

UCITS Financial Indices

I. Background and Overview

1. The purpose of this guidance is to clarify ~~the circumstances under which a UCITS should seek clearance from the Central Bank of Ireland before using a particular index and to describe the information that should be submitted~~ Central Bank requirements where a UCITS intends to use a financial index for investment or efficient portfolio management purposes. It also clarifies other related areas such as the use of indices composed of ineligible assets and prospectus disclosure requirements. Finally, it sets out the certification required from the Responsible Person of a UCITS and the process relating to that certification.

2. The Central Bank recognises that financial markets continually evolve and it is therefore expected that this guidance will be updated as necessary to reflect such developments. ~~Industry participants are always encouraged to discuss index proposals with the Central Bank in advance of an application for authorisation of a UCITS.~~

3. The following is the key legislation and ~~relevant~~ documentation in this area:

- European Communities (UCITS) Regulations 2011 (the “UCITS Regulations”)
- Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1))(Undertakings for Collective Investment in Transferable Securities) Regulations 2015 (the “Central Bank UCITS Regulations”)
- Council Directive 2009/65/EC (the "UCITS Directive")
- Commission Directive 2007/16/EC implementing Council Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards the clarification of certain definitions ~~(the "Eligible Assets Directive")~~
- ESMA guidelines concerning eligible assets for investment by UCITS (March 2007, updated September 2008) (Ref: CESR/07-044b)
- ESMA guidelines concerning eligible assets for investment by UCITS – The classification of hedge fund indices as financial indices (July 2007 – Ref: CESR/07-434)
- ESMA guidelines on ETFs and other UCITS issues (August 2014 – Ref ESMA/2014/937)

II. General Considerations

4. In reading this guidance, it is important to note the following:

- ~~Based on the criteria outlined in paragraphs 5 to 11 below, it is the responsible person’s responsibility to determine whether or not an index should be submitted to the Central Bank for review. It is also expected that an index submission will be submitted to, and receive clearance from, the Central Bank prior to the application for authorisation.~~

- The regulatory requirements [and the Central Bank's certification process](#) apply to all financial indices, whether comprised of eligible or ineligible assets, whether used for investment or efficient-portfolio management (“EPM”) purposes, and whether exposure to [ana financial](#) index is obtained via ~~FDI or directly through replication.~~ [financial derivative instruments \(“FDI”\) or direct investment.](#)
 - The creation of leveraged exposure to [ana financial](#) index via FDI, or the inclusion of a leverage feature in [ana financial](#) index, should also be taken into account in meeting the quantitative requirements of the UCITS Regulations. This requirement generally applies to index structures incorporating embedded leverage features, such as algorithms and “multipliers” that give UCITS exposure to leveraged investment returns.
- ~~• Non-financial indices are not eligible investments for UCITS.~~

~~III.—Circumstances Where an Index Submission is Not Required~~

- ~~5. A responsible person that proposes to use a financial index for tracking or replication, investment or EPM purposes for a relevant UCITS is not required to submit that index to the Central Bank for clearance if, on a “look-through” basis, it would be possible for the UCITS to directly invest in the constituents of the index as allowed by the UCITS Regulations (for example the “5/10/40” rule as applied to equity and debt securities.) [1]~~

~~6. Over time, market movements or other events may cause the weightings of [thea 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 (i.e. it is comprised of eligible assets and complies with the “5/10/40” rule), the~~ [has provided a relevant certification the financial](#) index will be deemed to meet index criteria set out in paragraphs 12 to 20. Accordingly, ~~the index will not need to be submitted to the Central Bank for clearance when the 5/10/40 limits are exceeded.~~~~

~~7. A UCITS that proposes to use a financial index for which there is no requirement to obtain clearance should state, when making the application for authorisation to the Central Bank, that such indices meet the regulatory requirements. The absence of such a statement will result in the Central Bank querying the use of the index, thus delaying the authorisation process should an index application be required.~~

~~8. Where a UCITS uses an index solely as a performance benchmark, the Central Bank does not review the index.~~
~~-7 to 9.~~

~~IV.—Circumstances Where an Index Submission is Required—Indices Based on Eligible Assets~~

