

Updated Central Bank Guidance on Financial Indices

The Central Bank of Ireland (“**Central Bank**”) has published updated guidance (“**Guidance**”) relating to the use of financial indices by UCITS for investment or efficient portfolio management purposes.

Background

In October 2018, the Central Bank introduced a self-certification obligation in respect of financial indices used by UCITS, with a pre-approval submission to the Central Bank required only in limited circumstances. Under this regime, UCITS management companies or self-managed investment companies (“**SMICs**”) (referred to in the Guidance as the “Responsible Person”) are required to assess each financial index that the UCITS intends to use in order to determine whether the index meets the regulatory requirements for financial indices. A director of the Responsible Person is required to certify in writing to the Central Bank that the relevant index meets the regulatory requirements when seeking authorisation of the relevant UCITS (or approval of an additional sub-fund in the case of an umbrella UCITS). Where an existing UCITS proposes to use a new index, the signed certification should be submitted to by way of a post authorisation submission prior to the UCITS gaining exposure to the relevant index.

Latest Guidance

On 23 July 2019, the Central Bank published updated **guidance** (“**Guidance**”) amending the certification process and clarifying the circumstances in which an index certification is not required to be submitted.

Certification will not be required in the circumstances set out below.

- Where the index is used for tracking or replication, investment or efficient portfolio management purposes and, on a look-through basis, the UCITS could invest directly in the constituents of the index / indices as permitted under the UCITS Regulations (for example, the “5/10/40” rule).
- Over time, market movements or other events may cause the weightings of a financial index to change so that it no longer complies with the “5/10/40” rule. Where this happens and on the basis that the UCITS confirms as part of its authorisation / post-authorisation process that the index meets the regulatory requirements (ie, it is comprised of eligible assets and complies with the “5/10/40” rule), the financial index will be deemed to meet index criteria set out in the Guidance.
- Where a UCITS uses an index solely as a performance benchmark.

A UCITS that proposes to use a financial index for which there is no requirement to submit an index certification should state, when making the authorisation application, that such index meets the regulatory requirements. The absence of such a statement will result in the Central Bank querying the

use of the index, and requesting the relevant certification, delaying the authorisation process. It is not currently clear from the Guidance what approach should be adopted by existing UCITS that do not have the ability to make this statement through the authorisation process, but it would be prudent for existing UCITS to review their current use of indices and confirm that they are in a position to make this statement and to furnish relevant information if required to do so, as noted below.

Comment

The clarifications provided in the Guidance are welcome and follow industry engagement with the Central Bank. The updates should reduce the number of self-certifications that are required to be submitted to the Central Bank. Self-certification will still be required where a financial index is comprised of either: (a) eligible assets, but it would not be possible for the UCITS to invest directly in such underlying assets without breaching the UCITS risk diversification rules; or (b) ineligible assets.

UCITS are still required to assess any proposed index prior to use to determine whether it meets the regulatory requirements for financial indices. The Central Bank may periodically conduct quality assessments of randomly selected financial indices used by UCITS to ensure compliance. Where the Central Bank selects an index for assessment, all relevant information must be provided immediately upon request. UCITS should therefore retain sufficient supporting documentation demonstrating that the financial index meets the relevant regulatory requirements and the Guidance and which can be provided to the Central Bank immediately upon request.

Please get in touch with your usual Asset Management and Investment Funds Department contact or any of the contacts listed in this publication should you require further information in relation to the material referred to in this update.

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