

Central Bank of Ireland UCITS Q&A – 23rd Edition

“Investment in Non UCITS Investment Funds”

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UCITS Q&A – 23rd Edition

On 5 July 2018, the Central Bank published the twenty third edition of the Central Bank UCITS Q&A ([link](#)). Of note are Question ID's 1002 & 1003;

ID 1002

Q. Must the non-UCITS investment fund include conforming provisions in its constitutional document in order to be eligible for investment by a UCITS or is it sufficient for the non-UCITS investment fund to operate in practice in a manner which complies with the requirements of Regulation 68(1)(e)?

A. The UCITS Regulations require that the constitutional document of the non-UCITS fund in which it is intended to invest includes a prohibition on investing more than 10% of its assets in other investment funds. A non-UCITS investment fund must also be subject to requirements in its jurisdiction of domicile which are equivalent to UCITS investor protections in order to comply with Regulation 68(1)(e). Alternatively, the non-UCITS fund must have requirements of the same effect in its constitutional document or offering document. A statement of the intended investment approach does not constitute a rule for this purpose.

ID 1003

Q. Guidance Note 2/03 on 'UCITS – Acceptable investments in other collective investment undertakings' lists categories of non-UCITS investment funds which are eligible for investment by UCITS. This list includes non-UCITS investment funds authorised in the US and which comply, in all material respects, with the provisions of the UCITS Notices. What category of US investment funds is being referred to?

A. Guidance Note 2/03 is referring to US investment funds which are subject to The Investment Company Act of 1940. It will be up to the UCITS to determine whether a specific US investment fund satisfies the requirements of Regulation 68(1)(e).

The CBI on issuing noted; "UCITS should be in compliance with this revised Q&A as soon as possible taking into account the best interests of the investors. In any event, compliance should be ensured no later than **5 October 2018.**"

Pre-July 2018 position:

The Central Bank weren't too prescriptive around the conditions that had to be met in order to invest in a non-UCITS CIS (namely that the underlying fund provided equivalent level of investor protection to that provided to investors in UCITS funds, in particular relating to rules on asset segregation, borrowing, lending, and uncovered sales of transferable securities and money market instruments.) The bank was comfortable if the underlying CIS operated in a manner so as to meet these requirements and a statement of same to provide the investing UCITS with a level of comfort was deemed sufficient.

Post July 2018 position:

Under the revised Q&A, the Central Bank has confirmed that a UCITS must ensure that one of the following conditions are met:

- 1. the underlying fund is subject to requirements in its jurisdiction of domicile which are equivalent to UCITS investor protections; or*
- 2. the constitutional document or offering document of the underlying fund must impose requirements of the same effect. The Central Bank has confirmed in the Q&A that a statement of intended investment approach does not suffice (i.e. these UCITS like limits need to be clearly detailed in the constitutional/offering documents)*

These revisions clarify that where a UCITS invests in a non-UCITS fund, the constitutional documentation of the target fund must clearly state a prohibition on investing more than 10% in other investment funds as well as disclosures relating to spreading of investment risk including concentration limits, ownership restrictions, leverage and borrowing restrictions; and that the non-UCITS must be subject to requirements in its jurisdiction of domicile which are equivalent to certain UCITS investor protections. If this is not the case the non-UCITS fund must have limitations to the same effect in its constitutional or offering documentation.

UCITS which currently invest in non-UCITS investment funds need to review their holdings of non-UCITS investment funds to ensure that the constitutional documents of these non-UCITS investment funds meet this requirement and **UCITS must realign their portfolios when this is not the case** (per the above, such a review was required by 5 October 2018).

