notice 14 / NU Notice 2

UCITS Notice 14 and NU Notice 2 provide that all transactions entered into by Connected Parties with the fund must be negotiated and carried out as if effected on normal commercial terms, negotiated at arm's length and in the best interests of the investors.

Prior to amendment of the Notices, such transactions were permissible subject to a number of conditions, including a provision of a certified valuation of the transaction by a person approved by the custodian/trustee as independent and competent.

The Notices did not make provision for transactions involving the trustee/custodian and, upon authorisation, funds were required to seek a derogation to permit the fund (or its manager or general partner, as appropriate) to approve such persons in transactions involving the trustee/custodian.

The amendment to the Notices means that such derogation requests no longer need to be made upon authorisation. While the text refers to the "UCITS" in the case of a UCITS and the "scheme" in the case of a non-UCITS, the explanatory memorandum to the UCITS Notices and NU Notices clarify that obligations imposed under the Notices are obligations of a management company where appropriate and, accordingly, it is still correct to refer to the Manager when drafting fund documentation.

Money Market Funds – Guidance Note 2/99

In line with the ESMA Guidelines on the Common Definition of Money Market Funds, the Central Bank has updated its Money Market Fund Guidance Note 2/99.

Previously, applications for authorisation were required to state whether, on the basis of the fund's

investment objectives and/or policies, the fund was a money market fund.

The revised Guidance Note requires notification during the authorisation process and not upon authorisation as to whether the fund is a “short-term money market fund” or a “money market fund”. Short-term money market funds are funds which operate a short term weighted average maturity of no more than 60 days and a weighted average life of no more than 120 days, as opposed to money market funds, which operate a longer weighted average maturity and weighted average life.

Both types of funds are required to make statistical reporting to the Central Bank. The objective is to supply monthly data on the business of monetary financial instruments (“MFIs”) in sufficient detail to provide the European Central Bank (ECB) with a comprehensive statistical picture of monetary developments in the euro area and to allow flexibility in the calculation of monetary aggregates.

QIF – Directors – Guidance Note 1/07

In line with the Central Bank’s new fitness and probity regime, Guidance Note 1/07 which deals

with the authorisation requirements for QIFs has been amended to include the requirement that directors must complete an on-line Individual Questionnaire as a pre-condition for approval. Notwithstanding the 24 hour fast track process that the Central Bank has in place for QIF authorisations, the online IQ must be completed 5 days in advance of the proposed authorisation date.

Application Forms – Updated

The Irish Funds Industry Association has announced that the Central Bank’s Fund Application Forms have been amended to reflect, as relevant, the recent amendments summarised above and the updated Application Forms will be available shortly on the Central Bank’s website.



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