6 July 2018

Central Bank of Ireland: Markets Update on Investment by UCITS in Non-UCITS and the Organisational Effectiveness Role

As part of a markets update which was issued yesterday, the Central Bank has published a revised edition of its UCITS Q&A (**"Q&A"**) and has also published a Notice relating to its Fund Management Company Guidance, commonly referred to as CP86.

1. Revised UCITS Q&A

In its revised Q&A, the Central Bank has clarified its expectations relating to investment by UCITS in non-UCITS collective investment schemes ("**Target Funds**"). This will be of relevance not only to UCITS and their managers but also to non-UCITS funds whose investor base includes Irish UCITS.

Background

As readers will be aware, Article 50(1)(e) of the UCITS Directive allows UCITS to invest in a Target Fund provided that the Target Fund satisfies a number of specific conditions. These conditions include ensuring that the relevant Target Fund provides an 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.

Under guidance issued to date by the Central Bank, it did not insist on such investor protections being expressly imposed under the laws applicable to the Target Fund or being stated in the Target Fund's fund documentation, provided that the UCITS could satisfy itself that the

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Target Fund was in practice operating in a manner which complied with such requirements.

Changes introduced under the revised Q&A

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

> (i) the Target Fund is subject to requirements in its jurisdiction of domicile which are equivalent to UCITS investor protections; **or**
>
> (ii) the constitutional document or offering document of the Target 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 constitute a rule for this purpose.

Timeframe for compliance and action to be taken by impacted funds

The Central Bank has confirmed that it expects all UCITS to comply with the above Q&A as soon as possible taking into account the best interests of investors and in any event no later than **5 October 2018** (the "**Deadline**").

UCITS Funds: UCITS managers should now conduct a review of existing investments in Target Funds and confirm that such Target Funds comply with either (i) or (ii) above. If a Target Fund does not meet either of the above requirements, the UCITS will need to engage with the Target Fund to ensure that its fund documentation is revised as necessary to comply with (ii) above by the Deadline.

Non-UCITS Funds: Non-UCITS managers whose investor base includes, or may include, Irish UCITS should also carry out a review to make sure that such funds can comply with these requirements by the Deadline to ensure that the non-UCITS fund remains eligible for investment by Irish UCITS funds

2. Notice relating to CP86

Background

As readers will be aware, CP86 took full effect on 1 July 2018. One of the new requirements introduced under CP86 was the obligation for an independent director of a fund management company ("**FMC**") [1] to undertake an organisational effectiveness role.

Supervisory Focus on Organisational Effectiveness ("OE") Role

The Central Bank has advised that in assessing how FMCs have implemented the new requirements introduced under CP86, it will place specific emphasis on "*assessing the appropriateness of the Fund Management Company's resources and organisational structure*". It confirms that through supervisory engagements with relevant firms, it will "*focus on the assessment work performed by the*

[1] This term refers to UCITS management companies, AIFMs, self-managed UCITS funds and internally managed AIF funds

Organisational Effectiveness role holder and, in particular, how the board of the Fund Management Company has implemented any proposals to improve organisational effectiveness".

Next Steps for FMCs

This Notice serves as a timely reminder to boards of FMCs to ensure that the functions and responsibilities of the OE role have been clearly delineated and agreed with the OE director.

Boards should also ensure that:

- A robust reporting framework is put in place which can, if needed, demonstrate to the Central Bank that the OE director is monitoring the adequacy of the existing resources and the organisational structure of the FMC on an ongoing basis; and
- Where relevant, minutes, reports and other records maintained by the FMC evidence that appropriate action has been taken to implement any proposals put forward by the OE director to improve its organisational effectiveness.

FMCs who ignore this advance notice from the Central Bank of its intention to focus on the OE role in its supervisory engagement may well do so at their peril!

If you have any questions relating to implications of the revised Q&A or the Notice, please contact your usual contact at Dillon Eustace.

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