- ~~9. A responsible person proposing to use indices comprised of eligible assets should make an index submission to the Central Bank if it would not be possible for the UCITS to invest directly in such underlying assets without transgressing the risk spreading limits [Where a UCITS intends to use an index referred to in Regulation 71\(2\)](#) of the UCITS Regulations. ~~This does not apply to UCITS applying the “look-through”~~~~

~~approach outlined in paragraph 5 or where the “5/10/40” rule is exceeded in circumstances described in paragraph 6 above.~~

~~Circumstances Where an Index Submission is Required—Indices Based on Ineligible Assets, a Responsible Person should, at the time the UCITS seeks authorisation[1], provide a submission to the Central Bank, setting out that the limit in Regulation 71(1)(a) is to be raised to a maximum of 35% for a single issuer and why this is justified by exceptional market conditions.~~

~~10. If it is not possible for a UCITS to invest directly in the underlying constituents of a proposed index, the index should be submitted to the Central Bank for clearance[2]~~

- ~~11.~~ Regulation 9(11)(b) of the Central Bank UCITS Regulations provides:

“sub-categories of a commodity shall be regarded as being the same commodity for the calculation of the diversification limits set out in Regulation 71 of the UCITS Regulations if those sub-categories are highly correlated within the meaning of paragraph (12)”.

This includes, for instance, commodities from different regions or markets or derived from the same primary products by an industrialised process. As an example, WTI Crude Oil, Brent Crude Oil, Gasoline or Heating Oil contracts should be considered as being all sub-categories of the same commodity – oil.

- Where a UCITS uses an index solely as a performance benchmark, no confirmation or certification is required.
- Non-financial indices are not eligible investments for UCITS.

~~V.~~—**Summary of Financial Index Assessment Criteria**

~~12. Once it has been determined by the responsible person that an index requires clearance from the Central Bank, a submission should be made to the Central Bank demonstrating that the index:—~~5. The following describes the assessment criteria that should be applied by a Responsible Person when determining if an index meets the criteria for financial indices. The criteria are that the index should be:

- ~~is~~ sufficiently diversified;
- ~~represents~~represent an adequate benchmark for the market to which it refers;
- ~~is~~be published in an appropriate manner; and
- ~~is~~be independently managed from the management of the UCITS.

~~13.6.~~ Where a UCITS uses multiple financial indices each financial index should meet these requirements.

~~14. The documentary evidence that should be provided with respect to each of these criteria is detailed in paragraphs 15 to 21 below. In this regard, the Appendix provides a checklist to assist applicants prepare their submissions.~~
criteria.

~~VI.~~—**Index Assessment Criteria—General**

~~15. A submission will be reviewed under four headings: sufficiently diversified; adequate benchmark; publication; and independently managed. The Central Bank requires sufficient~~

~~documentary evidence to assess the submission and so it is important that all the relevant data and information is included. The submission should include, inter alia, any technical and marketing documents produced by the index sponsor. Review of an index will be delayed in the event of an incomplete submission~~

VII.—Index Assessment Criteria - Adequate Benchmark

~~16. The submission should provide the rationale as to how the proposed index achieves [7. A financial index should achieve](#) the objective of being a benchmark for the market to which it refers. ~~The methodology used to construct the index should be adequately described, including data on constituent selection criteria, constituent price collection procedures, asset allocation rules and guidelines for altering and re-balancing the index, its constituents and their weights. Details should also be provided as to how the index calculation methodology is verified. Finally, information should be provided on any fees embedded in the index.~~~~

VIII.—Index Assessment Criteria - Publication

~~17.8.~~ Regulation 71(1) (iii) of the UCITS Regulations requires that the [financial](#) index is published in an appropriate manner. An investor should be able to access relevant material information on the [financial](#) index with ease, for example, via the internet. ~~Index performance~~[Performance of the financial index](#) should be freely and continually available. Information on matters [relating to the financial index](#) such as ~~index~~ constituents, ~~index~~ calculation, re-balancing methodologies, ~~index~~ changes and information relating to any operational difficulties in providing timely or accurate information should also be available to the extent permitted by the index provider. Information that an index provider considers to be of a proprietary and commercially sensitive nature is not expected to be published in a detailed manner.

