



FINANCIAL REGULATOR
Rialtóir Airgeadais

Policy Update - 1/2010

Multiple share classes within a
single collective investment
scheme

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Collective investment schemes – establishment of multiple share classes within a single scheme

Background

Irish collective investment schemes (“CIS”) are permitted to establish separate classes of shares within a CIS (or sub-fund of an umbrella CIS) provided that the structures involved do not result in any prejudice to investors in one class vis-à-vis investors in another. The two fundamental principles, which underpin the Financial Regulator’s approach to the use of one or more classes within a single CIS, are:

- Each CIS must consist of a single common pool of assets; and
- The capital gains/losses and income arising from that pool of assets must be distributed and/or must accrue equally to each shareholder relative to their participation in the CIS.

Share classes can be differentiated on the basis of currency, distribution policies or charging structures.

As an exception to the above principles the Financial Regulator also permits currency hedging at share class level whereby the costs/benefits of the hedge transaction is allocated to the share class, rather than to the pool of assets as a whole. Guidance Note 3/99 – “Share classes – hedging against exchange rate movements” sets out the requirements of the Financial Regulator in relation to the creation of hedged share classes.

Following a number of industry submissions, the Financial Regulator has revised its approach in relation to other scenarios when CIS intend to create multiple share classes. The purpose of this note is to communicate arrangements which have been permitted to date and to outline what will be acceptable going forward.

Interest Rate Hedging

The Financial Regulator will permit interest rate hedging at share class level where the benefits and costs of such hedging may be accrued and attributed solely to investors in a hedged share class. Such arrangements must be effected in accordance with the principles established in Guidance Note 3/99.

Financial Derivative Instruments at share class level

The use of financial derivative instruments at share class level may only be permitted where:

- The CIS constitutional document makes specific provision for the creation of share classes and contains clear provisions for the charging of any resultant gains/losses on the transaction to the relevant share class.
- The prospectus must contain a clear description of the strategies being pursued at share class level and the effect this will have on investors in each share class.
- The use of financial derivative instruments at share class level creates positive benefits for investors and does not prejudice the interests of holders in other share classes.

The Financial Regulator will permit financial derivative instruments at share class level where their purpose is to effect currency and interest rate hedging (subject to the principles set out in Guidance Note 3/99) and different distribution policies or fee structures at share class level.

The Financial Regulator will also consider proposals where financial derivative instruments may be used at share class level to provide:

- a different level of participation in the performance of the underlying portfolio; or
- different levels of capital protection.

In such cases, the financial derivative instrument for each share class must be based on the same underlying portfolio or index. Moreover, the transactions cannot result in a leveraged return per share class, i.e. the

participation rate can be up to but not exceeding 100% of the relevant share class's performance of the underlying portfolio.

Where financial derivative instruments per share class, other than for the purposes of currency/interest rate hedging are proposed, the issue of segregated liability must be addressed. In this regard, the Financial Regulator will require:

- A legal opinion that the over-the-counter counterparty's recourse to the CIS is limited to the relevant share class's participation in the CIS's assets; and
- Confirmation from the board of the CIS/management company that they have reviewed and are satisfied that the proposal will, as a result of the agreement between the CIS and the over-the-counter counterparty, not result in any prejudice for investors in one class over another. The board must also confirm that there will be no cross liability between share classes.

In the case of professional and qualifying investor funds, the Financial Regulator will consider proposals for financial derivative instruments at share class level with different features, for example to provide an additional add-on exposure to that generated from the underlying portfolio, or to generate a leveraged return at share class level, or where the underlying to the derivatives are different versions of the same underlying, e.g. two classes with different swap instruments based on sub-indices derived from the same initial index.

Other arrangements similar to these examples will be considered on a case-by-case basis. The use of such financial derivative instruments at share class level is subject to the condition that the management of the CIS must be in a position to demonstrate segregated liability between share classes in the manner described above.

New Issues

The Financial Regulator will permit professional and qualifying investor funds to establish a separate class within a CIS where any gains/losses on investment in 'New Issues' can be allocated for the benefit of investors not deemed to be Restricted Persons in accordance with Rule 5130 of the US Financial Industry Regulatory Authority Inv ("FINRA"). The constitutional documents and prospectus must clearly provide for these arrangements.