

CP130 - Central Bank of Ireland consultation paper on treatment, correction and redress of errors in Investment Funds

Introduction and Background

On 9th September 2019, the Central Bank of Ireland (“CBI”) published its long awaited regulatory framework (“the Framework”) consultation paper CP130 “Treatment, Correction and Redress of Errors in Investment Funds”. The consultation paper is part of a process designed to establish both rules and guidance in relation to errors in investment funds.

In 2014, the International Monetary Fund (“IMF”) made a recommendation to the CBI that it publish rules to stipulate how pricing errors should be handled for Irish funds. Following this, the CBI undertook a thematic review of the funds industry’s approach to/treatment of NAV errors which have been based on the industry guidance issued by Irish Funds.

The key finding from the CBI’s thematic review was that whilst the application of industry guidance was ‘widely adopted and employed’, there were a number of areas including reporting that required attention. The CBI wishes to use the Framework to ensure that there is a clear and consistent approach in dealing with fund errors/breaches and reporting in the industry.

The Framework outlines that once an error has been identified, it must be “appropriately rectified”. The term ‘appropriately rectified’ entails:

- Identification and classification of the error (including assessing materiality)
- Correction of the error (including compliance with any reporting and notification obligations)
- Redress of the error (including the payment of redress to investors).

Who is directly affected by the Framework?

Fund management companies, which are UCITS management companies, authorised Alternative Investment Fund Managers (“AIFMs”), self-managed UCITS investment companies and internally managed Alternative Investment Funds (collectively “ManCos”), which includes AIFMs appointed to non-Irish authorised funds, are directly affected. ManCos are ultimately responsible for ensuring that an error is “appropriately rectified”. CP130 suggests that the depositary will be required to ensure that the error has been “appropriately rectified” by the ManCo.

Error Types

Under the Framework, there are four potential error types:

- A NAV Error, which is an error in the calculation of the Net Asset Value
- An Investment Breach Error, which relates to the investments of a fund and non-compliance with the applicable investment restrictions
- A Fee error, that is an error related to the overpayment of a fees
- A Control Breach error, which is a type of error that does not fall into the three categories. Such errors may indicate a significant control failure despite not having a monetary impact on the fund / investor.

Treatment of Errors

Once an error has been identified, the CBI states it must be corrected without delay. The ManCo and depositary will also have to assess the materiality of the error as this will affect the treatment of that error in terms of reporting, notification and redress. When considering materiality, the CBI is of the view that there may be quantitative materiality thresholds and qualitative materiality factors to consider.

From a quantitative perspective, it is proposed that any error should be considered material if it results in an impact the same or greater than:

- 0.10% of NAV for a money market fund; or
- 0.50% of NAV for other investor funds

The CBI proposes a qualitative overlay, so that even if an error is deemed not to meet the quantitative threshold, it should be assessed in the context of qualitative factors, e.g. the existence of inadequate controls.

Reporting

Under existing legislation, the CBI must be notified by the ManCo and the depositary of any breach of the Irish UCITS Regulations/AIFM Regulations or other relevant Irish legislation, regardless of the materiality of that breach. Under CP130, it is proposed that the CBI must be notified of material errors only.

Under the Framework, the ManCo will be obliged to:

- Report errors to the depositary which would meet the regulatory reporting requirement, or
- Report any material error which has not been reported by the depositary to the CBI.

The Framework notes that both the ManCo and the depositary will be required to maintain a written record of all errors that occur. This will be a new requirement in respect of depositaries for AIFs as this obligation is already in place for depositaries of UCITS funds.

Notification to investors

The CBI proposes to introduce an obligation on ManCos to notify investors of any error found to be material irrespective of whether redress is required or not.

Redress

The CBI has set out a list of elements that are proposed to be included in the Framework where the ManCo is ensuring payment of redress. These elements include:

- In the case of NAV Errors or Control Breach Errors deemed to be material, the payment of redress should be made in all circumstances;
- In the case of Investment Breach Errors, the payment of redress should be made in all circumstances where the error is as a result of an advertent breach (regardless of materiality);
- In the case of Inadvertent Investment Breach Errors, the payment of redress will generally not be payable unless otherwise determined by the depositary; or
- In the case of Fee Errors, the payment of redress must be made in all circumstances (with the amount of redress reflecting the amount of overpayment).

CP130 - Next Steps

The consultation paper is open for responses until 9th December 2019. Stakeholders are advised that comments should be provided to fundspolicy@centralbank.ie. The CBI intends to publish all written contributions submitted in addition to providing the finalised requirements of the Framework.

KB Associates' Services

KB Associates offers a range of services including:

- The provision of ManCo services.
- The provision of designated persons to perform UCITS business plan and AIFMD programme of activity managerial functions.

If you would like to discuss any issues raised in this article or related to KB Associates' services in general, please feel free to contact Mike Kirby (+353 1 667 1980), Peter Northcott (+44 203 170 8813) or Mike Parton (+1 345 946 4224).