TRIUM IRELAND

Guide to UCITS 2020

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INTRODUCTION – THE EVOLUTION OF UCITS

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Undertakings for Collective Investment in Transferable Securities (UCITS) were introduced in the mid 1980's with the intention of creating harmonisation in fund structures across the European Union. Over the subsequent decades, UCITS has become firmly established as the most successful cross border fund product ever conceived and continues to go from strength to strength.

The possibility of establishing a fund product in one EU Member State which could be sold across all EU Member States, without the need for subsequent authorisations, has been transformative to the European fund management industry. The 'fund passport' has opened up new markets for fund promoters to sell their products, and has given investors access to a range of products that would previously have been unimaginable. These products are delivered in a fund format which has investor protection, transparency and liquidity at its core.

Such has been the unrivalled success of UCITS that the brand has become firmly established as the brand of choice far beyond the shores of Europe; in Asia, South Africa, Latin America and, more recently, in Canada, the growth of UCITS continues unabated.

There have been a number of iterations of the UCITS Directives, but UCITS III has had the most far-reaching implications for the instrument types and strategies that could be deployed in UCITS funds. Whilst the fundamental rules around liquidity and risk management were unchanged, this Directive permitted the use of exchange traded and over the counter derivatives as part of the investment process rather than purely for hedging purposes. This widened the scope of UCITS funds, introduced the ability to take short positions (physical shorting is not allowed, but synthetic shorting through instruments such as CFDs is permitted), and heralded the entry of alternative UCITS into the product mix.

Alternative UCITS funds began to attract considerable assets after the global financial crisis and became the fund vehicle of choice for many investors who had previously primarily invested in offshore hedge funds. The combination of the flexibility afforded by UCITS III, and the strict rules around liquidity, risk management and diversification, represented a compelling proposition for investors looking for alpha but with all the protections that UCITS provide.

Trium Ireland Limited is here to help. We are experts in the structuring of UCITS Funds, the cross-border distribution of UCITS and indeed the EU regularity landscape. Whether you are considering an appropriate distribution strategy to address the challenges of Brexit, or you are simply looking to tap into the vast UCITS investor base, Trium can help. We hope that this guide is useful – we are available to discuss any aspects of it. Please also refer to our *"Guide to Establishing an Alternative Investment Fund in Ireland.*

TRIUM IRELAND'S SOLUTIONS

Trium Ireland Limited ("**Trium**") is a full scope UCITS Management Company and AIFM. Trium delivers a turn-key solution for the establishment and distribution of EU funds, both UCITS and AIFs. Our hands-on approach means we spend a lot of time up front with clients in order to design the optimal product for the target investor base, giving consideration to the unique features of the underlying strategy.

Trium Ireland's services include:

- Fund product design and structuring
- Hosting of UCITS and AIFs
- Country registrations
- Distribution Support
- Annex IV Reporting
- KIID Production
- Risk Management
- Trading and operations for early stage managers

Our sister business Trium Capital LLP ("**TCL**") is an FCA regulated alternative asset manager. TCL runs a range of alternative investment funds and managed accounts.

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THE GROWTH OF THE UCITS MARKET AND KEY FACTS ABOUT UCITS

UCITS are distributed globally to a broad range of investors and have been the main growth engine for the European fund management industry over the last few decades. Originally intended for retail investors, UCITS have become internationally recognised in the funds industry as the 'gold standard' for investor protection.

With many liquid strategies now being compatible with the UCITS structure, and the investor demand for the fund structure continuing to grow unabated, this increase is expected to continue. The Association of the Luxembourg Fund Industry, ALFI predicts that the UCITS industry will hit €42 trillion by 2048 which could make Europe the home of the largest funds industry in the world at that point in time.

Key facts and figures on the current UCITS market;

- UCITS hold 76% of overall share in terms of retail market size compared to 15% and 9% for retail AIFs and Structured Retail Products in the EU.[1]
- UCITS funds accounted for assets of €10.5 trillion at the end of Q3 2019. [2]
- Net Sales of UCITS were €157 billion in Q3 2019.[2]
- Total sales of UCITS in 2019 have surpassed €247 Billion in the first three quarters. [2]
- Net sales of UCITS in Ireland during Q3 2019 exceed €100 billion. [2]
- Twenty-one countries attracted positive net sales in Q2 2019.
- 70-80% of publicly sold funds in Asia are UCITS

[1] ESMA Annual Statistical Report on Performance and costs of retail investment products in the EU 2019 – No.1 2019
[2] EFAMA – Quarterly Statistical Release Q3 2019 – December 20119 N°79

WHAT ARE UCITS FUNDS?

UCITS - Undertakings for the Collective Investment in Transferable Securities.

UCITS is an EU regulated fund vehicle that has been in existence for over 30 years, which has the ability to be sold on a cross border basis within the European Economic Area (EEA), based on its authorisation in one EU member state. This offers asset managers the opportunity to significantly expand their investor bases beyond their home market. UCITS funds are capable of being sold to both retail investors and institutional investors and are often marketed to both.

UCITS are opened-ended investment funds and can be established as:

1. Variable capital companies – *Companies are registered under a series of Acts called the Companies Acts. A company is managed for the benefit of its shareholders. Variable capital companies may repurchase their own shares.*

2. Irish Collective Asset-management Vehicles (ICAVs) – *ICAVs are corporate vehicles designed specifically for Irish investment funds providing managers and promoters with a corporate structure that is specifically designed for investment funds whilst limiting the compliance requirements under Irish company law provisions originally intended and designed for trading companies, and providing flexibility from financial reporting.*

3. Unit trusts – *A unit trust is an unincorporated fund structure that allows funds to hold assets and provide profits that go straight to individual unit owners instead of reinvesting them back into the fund. The investment fund is set up under a trust deed and is not a separate legal entity. The trustee acts as the legal owner of the fund's assets on behalf of the investors. The investor is effectively the beneficiary under the trust. A trust may be setup as an umbrella structure with segregated liability between sub funds.*

4. Common Contractual funds (CCF) – A *CCF is an unincorporated body established under a deed, by a management company, where investors are "co-owners" of underlying assets which are held pro rata with their investment. Generally, setup where a tax transparent vehicle is required. Its income and gains are treated as income and gains of each unit holder directly. A CCF may be setup as an umbrella structure with segregated liability between sub-funds.*

5. *SICAV - a publicly-traded open-end investment fund structure common in Luxembourg, Switzerland Italy Spain, Belgium, Malta, France, and the Czech Republic. SICAV is an acronym in French for 'Société d'Investissement à Capital Variable', which can be translated as 'Investment Company with variable capital.*

The choice of fund structure is one of the key decisions to be made at the outset of a fund setup as it will determine the tax treatment of different categories of investors.

UCITS funds are also sold in many non-EEA countries. Given their long-established framework of rules and investor protection, many investors have opted for the regulatory protection that UCITS offer.

A UCITS may be setup as a single fund or as an umbrella structure comprised of individual sub-funds with different strategies and objectives and with limited liability between the sub-funds.

UCITS continue to evolve, with UCITS Directive 2014/91/EU (commonly referred to as UCITS V) which came into force on 18 March 2016 being the latest update.

UCITS DOMICILES

Where UCITS are typically domiciled?

The structure of UCITS is designed to give managers a great deal of flexibility within the EU. The UCITS rules are the result of various EU directives which are transposed into national legislation across the EU member states. Therefore, in theory, a UCITS fund can be established in any EU member state.