~~18.9.~~ Regulation 9(6)(a) of the Central Bank UCITS Regulations prohibits a ~~responsible person~~[Responsible Person](#) from investing in ~~a financial~~[an](#) index, “that rebalances on an intraday or daily basis, or the rebalancing frequency of which prevents investors from being able to replicate the financial index”.

Technical adjustments made to financial indices (such as leveraged indices or volatility target indices) according to publicly available criteria should not be considered as rebalancing in the context of Regulation 9(6)(a) of the Central Bank UCITS Regulations.

IX.—Index Assessment Criteria - Independently Managed

~~19. The Central Bank will take into account the~~[10. The](#) relationship, if any, between the responsible person and the index sponsor [should be taken into account](#). The performance of the [financial](#) index should be calculated in an independent environment, free from any external influences.

~~X.~~ Disclosure Requirements

~~20.11.~~ The UCITS should comply with the disclosure requirements set out in the UCITS Regulations and the Central Bank UCITS Regulations. If ~~an~~ a financial index is used for EPM purposes there is no requirement to disclose details of the financial index in the prospectus other than the fact that the UCITS will gain exposure to financial indices for such purposes

~~21.~~

12. The Central Bank recognises that a UCITS investment strategy may not, in all cases, be able to specify the exact financial indices that the strategy may require exposure to, or that it may be impractical to provide such detail in the prospectus. In such situations it is considered that the UCITS will provide sufficient detail on the types of financial indices being used in order to satisfy the investment strategy being pursued and where more specific information may be accessed, for example, in the annual reports of the UCITS, insofar as that is practical and permitted.

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Certification

13. Based on the criteria outlined above, a Responsible Person should assess each index that the UCITS intends to use in order to determine whether the index meets all of the regulatory requirements. Once determined that this is the case, this must be certified by the Responsible Person when the UCITS seeks authorisation, (or approval of an additional sub-fund in the case of an umbrella UCITS).

Where the Responsible Person has determined that an index is eligible, the following certification must be provided[2] :

I (being a director of the Responsible Person), on behalf of the [Responsible Person] of {name of UCITS} certify that {name of Index} is a financial index which complies with: the requirements of the UCITS Regulations 2011, the Central Bank UCITS Regulations 2015 and the Central Bank's Guidance on UCITS Financial Indices. [name of Index] is a UCITS eligible financial index.

Where a previously authorised or approved UCITS/sub-fund of an umbrella UCITS proposes to use a financial index, the certification should be provided by the Responsible Person to the Central Bank by way of post authorisation submission.

Quality Assessments

14. The Central Bank will periodically conduct quality assessments of randomly selected financial indices used by UCITS to ensure that they comply with relevant regulatory requirements and guidance.

Where the Central Bank identifies a financial index for assessment, it will request a written submission, with supporting documentation, from the Responsible Person demonstrating that the financial index meets relevant regulatory requirements and guidance. This information must be provided immediately upon request.

Sufficient documentary evidence should be provided to assess the financial index and so it is important that all the relevant data and information is included. The submission should include any technical and marketing documents produced by the index sponsor.

The Central Bank will expect a Responsible Person (at least) to provide

- the rationale as to how the proposed index achieves the objective of being a benchmark for the market to which it refers;
- the methodology used to construct the index (which should be adequately described and include data on constituent selection criteria, constituent price collection procedures, asset allocation rules and guidelines for altering and re-balancing the index);
- information on index constituents and their current as well as historic weights;
- details as to how the index calculation methodology is verified; and
- information should be provided on any fees embedded in the index.

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[1] Or: at time of approval in the case of an additional sub-fund to an umbrella UCITS; by way of a post-authorisation submission in the case of previously authorised / approved UCITS/sub-funds.

~~XI. APPENDIX~~

~~XII. Index Review Checklist~~

~~[1] The Regulations restrict a UCITS exposure to a single issuer so that a UCITS may invest no more than 10% of its assets in transferable securities or money market instruments issued by the same body, provided that the total value held in the issuing bodies in each of which it invests more than 5% of its net assets must not then exceed 40% of the net asset value (“NAV”) – the “5/10/40” rule.~~

~~[2] Indices based on FDI on commodities or indices on property may be eligible provided they comply with the criteria set down for Financial Indices in Notice UCITS 10, in Notice UCITS 21 and in this Guidance Note.~~

[2] To be amended as appropriate for multiple index submissions.