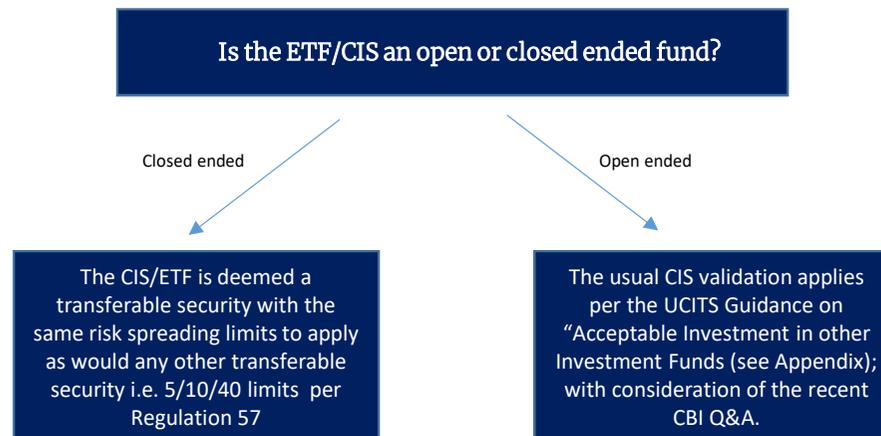
Next Steps

UCITS funds still have the same options available to them to gain exposure to an index, namely;

1. Purchasing units of an index tracking ETF; or
2. Gaining exposure to the index via derivatives

(both remain dependent on these being permissible investments per the prospectus etc.)

If the Investment Managers' intention is still to gain exposure through a CIS/ETF the following considerations must be made;



Appendix

UCITS Acceptable Investment in other Investment Funds

Investment in AIFs - Acceptable Types of AIFs

1. Subject to completion of the specific application procedures detailed below, the Central Bank will permit investment by UCITS in the following categories of AIFs:

- (a) schemes established in Guernsey and authorised as Class A Schemes;
- (b) schemes established in Jersey as Recognised Funds;
- (c) schemes established in the Isle of Man as Authorised Schemes;
- (d) Retail Investor AIFs authorised by the Central Bank provided such investment funds comply in all material respects with the provisions of the UCITS Regulations and the Central Bank UCITS Regulations;
- (e) AIFs authorised in a Member State of the EEA, the US, Jersey, Guernsey or the Isle of Man and which comply, in all material respects, with the provisions of the UCITS Regulations and the Central Bank UCITS Regulations.

- The consideration of “all material respects” should include, inter alia, consideration of the following: the existence of an independent depositary with similar duties and responsibilities in relation to both safekeeping and supervision;
- requirements for the spreading of **investment risk including concentration limits ownership restrictions, leverage and borrowing restrictions**, etc.;
- availability of pricing information and reporting requirements;
- redemption facilities and frequency;
- restrictions in relation to dealings by related parties

2. Other jurisdictions and types of AIF may be considered by the Central Bank on the basis of submissions made for that purpose. In assessing any submissions made, the Central Bank will have regard to:

- memoranda of understanding (bilateral or multilateral), membership of an international organisation of regulators, or other co-operative arrangements (such as an exchange of letters) to ensure satisfactory cooperation between the Central Bank and the competent authority of the AIF;
- whether the management company of the target AIF, its rules and its choice of depositary have been approved by its regulator;
- whether the AIF is authorised in an OECD jurisdiction.

The Following Factors Can be Used by The Central Bank to Guide a Decision on Equivalence:

- rules guaranteeing the autonomy of the management of the AIF and management in the exclusive interest of the unit holders;
- the existence of an independent depositary with similar duties and responsibilities in relation to both safekeeping and supervision. Where an independent depositary is not a requirement of local law as regards the AIF, robust governance structures may provide a suitable alternative;
- availability of pricing information and reporting requirements;
- redemption facilities and frequency;
- restrictions in relation to dealings by related parties;
- the extent of asset segregation; and
- the local requirements for borrowing, lending and uncovered sales of transferable securities and money market instruments regarding the portfolio of the AIF.

Such submissions would need to be detailed and comprehensive and should contain supporting documentation from the jurisdiction in question. In view of the detailed review which such a proposal would require, the complete submission would need to be provided to the Central Bank well in advance of an authorisation application.

Specific Application Procedures

3. The responsible person should confirm in writing to the Central Bank that investments in AIFs will fall under the categories outlined in this guidance. It is not necessary to refer to this confirmation in the prospectus.

4. In the case of UCITS which may invest more than 20% of net assets in other investment funds the prospectus should list:

- the jurisdictions in which prospective investment funds investments will be domiciled;
- the types of investment funds in which the UCITS will invest, including a description of their regulatory status