In practice Ireland and Luxembourg have been the preferred domiciles for UCITS funds, currently these two countries account for 57%[3] of assets invested in UCITS funds. Both countries now have well established and mature infrastructures to service UCITS funds with comprehensive choices of high-quality service providers.

One of the first steps in establishing a UCITS fund is choosing the domicile.

There are many factors that can influence a manager's decision of where to domicile their UCITS funds; for example, distribution strategy and location of target investors, service provider considerations based on the fund's characteristics, legal system, language and political and economic stability.

Ireland has established itself as a centre of excellence for UCITS having been pro-active in implementing the UCITS Directives into domestic legislation and developing an efficient regulatory approval process.

A survey conducted by the Economist Intelligence Unit (on behalf of Matheson) of global asset managers revels that Ireland is consistently highly regarded in all areas relating to fund domiciles:

- 71% of global asset managers indicate that, if starting over, they would choose Ireland as one of their top 3 European fund domiciles. [4]
- As a European fund domicile, 73% of managers ranked Ireland as a top-3 jurisdiction in terms of its legal and tax framework for investment funds. [4]
- 72% of managers ranked Ireland as a top–3 domicile as regards business conditions for domiciling funds. [4]
- 67% of respondents ranked Ireland as a top-3 domicile as regards regulatory conditions. This included regulatory sophistication, accessibility, and responsiveness. [4]

[3] EFAMA – Quarterly Statistical Release Q3 2019 – December 20119 N°79
[4] Matheson – Choosing a European fund domicile: The views of global asset managers. A survey conducted by the Economist Intelligence unit on behalf of Matheson.

Current UCITS market in Ireland

- 75% of all assets domiciled in Ireland are held in UCITS funds.[5]
- Ireland had a total net sales of over €100 billion in UCITS during Q3 2019.[3]
- Ireland had a combined total of 4,658 UCITS funds as of Q3 2019.[3]
- Irish domiciled funds are currently sold to 90 countries globally. [5]

Benefits of Ireland as a Fund Domicile

Ireland has cultivated a reputation as a major player in the international financial services industry. Ireland's geographical position, in the same time zone as London, allows business to be conducted with Japan, Hong Kong and Australia in the morning and North and South America in the afternoon.

In April 2019 the Government of Ireland also launched "*Ireland for Finance*" a whole-of-government approach for the further development of the international financial services sector through to 2025. This demonstrates Ireland's continued commitment to ensuring it remain a centre of excellence for financial services.

Listed below are some clear examples of the benefits of Ireland as a fund Domicile:

- Ireland is an English language speaking country with a common law system.
- Ireland is a committed EU Member State and benefits from the harmonisation of EU financial services regulation. It therefore qualifies as a UCITS and AIF domicile and as a "home" or "host" state for the provision of EU investment services under MiFID to the European Market consisting of 500 Million consumers.
- Ireland is a participating member of the Economic and Monetary Union and has the euro as its currency.
- Ireland operates an attractive tax environment to the funds industry by offering a range of tax-exempt fund vehicles (including ICAVs, investment companies, unit trusts, investment limited partnerships and common contractual funds) to suit most investor requirements.
- Ireland was the first regulated jurisdiction to provide a regulatory framework specifically for the alternative investment fund industry and is at the forefront of product innovation, providing opportunities and solutions for this sector.
- Ireland has a well-developed technological and information infrastructure with sophisticated telecommunications networks.
- 53% of 25–34 year olds in Ireland have a third level qualification (OECD) higher than any other country in the EU. [6]
- Ireland's professional services infrastructure is well developed and experienced, with the specialist legal, tax and accounting skills necessary to support the funds and financial services industry.

5 https://www.irishfunds.ie/getting-started-in-ireland/why-ireland

6 Why Ireland – Irish Funds Brochure - https://irishfunds-secure.s3.amazonaws.com/1551880566-5648-Irish-Funds-Why-Ireland-Brochure_EU_WEB.pdf

- Ireland has one of the most developed and favourable tax treaty networks in the world, with a continuously expanding double taxation treaty/agreement network including over 70 countries.
- Ireland was ranked 7th on the IMD World Competitive Rankings 2019 with only Switzerland and the Netherlands in Europe scoring higher. [7]
- There are currently over 7,000 funds domiciled in Ireland. [8]

Service Providers for Irish Domiciled UCITS

Trium has built strong relationships with tier 1 service providers and brokers. These relationships are central to a partnership with Trium and help us provide our partners with a quick and efficient service to getting their UCITS funds to launch.

Service Provider	Required under UCITS or Irish Law
Administrator	UCITS must appoint an administrator incorporated in Ireland and authorised to provide administration services by the Central Bank: The Administrator is responsible for: - Processing fund subscriptions and redemptions - Calculating the net asset value (NAV)
Depositary	UCITS must appoint a depositary which may be: - A credit institution - An institution authorised by a national competent authority under the UCITS Directive. The depositary is responsible for: - Safekeeping the assets and settling trades - Cash monitoring - Overseeing the activities of the administrator
Investment Manager	An investment manager must be regulated in its home country, which must be a country recognised by the CBI as having equivalent regulatory oversight
Legal Advisor & Listing Agent	The fund's legal advisers will advise on matters of Irish law (where relevant) and of the UCITS requirement, draft fund documentation and material contracts, and acts as the main liaison with the CBI. If a fund wishes to be listed on the Irish Stock Exchange, a listing agent is required. Many of the legal advisors offer listing agent services as do a number of stockbroking firms. Legal advisors also provide documentation services to fund platforms from submission to the CBI

[7] IMD World Digital Competitiveness Ranking 2019 - https://www.imd.org/wcc/world-competitiveness-center-rankings/world-digital-competitiveness-rankings-2019/
[8] Why Ireland – Irish Funds Brochure - https://irishfunds-secure.s3.amazonaws.com/1551880566-5648-Irish-Funds-Why-Ireland-Brochure_EU_WEB.pdf

Tax Advisor	UCITS may appoint a tax advisor to advise on disclosures relating to taxation in the prospectus, on accessing double taxation treaties and general tax compliance.
Irish Resident Directors	There is a regulatory requirement to appoint two Irish resident directors, one of whom must be independent. The directors of a fund (both Irish resident and non-Irish resident) are subject to the approval of the Central Bank.
Money Laundering Reporting Officer	An Irish investment fund is required to appoint a Money Laundering Reporting Officer ("MLRO"). There is no requirement that this position be filled by an Irish resident.
Company Secretary	Irish Company Law requires every company to have a company secretary.
Auditor	UCITS need to appoint an auditor. The 'big four' and several other firms provide audit services to funds.
Management Company	A UCITS, if it is not a self-managed investment company, must appoint a management company or must appoint a minimum of two local designated persons.
Distributor	There no requirement under UCITS or Irish Law to appoint a distributor.
Foreign Registration Service	There is no requirement under UCITS or Irish law to appoint a foreign registration service, however if the funds are to be registered for distribution in various countries, these countries may have requirements that the fund hire paying agents, information agents etc.

Liquidity- UCITS funds through their design and the implementation of legislation are required to be liquid, and must be able to meet redemption requests on at least a fortnightly basis. The most common liquidity option in UCITS funds is daily, although some do offer weekly or bi-monthly liquidity. In order to ensure they meet these requirements the underlying investments in UCITS tend to also be highly liquid. As UCITS continue to evolve, liquidity risk management is a key area of focus for regulators. In both Luxembourg and Ireland, regulators require details on the liquidity risk management process to be detailed and documented.

