

CBI Streamlines Russia Side-Pocketing Process for UCITS Funds

Background

The invasion of Ukraine by Russia has had a significant impact on global financial markets. In May 2022, the European Securities and Markets Authority (“ESMA”) released a public statement in which it addressed measures to be taken to manage the impact on funds holding securities with exposure to Russia, Ukraine and Belarus.

The ESMA public statement supports the use of side pockets as a liquidity management tool where *“preferable from an investor protection perspective compared to a temporary suspension that would not allow existing investors to access liquidity”*. Side pockets are used by funds to separate riskier, bad or illiquid assets from the rest of a portfolio. ESMA also stated that *“in particular, the use of side pockets might prevent the need to suspend all subscriptions and redemptions and provide initial investors with protection against potential dilution effects, especially where the illiquid assets are valued at zero or significantly lower prices.”*

The Central Bank of Ireland (“CBI”) issued a notice of intention outlining its approach shortly after the ESMA public statement. A summary of this approach is included in this note.

Summary of the CBI Approach

The CBI will allow a UCITS to implement side-pocket arrangements only for Russian, Ukrainian or Belarusian assets which have been directly and/or indirectly impacted by the Russian invasion of Ukraine and/or related sanctions imposed (“Affected Securities”). According to the CBI *“The side pocketing of UCITS assets is only available in the context of Affected Securities and should not be interpreted as creating a precedent by the CBI for any other current or future situations.”* Affected Securities are such instruments which have become illiquid, non-tradable or difficult to value accurately as a result of the Russian invasion of Ukraine.

The CBI will allow a side-pocket arrangement by way of a newly approved clone UCITS fund/sub-fund into which liquid assets of an original UCITS may be transferred. Shareholders in the newly established clone UCITS fund/sub-fund will hold shares in that fund pro-rata to their holdings in the original UCITS. Investors in the original UCITS will continue to have a pro-rata holding in the original UCITS. The original UCITS would be wound down over time with any realised value paid out to shareholders.

The CBI side pocket by use of a clone UCITS fund/sub-fund approach is permitted provided that:

- The proposal is in the best interests of unitholders.
- Investors have approved the transfer into the newly established clone UCITS side-pocket.
- The UCITS has obtained prior written approval of the CBI for the proposal.
- The UCITS provides a clear description to unitholders of the costs and fees associated with establishing the side-pocket. The UCITS must also provide details of the ongoing costs and fees payable in its prospectus.
- The original UCITS is placed in wind-down mode at the same time as the creation of the new clone UCITS fund/sub-fund.
- The original UCITS has established written policies in relation to management of the Affected Securities, including policies relating to the costs and fees associated with maintenance of the original UCITS.
- The original UCITS reports to the CBI on an annual basis confirming whether or not the parameters and policies continue to be respected and outlining the prospects and/or plans for the side-pocketed assets and liquidation of the original UCITS.

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The CBI has proposed a streamlined authorisation/approval process to facilitate the implementation of the side-pockets arrangements. An application for approval of a new fund/sub-fund will be processed by the CBI in five working days provided that they are accompanied by:

- A confirmation from the directors of the fund that the new fund/sub-fund is identical to the original UCITS
- A copy of the Resolution approving the establishment of the new fund/sub-fund
- A mark-up of the investment objective and policy against that of the original UCITS

KB Associates' Services

KB Associates provides a range of services to investment funds including:

- The provision of UCITS management company/AIFM services.
- The provision of designated persons to perform UCITS business plan/AIFMD programme of activity functions.
- The provision of operational and compliance services to both UCITS and AIFMD compliant structures.

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