UPDATE

CBI Enhances Asset Suitability Review for New UCITS Applications

On 29 January 2020, the Central Bank of Ireland (the "Central Bank") published its latest UCITS Q&A which gives guidance on the asset suitability review process for new UCITS applications. The new question added asks whether a UCITS can invest in contracts for difference ("CFDs"), collateralised loan obligations ("CLOs"), contingent convertible securities ("CoCos") or binary options. In its response, the Central Bank elaborates on the additional scrutiny it will apply for these types of assets, and recaps the information that UCITS management companies[1] should produce.

Background

The UCITS regime contains various requirements designed to support investor protection, including rules around eligible assets, diversification, liquidity, valuation, risk management, compliance and oversight and safekeeping of assets.

In particular, when formulating a UCITS' investment objective and strategy, the UCITS Regulations[2] require UCITS management companies to *"employ a risk-management process which enables [them] to monitor and measure at any time the risk of the UCITS' positions and their contribution to the overall risk profile of the portfolio of assets of the UCITS*." This risk-management process must take account of Schedule 9 of the UCITS Regulations, including that UCITS management companies must:

- Employ an appropriate liquidity risk management process in order to ensure that the UCITS is able to redeem or repurchase units at the request of unitholders;
- Have a risk management policy that enable the assessment of the exposure to market, liquidity and counterparty risks, and all other risks, including operational risks for the UCITS;
- Conduct stress tests which enable assessment of the liquidity risk of the UCITS under exceptional circumstances; and
- Conduct, where appropriate, periodic stress tests and scenario analyses to address risks arising from potential changes in market conditions that might adversely impact the UCITS.

In addition, as set out in Schedule 5 of the UCITS Regulations, UCITS management companies must "*formulate forecasts and perform analyses concerning [a foreseen] investment's contribution to the UCITS portfolio composition, liquidity and risk and reward profile before carrying out the investment. The analyses shall only be carried out on the basis of reliable and up-to-date information, both in quantitative and qualitative terms.*"

Additional information and scrutiny

During the UCITS authorisation process, in addition to the standard suite of documentation, the Central Bank has stated that it may request additional information in the context of reviewing a specific application.

For example, where a UCITS proposes to invest in CFDs, CLOs, CoCos or binary options that UCITS may be subject to enhanced scrutiny at the authorisation phase with a view to ensuring that the proposal is appropriate taking into account the overall portfolio of assets proposed.

Such enhanced scrutiny may include the review of (i) model portfolio information; (ii) the due

[1] Including self-managed investment companies for these purposes.
[2] The European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011.

diligence carried out in respect of the proposed underlying portfolio; and (iii) evidence to support the view that the proposed investment portfolio is suitable taking into account the above-mentioned requirements. Information provided must be sufficiently detailed to enable the Central Bank to make an informed judgement on the particular application involved.

This guidance is welcome as it provides some more clarity on the Central Bank's expectations for the UCITS authorisation process.

Further Information

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