Investor Protection- UCITS are regarded as the one of most highly-regulated funds because of the necessity to comply with a common European standard. The increased responsibility of service providers (Management Company, depositary, administrator etc.) means a UCITS fund has a lot of in-built protection and oversight, for example; a UCITS fund must appoint an independent depositary to hold fund assets and such assets must be held in segregated custody account with the depositary. The depositary is responsible for the safekeeping of the assets and settling trades, cash monitoring and overseeing the activities of the administrator. Ireland and Luxembourg with their histories of being the preferred domicile for UCITS funds have experienced and competitive service providers available to ensure independence in key support and oversight functions.

Risk Management- UCITS funds with their investment and borrowing limits, which apply to all UCITS, ensure that the funds are spreading and limiting their investment risk appropriately. UCITS management companies are also obligated to consider and document the policies and procedures for all material risk to the UCITS under management including liquidity risk and operational risk either through their Risk Management Plans (Luxembourg) or in a Risk Framework according to CP86 (Ireland). UCITS also require a comprehensive governance framework which includes local substance such as independent directors, regular (usually quarterly) board meetings and a management company or conducting officers/designated persons responsible for the oversight of the management of the UCITS.

Transparency- UCITS must publish a prospectus and a Key Investor Information Document (KIID) which provide the investors with information on the essential elements of the fund and detail where and how to obtain additional information. Financial statements must be published annually (audited) and semi-annually (unaudited). Most investor documents have been standardised with few exceptions, making UCITS easier to market in the EU.

Tax- UCITS tend to receive the most favourable tax treatment in the EU. Many EU countries have introduced tax incentives which make UCITS products more attractive relative to offshore funds. UCITS funds that are domiciled in Ireland or Luxembourg are generally considered “tax neutral” and there is no tax levied at the fund level. Luxembourg and Ireland also benefit from access to many double taxation treaties with other countries which can allow for reduced levels of withholding taxes on dividend and/or coupon payments.

The UCITS Brand- UCITS is already a globally recognised brand regarded for their consistency and investor protections. Investing in a UCITS gives reassurances and the peace of mind that UCITS have built their reputation on. UCITS, although a European product, has a large market in both the Asia Pacific region and the Middle-East Africa region.

WHY UCITS … FOR MANAGERS

Wide Range of Eligible Investment Strategies - The UCITS framework has been expanded over its lifespan by various directives and acts of legislation. The UCITS III regulation in 2002 and the eligible assets guidelines in 2007 both expanded the list of eligible assets that UCITS funds can invest in. Including derivatives in this list has allowed fund managers to replicate many alternative strategies in a UCITS format.

Structuring – UCITS may be structured as either stand-alone funds or umbrella funds. Umbrella funds are structures that typically will contain two or more sub-funds, with each sub-fund having separate investment policies, and in some cases separate investment managers, with segregated liability between the sub-funds. For firms wishing to enter the European market without bearing the full weight of costs and regulatory burden entailed in setting up a new standalone or umbrella fund, a common solution is the UCITS platform model. A platform provider can create a new sub-fund under a pre-existing umbrella fund and delegate investment management to the respective manager so that they can focus on portfolio management and return generation, leaving other duties to the platform manager. The platform model permits taking advantage of economies of scale with respect to certain aspects of costs and the regulatory burden

Investor Diversification – Institutional investors are looking to diversify their assets and strategies whilst alternative investment managers are looking to diversify their client base. Alternative strategies wrapped in the UCITS structure are a great way for both managers and investors to meet each other's needs.

Cost Saving – UCITS have access to advantageous double taxation treaties/agreements which allow for reduced withholding tax rates to apply on dividend income from certain countries.

Distribution – One of the main benefits of UCITS funds is the European Economic Area (EEA) wide "passport" which means that once a UCITS fund is authorised in one EEA member state, they can be sold in any other EEA member state without the need for additional authorisation. This means that the opportunities for distribution of UCITS funds are not confined to the home domicile of the fund but are expanded to the entire EEA from one authorisation.

A notification is required before sale can begin; however, this process is significantly shorter with less regulatory red tape than an authorisation request.

The notification procedure involves providing your home state regulator with a notification letter (a standard template) which includes the following

- Fund Rules
- Latest Annual and/or Semi-annual report
- KIID
- Prospectus

Although there are costs associated for each country where a UCITS fund is to be taken public - primarily local regulatory application cost, local agent costs, and translations (if applicable), and then ongoing regulatory reporting, NAV publication - registration is a relatively painless and inexpensive process.

The strong brand recognition that UCITS have developed over their 30+ year history means they continue to be the preference of many professional investors. Many institutional investors devote a large part of their allocation of portfolios to regulated funds such as UCITS for a multitude of reasons such as regulatory restrictions, self-imposed restrictions, risk appetite, transparency or liquidity requirements.

There is currently no consistent European wide private placement regime and some countries have withdrawn their private placement regimes in the wake of the AIFM Directive. This can lead to expensive legal costs in securing advice around the uncertainty on the rules for marketing unregulated funds in certain jurisdictions. This compares unfavourably with the ease and clarity of the UCITS distribution rules and makes the UCITS structure even more desirable.

Trium has extensive experience in EEA country registrations with established partnerships in most EEA countries and can provide our partners with expert advice in this area.

BASIC OUTLINES OF UCITS REGULATIONS

The UCITS regulations contain many investment rules. These rules come from EU UCITS directives which have been implemented into national legislation in the various EU countries, advice from ESMA, and national regulators (although most rules are harmonised across the EU certain rules can be interpreted slightly differently between fund jurisdictions).

The main UCITS rules can be divided into the following categories:

(i). Eligible assets
(ii). Eligible markets
(iii). Liquidity rules
(iv). Risk spreading rules
(v). Rules relating to derivatives
(vi). Rules relating to efficient portfolio management

Below is a brief description of the above categories, this is not intended to be an exhaustive list, the intention is to give you a flavour of the type of regulations UCITS are required to follow:

i) Eligible Assets

- Transferable securities
- Money market instruments
- Financial derivative instruments ("derivatives" or "FDIs")
- Open-ended collective investment schemes
- Deposits with credit institutions
- Ancillary liquid assets
- Financial indices

ii) Eligible Markets

For transferable securities and money market instruments:

- UCITS can only invest in regulated markets (subject to 10% limit in unlisted securities and rules regarding issuers of money market instruments – see below);
- The onus is on the UCITS to ensure that all markets into which the UCITS will invest are regulated markets (the regulator will not confirm this) i.e. that the markets are open to the public, recognised, regulated and operate regularly.

iii) Liquidity Rules

- A UCITS fund must re-purchase or redeem its shares/units at the request of any unit holder. UCITS funds can operate via daily, weekly, or bi-monthly dealing. A UCITS can impose a 10% of NAV limit on the amount of redemptions that are paid out on any one dealing day. The balance is then carried forward to the next dealing day and added to other redemption requests.

- A temporary suspension of redemptions is permitted in exceptional circumstances if in the interest of unit holders.

iv) Risk Spreading Rules

This is one of the most important sections of the UCITS legislation, it deals with the investment restriction limits imposed on UCITS products. Careful review of these rules is required before any UCITS launch in considered. The below is a summary of the key rules

The risk spreading rules can be divided into the following categories:

- Unlisted securities – Max 10% of NAV in Unlisted Securities (certain limited exceptions apply)
- 5/10/40 exposure rules (also 5/25/80) – Max 10% of NAV with any one issuer. If investment in one issuer exceeds 5% of NAV a max of these investments in total is 40% of NAV
- Control rules – Max 10% of non-voting shares, debt securities, and money market instruments in any one issuer
- Index Tracking funds – 20% of NAV
- Government Securities – Up to 100% of NAV may be invested in instruments issued by a member state
- Borrowing rules – A fund may borrow up to 10% of NAV for temporary purposes only
- Cash and Deposits – Max 10% NAV may be held in Cash. Max 20% with Custodian/Depositary
- Other limits – Max of 20% in the same issuing body

v) Rules relating to derivatives:

To invest in a derivative one needs to assure that the underlying is an eligible asset according to the UCITS rules (look through principle).

vi) Rules relating to efficient portfolio management:

- A UCITS can enter into repo agreements, reverse repos and stock lending arrangements subject to certain conditions and disclosure requirements:
- Transactions must be entered into in accordance with market practice
- UCITS must consider implications for liquidity risk management re meeting redemptions
- Need to assess credit rating of counterparty if existing or, if counterparty is downgraded below A-2, a new credit assessment must be carried out
- Collateral must be posted
- ESMA has published rules on collateral including rules on credit quality, diversification, liquidity, valuation, reinvestment of collateral
- Security repo'd or lent (or cash for reverse repo) must be instantly recallable or UCITS must be able to terminate agreement
- UCITS must be able to terminate a reverse repo on an accrued or MTM basis (if on an MTM basis then this must be used in the NAV)
- Various disclosures required in annual report (exposures, revenues, counterparties, collateral)

UCITS V

This is the latest amendment to the regulatory framework for UCITS published in the official Journal of the European Union on 24th March 2016 and came into effect from 13th October 2016.

The directive focuses on three key area:

- a new depositary regime which includes a clarification of depositary eligibility, duties, liabilities and depositary-related disclosure requirements and a set of rules under which tasks and responsibilities can be delegated. This new regime also seeks to align depositary liability and duties with the Alternative Investment Fund Manager Directive (AIFMD) regime.
- rules governing remuneration policies of both management and investment companies managing UCITS, that must be applied to key members of the UCITS managerial staff
- the harmonisation of the minimum administrative sanctions regime across member states

The Depositary

Depositary Liability:

The duties imposed upon the Depositary under the UCITS V Directive are closely aligned with AIFMD.

The liability standard is the same except that, in contrast to AIFMD, the option to transfer liability to a sub-custodian (the so-called “contractual discharge provision”) is not available to depositaries under the UCITS V framework. The depositary will only be able to avoid liability where it can prove that the loss of assets is due to an “external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary.

Depositary Eligibility:

Under the previous regime, member states enjoyed discretion over the institutions deemed eligible to act as UCITS depositaries, provided that the depositaries were institutions which were subject to prudential regulation and ongoing supervision and which could furnish sufficient financial and professional guarantees. UCITS V alters the rules in relation to eligible depositaries by requiring that a UCITS depositary must be: (1) a national central bank; (2) a credit institution; or (3) a legal entity authorised by its national competent authority to carry on depositary activities under the UCITS Directive, subject to the fulfilment of certain capital, prudential and organisational requirements.

Depositary Obligations:

Under UCITS V, the oversight duties imposed on depositaries remain substantially the same as those imposed by the previous UCITS Directive and were already captured within the pre-existing Central Bank requirements. With regards to safe-keeping, UCITS V distinguishes between financial instruments that are capable of being held in custody by the depositary and all other assets, which are subject to record keeping and ownership verification duties. UCITS V requires that financial instruments held in custody are registered in segregated accounts so that they can be clearly identified as belonging to the UCITS at all times. A depositary (or its delegate) is prohibited from re-using the assets which it holds in custody for its own account. The re-use of assets for the account of the UCITS is subject to conditions, including that the re-use be for the benefit of the UCITS and in the interests of unit-holders and that the transaction is covered by high quality, liquid collateral received by the UCITS under a title transfer arrangement, the market quality of which at all times amounts to at least the market value of the reused assets plus a premium.

Remuneration

The UCITS V Directive requires that a UCITS management company has a remuneration policy which are:

- are consistent with and promote sound and effective risk management of the UCITS
- discourage disproportionate risk-taking which is inconsistent with the risk profiles or fund rules governing the relevant UCITS
- are in line with the business strategy, objectives, values and interests of the management company and the UCITS it manages or the investors
- include measures to avoid conflicts of interest

STRATEGIES SUITABLE FOR ALTERNATIVE UCITS

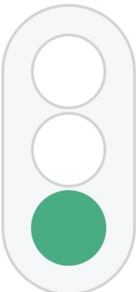
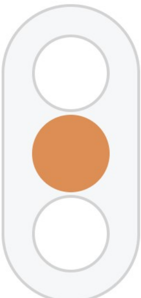
Alternative Investment strategies in UCITS are generally understood to be investment strategies that use derivatives as part of their investment policy and that execute strategies similar to those used in hedge funds.

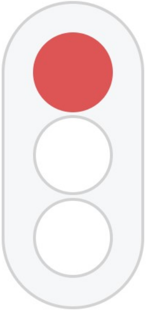
UCITS III regulation in 2002 and the eligible assets guideline in 2007 both expanded the list of assets that UCITS funds can invest in. The inclusion of derivatives allowed UCITS to engage in leverage positions and to short exposures synthetically. These regulations came in response to a demand from investors to diversify their portfolios and to compliment investor long only strategies.

A large amount of hedge fund style strategies are now available to UCITS fund managers. The greatest UCITS constraint for alternative managers is liquidity. Illiquid strategies cannot be made available under the stringent regulation, these would violate important investor protection mechanisms.

Trium will engage with potential partners early to ensure the viability of their trading strategy within the UCITS framework. The Trium team has lots of experience in adapting strategies to fit the UCITS framework.

Below is Trium's summary guide to Alternative Investment Strategies that are suitable for UCITS.

Suitability	Strategy / Funds	Explanation / Notes
	➢ Alternative Beta / Risk premia ➢ Equity Long/ short ➢ Global Macro ➢ Multi-strategy ➢ Relative Value	➢ UCITS can engage in most equity long/short strategies by using derivative to engage in synthetic short positions as physical short selling is still prohibited. ➢ Global Macro, Relative value and Multi-Strategy given the inclusion of synthetic shorting should all be easily replicable in a UCITS structure with careful review of the UCITS concentration limits. ➢ There is no UCITS limitations on discretionary or systemic trading strategies.
	➢ Convertible Bond Arbitrage ➢ CTA ➢ Event-Driven ➢ Fixed Income long / short ➢ M & A arbitrage	➢ There are limitations to the amount of leverage UCITS funds can use and some highly leveraged strategies may not be appropriate in a UCITS format. ➢ UCITS rules forbid funds to invest in commodities or in financial derivatives instruments of commodities with embedded delivery mechanisms. ➢ '5/10/40' rules limits the percentage which may be invested in securities issued by a single issuer, making some event-driven strategies problematic.

	➢ Private Debt ➢ Private Equity ➢ Real Estate	➢ UCITS Funds must offer a minimum of bi-monthly liquidity which makes strategies that deal in illiquid assets very difficult to translate into UCITS. As such strategies that focus on real estate investments and private equity can be difficult to translate into UCITS.

Adoption of Alternative UCITS

As discussed previously, it was the UCITS III regulation that allowed for the formation of alternative UCITS. Alternative managers from unregulated off-shore structures are now able to replicate their strategies in an onshore regulated format. This change represented a response to increasing investor demands for a demonstration of good governance and a more compressive risk mitigation strategy in a post 2008 investor landscape. These two factors together have led to increased competition in the alternatives UCITS market giving investors more choice and flexibility into their investment decisions. It should also, in theory, lead to more value for money as the increased competition of bigger players moving into the market increases the bargaining power of investors and helps drive down costs and therefore provide better value for money to investors

Alternative UCITS have demonstrated that they have a continuing role to play in investor diversification more now than ever as the rate of passive investing increases and investors search for highly regarded products with an ability to generate alpha. This along with the distribution benefits which are applicable to all UCITS ensures that alternative UCITS will be an important option for many types of investors for the foreseeable future.

Key Facts of Alternative UCITS

- Assets under management in alternative strategies in UCITS funds have been growing steadily, achieving a compounded annual growth rate (CAGR) of over 18% between January 2014 and September 2018, with current AUM in alternative strategies UCITS standing at $374bn[9]
- Over half of UCITS allocators expect to increase their allocation to alternative UCITS in the next 12 months.[10]
- Almost three quarters (74%) of UCITS allocators surveyed in the Deutsche Bank 2018 Alternative UCITS survey[11] stated liquidity as one of the main motivations for their allocations into Alternative UCITS.
- Alternative UCITS represent approximately 7% of total assets currently invested in UCITS.
- Of Alternative UCITS allocators 91% have invested in Fundamental equity long/short strategies, making this by far the most popular strategy

[9] (Absolute Hedge, www.absolutehedge.com, "Q3 2018 Alternative UCITS Report", October 2018 n.d.)
[10] Deutsche Bank – 2019 Alternative UCITS Survey – December 2018
[11] Deutsche Bank – 2019 Alternative UCITS Survey – December 2018

BENEFITS OF ALTERNATIVE STRATEGIES IN UCITS

For investors alternative strategies in a UCITS format offer the benefits of liquidity, transparency, and strict risk management under the UCITS guidelines, along with a hedge fund like absolute return that has a lower correlation to traditional equity, bond and cash markets. The risk driven rules around leverage, concentration and counterparty risk are part of the framework and differentiate UCITS from typical offshore hedge fund products or AIFMD funds and can provide investors with confidence and surety in their investments.

The growth of the alternative UCITS fund industry has been driven by investors seeking diversification in their traditional portfolios of stocks and bonds, while also being vigilant to protect their assets and ensure they are only investing in liquid and transparent instruments.

The UCITS structure of these alternative strategies can also open up an entirely new market of institutional investors who may be prohibited from investing their client's assets in non-regulated funds. The opening up of this market to institutional investors ensures that investors have access to critical strategies to help diversify their portfolios and continue to ensure that strict investor protections criteria are met. With most equities markets at all-time highs at the time of writing, many of these traditional investors are increasingly interested in capital preservation strategies to protect and ensure the long-term growth and stability of their client's investments.

The favourable tax treatment of UCITS funds discussed previously is another benefit for investors, again making the investment in alternative UCITS more attractive than their hedge fund counterparts.

Alternative UCITS are also of particular interest to private wealth managers targeting high net worth individuals. They can be packaged into a fund of funds product and ensure diversification for investors even within alternative strategies.

The benefits for managers are also substantial. Fund managers looking to build assets in Europe Asia and Latin America have the benefit of offering a product type with over 30 years of establishment knowledge globally. The UCITS product type will also allow many institutional investors who often have limitations or their ability to invest in illiquid assets to diversify their assets and gain exposure to different strategies that may have been unavailable in the past.

A PARTNERSHIP WITH TRIUM

Trium's approach is to engage in strategic partnerships with various groups rather than to simply be an infrastructure platform for managers. This operating model allows Trium to focus its efforts on a limited number of partnerships and to deliver excellent pre- and post-launch technical expertise along with a multitude of other benefits that are unique to Trium, most notably distribution. All the services Trium can provide are aligned to the long-term growth of partners, meaning Trium succeeds and benefits when our partners do.

This approach allows Trium to be flexible and tailor a unique approach to the needs of each of our partners, and not just present an "off the shelf" agreement that does not offer the right services.

Speed to Market – In certain circumstances using an established UCITS structure or an established UCITS platform will facilitate a much smother and quicker launch as the UCITS structure has already been approved. For certain partners and certain funds where the speed to market is an important consideration, Trium is flexible enough to be able to adapt to their partner's needs.

Structuring Advice – Members of the Trium UCITS team with the experience in the funds sector can help advice potential partners on the best structure within UCITS.

Distribution Support - Trium has extensive experience in registering UCITS funds for distribution in EU Member states, in addition to non-EU member states that recognise the UCITS brand in their jurisdictions. Additionally, Trium has vast experience working with the distribution platforms that are prevalent across Europe, both the process upfront for onboarding funds in addition to the ongoing maintenance requirements.

Trium continues to build relationships with the main Fund platforms, albeit many of these will only invest once the Fund has a more mature track record and/or when there is clear demand (from Private Wealth Managers, IFAs etc.)

LAUNCHING A UCITS WITH TRIUM

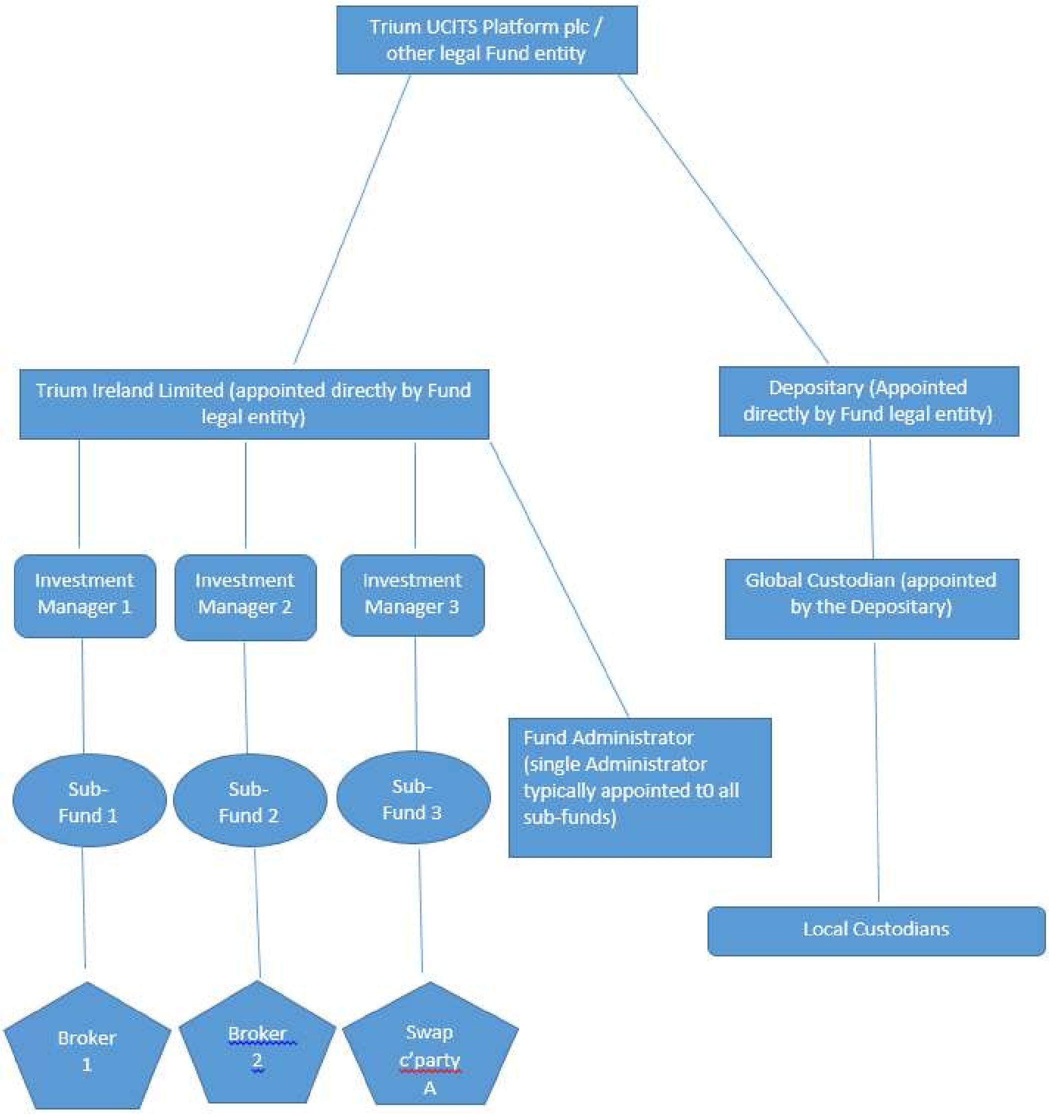
Structure and Timeline

Trium engages in a partnership with investment managers wishing to launch a UCITS fund.

The Trium UCITS Platform represents a menu of UCITS funds. It comprises of both funds on Trium's general umbrella in addition to dedicated umbrella funds for clients. Should the client require a dedicated vehicle, we will set up an umbrella UCITS structure, giving the flexibility to establish future Sub-Funds in a cost effective and timely manner.

The umbrella fund is comprised of a number of different sub-funds, with legal separation of assets and liabilities between sub funds i.e. no cross liability.

Trium Ireland Ltd Structure



Trium has responsibility as the Management Company, with our partners acting as the Investment Managers. Custodian and Depositary services are provided by Northern Trust Ireland, and our partners are free to choose their preferred ISDA and other counterparties.

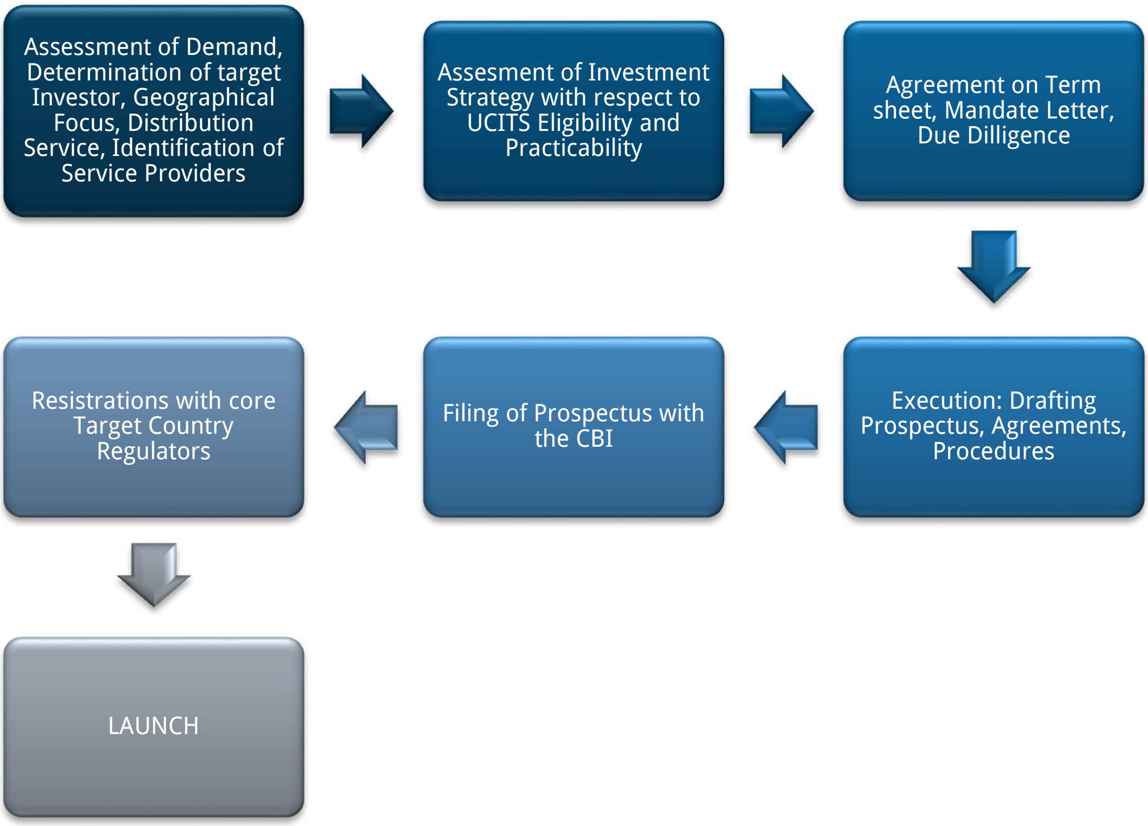
Trium provides the Designated Persons who through close collaboration with Investment Managers, carryout all the necessary oversight and monitoring.

The Investment Manager will retain responsibility for trading and management of the Sub-Fund(s), as well as reconciliations and NAV signoff.

The Investment Manager will conduct pre- and post-trade compliance in accordance with UCITS rules (and any other rules set out in the Prospectus), with Trium agreeing these rules upfront and verifying them on an on-going basis.

The below is an overview of the process for launching a UCITS in partnership with Trium.

Trium will project manage the entire process leveraging on previous experience to make this as painless for partners as possible.



Then following the above process in more detail:

- Assessment
  - Assess the level of demand amongst UCITS investors for the proposed strategy
  - Assess the strategy for UCITS eligibility
  - Determine (if the strategy needs to be modified) what eligible instruments will best replicate the desired strategy
  - If the proposed strategy is approved, a determination of who potential investors are and a determination of geographically where to focus our distribution efforts
  - Identification of the service requirements the fund will require and Trium's, plus our service provider's capacity to provide these services. (see below)
  - Ensure the managers are familiar with the UCITS rules and specific rules that will affect their strategies

- Agreements
  - Trium will commence KYC on the manager
  - A mandate letter between Trium and the manager will be drafted and signed instructing Trium to set up the UCITS fund

- Execution
  - Trium and Irish Lawyers to draft the legal documentation
  - On boarding by Administrator
  - Negotiate custody and administration agreements
  - Formal fund manager due diligence to be carried out by Trium
  - Fund manager and Trium's marketing team to coordinate and create marketing material

- Filing of the Fund with the Central Bank
  - Trium to file the fund documentation with the Central Bank of Ireland ('CBI')
  - Address any CBI follow-up and then wait for approval to come through
  - Fund manager and Trium to finalise counterparty agreements
  - Trium to finalise marketing material and distribution agreements with the fund
  - Roadshow to be arranged, to include presentations to Trium distribution partners and to direct clients of Trium

- Launch
  - Once the fund is approved by the Central Bank, it is 'live' and can be seeded
  - Press release and marketing to begin

Required Documentation

Launching a UCITS involves having various legal and other documentation reviewed and commented on by the home state regulator (usually The Central Bank of Ireland (CBI) or Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg).

Prospectus– a formal document that is required by and filed with the relevant regulators which defines the operating parameters of the fund, its investment objectives, investment policies, valuation rules, and risk factors.

KIID (Key Investor Information Document)- The KIID is a document that provides key information about investment funds, in order to help a potential investor compare different investment funds and assess which fund meets their specific needs.

Business Plan / Substance Application– The CBI requires a business plan to be submitted which sets out the governance framework for a UCITS management company (or self-managed fund). It names the directors and designated individuals, their roles and responsibilities, frequency of board meetings, reporting items that they will receive, escalation process, etc. The CSSF has a questionnaire that is required to be completed by all new management companies and self-managed UCITS authorisations. The completed questionnaire must provide the address of an officer in Luxembourg for the Management Company or the self-managed UCITS.

Risk Management Process (RMP)– Both the CBI and CSSF require a risk management process statement is required to be submitted to the regulator.

Policies Procedures and Service Level Agreements "SLAs"– The fund or the management Company must ensure that they have in place sufficient documentation and procedures for the operation of the business.

Constitutional Documentation– This varies depending on the legal structure of the fund (SICAV, ICAV etc.), but this will be the memorandum and articles of association, trust deed, deed of constitution etc.

Legal Agreements– Legal agreements between management company and service providers. Some, but not all of these, agreements will need to be reviewed and approved by the central regulator.

Application Form– The CBI & CSSF both have application forms that need to be completed in the application for a UCITS fund.

As part of the application, both a management company and a self-managed UCITS must include their detailed Business Plan with the application. The business plan must detail and demonstrate how the management company or self-managed UCITS will comply with all relevant legislation and business requirements.

Trium has a business plan reviewed and approved by the central bank of Ireland detailing all our written policies and procedures if not provided by the service providers. The below is selection of said the policies;

- Risk management
- Complaints handling
- Accounting policies and procedures
- Conflicts of interest/related party transactions
- Exercise of voting rights
- Valuation
- Remuneration
- Due diligence on investments
- Best execution
- Order handling
- Inducements
- Subscriptions/redemptions
- Late trades and market timing
- Cyber security
- Business continuity planning
- Recordkeeping
- Whistleblowing
- Anti-Money Laundering (“AML”) and Counter-Terrorist Financing (“CTF”)
- Personal transactions

Any new Investment Manager who wishes to partner with Trium will be required to be authorised by the Central Bank of Ireland. They will be required to complete and provide the following documentation to the CBI;

- FORM IVM 3 - Investment Manager/Advisor with discretionary powers.
- Prospectus/Supplement.
- Executed Investment Management Agreement.

(i). Eligible assets
(ii). Eligible markets
(iii). Liquidity rules
(iv). Risk spreading rules
(v). Rules relating to derivatives
(vi). Rules relating to efficient portfolio management

(i). Eligible assets- categories as follows:

1. Transferable securities
2. Money market instruments
3. TS and MMI embedding a derivative element
4. Financial derivative instruments ("derivatives" or "FDIs")
5. Open-ended collective investment schemes
6. Deposits with credit institutions
7. Ancillary liquid assets
8. Financial indices

For each of the asset classes listed above (1 – 8) as eligible assets, there are definitions in the regulations setting out the criteria for each asset class.

Direct and indirect (through derivatives) investment in following asset classes is generally not permitted:

- Commodities (Including precious metals or certificates representing them)
- Property/real estate
- Private equity
- Hedge funds
- Non-financial indices

UCITS may be permitted, within limits, to gain exposure to the above through financial indices; some exposure is possible up to 10% in unlisted securities. Physical short selling is not permitted in UCITS although synthetic shorting is possible.

(ii). Eligible markets

For transferable securities and money market instruments:

- UCITS can only invest in regulated markets (subject to 10% limit in unlisted securities and rules regarding issuers of money market instruments – see below)
- The onus is on the UCITS to ensure that all markets into which the UCITS will invest are regulated markets (the regulator will not confirm this) i.e. that the markets are open to the public, recognised, regulated and operate regularly.

(iii). <u>Liquidity rules</u>

- A UCITS fund must re-purchase or redeem its shares/units at the request of any unit holder. UCITS funds can operate via daily, weekly or bi-monthly dealing. A UCITS can impose a 10% of NAV limit on the amount of redemptions that are paid out on any one dealing day. The balance is then carried forward to the next dealing day and added to other redemption requests
- A temporary suspension of redemptions is permitted in exceptional circumstances if in the interest of unit holders
- In Ireland, a UCITS fund must Assess and document in writing:
  - Liquidity risk where investment in a transferable security could compromise liquidity of fund
  - Liquidity risk of a transferable security when investing in a transferable security (at a minimum including volume and turnover of the transferable security, issue size and portion of issue to buy, opportunity/timeframe to buy or sell the transferable security, assessment of secondary market activity, intermediaries and market makers
  - Liquidity and Negotiability of the transferable security in the fund where the transferable security is not traded on regulated markets

(iv). <u>Risk spreading rules</u>

The risk spreading rules can be divided into the following categories:

- Unlisted securities
- 5/10/40 exposure rules (also 5/25/80)
- Control rules
- Borrowing rules
- Other limits

Unlisted securities:

- Max 10% of NAV in unlisted/unregulated securities
- Additional 10% permitted in recently issued transferable securities with an intention to list within one year
- Limit does not apply to certain 144A securities provided they register with SEC within one year and are not illiquid

5/10/40 rules: transferable securities and money market instruments

- Maximum 10% of NAV in in assets of any one issuer
- Where investment in assets of any one issuer exceed 5% of NAV, maximum allowed of these investments in total is 40% of NAV
- 10% limit may be raised to 25% NAV for bonds issued by EU credit institutions subject by law to special public supervision designed to protect bond holders
- For these bonds, holdings in excess of 5% NAV cannot in aggregate exceed 80% of NAV (5/25/20)

Control rules: -can hold Max of 10% of

- Non-voting shares of any issuing body
- Debt securities of any issuing body
- Money market instruments of any issuing body
- Cannot acquire shares with voting rights enabling significant influence over an issuing body (rule of thumb is 20%)

Index tracking funds:

- Where the investment policy of a fund is to replicate an index, the 10% of NAV limit in any one issuing body may be raised to 20% of NAV
- This 20% limit may be raised to 35% of NAV for a single issuer in exceptional circumstances
- The index must satisfy certain criteria such as:
  - Acting as an adequate benchmark for the market
  - Published in an appropriate manner
  - Independently managed from the management of the UCITS.

Government Securities:

- Max 10% of NAV limit in any one issuing body is increased to 35% of NAV for transferable securities/ money market instruments issued by
  - EU member state or its local authorities
  - Non-member state
  - Public international body of which at least one member state is a member
- 5/40% of NAV rule does not apply to these securities
- Up to 100% of NAV may be invested in transferable securities and money market instruments issued by a member state (or local authority), non-member state or public international body:
  - If investing more than 30% in one government issuer, the UCITS must hold at least six different issues from that issuer
  - max 30% of NAV in any one issue
  - UCITS must specify in constitutional documentation the names of government bodies in which it intends to invest more than 35%
  - Such government bodies are limited to certain approved countries – e.g. OECD/investment grade

Cash and Deposits:

- Max 10% of NAV can be held in cash/deposits with the same credit institution
- 10% limit increased to 20% for:
  - Credit institutions authorised in EEA (EU plus Norway, Iceland and Liechtenstein)
  - Signatory state to Basel (Switzerland, Canada, Japan, US)
  - Jersey, Guernsey, Isle of Man, Australia, New Zealand
- Max 20% with Custodian/Depositary

Investment in other open-ended collective investment schemes ("CIS"):

- Max 20% of NAV in any one CIS
- Max 30% of NAV in aggregate in non-UCITS CIS; (Non-UCITS funds must have investor protection measures and regulation equivalent to UCITS)
- Investee CIS must limit their own investment in other CIS to 10% of their NAV; - this restriction must be explicitly stated in the investee CIS prospectus/supplement and its constitutional documentation (memorandum & articles of association /trust deed/instrument of incorporation
- UCITS may not hold more than 25% of the units in issue of a single CIS (control limit)
- Close-end funds – eligible provided they qualify as transferable securities, limits as per 5/10/40 restriction

Other/general rules:

- Max 20% of NAV in respect of investment in the same issuing body taking into account:
  - Investment in transferable securities and money market instruments
  - Deposits/cash
  - Counterparty exposures through OTC derivatives/(reverse) repos/stock lending
  - Position exposure of assets underlying derivatives
- Max 20% of NAV in respect of all exposures to issuing bodies within the same corporate group
- Issuers from same corporate group are considered the same issuer for the purposes of the risk spreading rules except that investment up to 20% is allowed for transferable securities and money market instruments issued by the same issuer/group
- Max 5% of NAV in warrants
- Cannot carry out uncovered sales of transferable securities, money market instruments, collective investment schemes or derivatives
- Limits do not apply when exercising subscription rights (although this may result in an inadvertent breach)
- Exposure from reinvestment of collateral must be included for purposes of risk spreading limits

Borrowing rules:

- A fund may borrow up to 10% of NAV for temporary purposes only
- Credit balances may not be offset against borrowings in other currencies/accounts in calculating % borrowed
- Foreign currency borrowings exceeding back to back deposits must be treated as borrowings

(v). <u>Rules relating to derivatives</u>

General criteria: To invest in a derivative one needs to assure that the underlying is an eligible asset according to the UCITS (look through principle)

- Underlyings consist of one or more of:
  - Transferable securities, money market instruments, collective investment schemes, derivatives or deposits
  - Financial indices
  - Interest rates

- FX rates/currencies

OTC Derivatives:

- General criteria for derivatives plus:
  - Dealt with counterparties fulfilling certain requirements
  - Counterparty will provide reliable valuations
  - Counterparty will close out transaction at fair value at the request of the UCITS.

Total Return Swaps:

- Underlying assets must comply with investment objectives and investment limits of the UCITS
- Prospectus disclosure required:
  - Information on underlying strategy and composition
  - Information on counterparties
  - Risk of counterparty default
  - Extent of counterparty's discretion in managing exposures/underlyings or if counterparty approval is required for a transaction
- Possible requirement for counterparty to be disclosed as an investment manager (if a counterparty has discretion over the composition or management of the underlying of the FDI)

Collateral

- Counterparty risk can be reduced by eligible collateral which meets the following criteria:
  - Liquidity
  - Valuation
  - Issuer credit quality
  - Correlation
  - Collateral diversification - diversify on country markets and issuers
  - Risks identified in RMP
  - Held at custodian or agent (with conditions)
  - Enforceable/immediately available
- Non-cash collateral cannot be sold, pledged or re-invested
- Cash collateral must only be invested as follows:
  - Deposits with certain institutions, high quality gov bonds, reverse repos (with conditions), short term money market funds
  - Must be diversified as above
  - Can't place cash collateral on deposit with counterparty or affiliate
- If more than 30% of AUM received as collateral, UCITS must perform stress tests on the collateral under normal and exceptional liquidity conditions and have a stress testing policy
- UCITS must have a collateral haircut policy
- Investors must be informed of the collateral policy in prospectus

Global Exposure - Commitment approach:

- Looks to the positive market exposure of the asset(s) underlying the derivatives* (i.e. the notional value)

- Global exposure is NIL for derivatives used for hedging purposes (risk reducing) if certain criteria are met
- Options can use delta adjusted exposure
- Must have sufficient "cover" in place for derivatives
- Purchased and sold derivatives can be netted if certain criteria are met
- A currency derivative involving 2 legs not in the base currency must aggregate both legs

Global Exposure - Value at Risk (VaR):

- Fund employing VaR as risk measure for global exposure can choose between:
  - Relative VaR: This is the VaR of the fund divided by the VaR of a derivatives-free benchmark or reference portfolio. The fund's VaR must not exceed twice the benchmark's VaR, OR
  - Absolute VaR: This is the fund's VaR relative to its NAV. Absolute 20-day VaR cannot exceed 20% of NAV
- VaR model must meet certain criteria and satisfy regulator:
  - 99% confidence interval (however one can adjust such parameters to e.g. 95%)
  - historical observation period minimum of one year
  - stress testing and back testing must be applied
  - adequate internal controls, staffing and experience in risk area
  - description of VaR model including any third-party verification
  - overview of software and work done to ensure accuracy of results
- In addition, all funds applying a VaR need to provide additional disclosure on the expected leverage (gross exposure) of the fund:
  - Disclose expected leverage in the prospectus together with a statement on the possibility of higher leverage
  - Disclose the actual leverage of the period in the annual report together with VaR utilization (min, max, average)
- As a calculation method, regulators require UCITS to use the sum of notionals. UCITS may additionally disclose leverage levels in accordance with the commitment approach
- Position exposure/concentration risk
- "Position exposure" to underlying investments combined with exposure from direct investments not to exceed standard risk spreading limits in UCITS regulations
- For example, 10% in single issuer limit and 5/40% limits must also combine with exposures to assets underlying derivatives in the fund
- Position exposure can be ignored for index based derivatives meeting certain criteria

Counterparty exposure:

- "Risk exposure" to an OTC qualifying counterparty – which is the unrealised profit - may not exceed 5% NAV or 10% (in case of EU or equivalent credit institutions)
- Counterparty risk may be reduced by fund receiving collateral from CP that meets certain conditions
- Positive and negative positions with the same CP may be netted if a contractual netting agreement is in place which creates a single legal obligation

- UCITS should establish whether its exposure is to an OTC counterparty, broker or clearing house
- Any exposures relating to repos, reverse repos or stock lending must also be included within the 5%/10% counterparty risk limit
- When assessing counterparty exposure, UCITS have to take into account margin paid to the counterparty or margin due from the counterparty where the margin is not subject to client money rules

Cover requirements:

- A UCITS must at all times be capable of meeting its payment and delivery obligations for FDIs
- Cover for an FDI must be:
  - Liquid assets for cash settled FDI
  - For FDIs requiring physical delivery, UCITS must hold the underlying or hold liquid assets where:
  - Underlying is highly liquid fixed income security and/or UCITS considers that the exposure is adequately covered without holding the underlying, risks are captured in the RMP and details are included in the prospectus

(vi). <u>Rules relating to efficient portfolio management</u>

A UCITS can enter into repo agreements, reverse repos and stock lending arrangements subject to certain conditions:

- Transactions must be entered into in accordance with market practice
- UCITS must consider implications for liquidity risk management re meeting redemptions
- Need to assess credit rating of counterparty if existing or, if counterparty is downgraded below A-2, a new credit assessment must be carried out
- Collateral must be posted
- ESMA has published rules on collateral including rules on credit quality, diversification, liquidity, valuation, reinvestment of collateral
- Security repo'd or lent (or cash for reverse repo) must be instantly recallable or UCITS must be able to terminate agreement
- UCITS must be able to terminate a reverse repo on an accrued or MTM basis (if on an MTM basis then this must be used in the NAV)
- Various disclosures required in annual report (exposures, revenues, counterparties, collateral)