

RECAST UCITS DIRECTIVE - UCITS IV

The European Union (EU) Commission has issued its long awaited policy proposals covering investment funds.

The Commission has proposed revisions to the UCITS (Undertakings for Collective Investment in Transferable Securities) Directive, to overcome what it sees as shortcomings in the current structure. The proposals are intended to increase the efficiency of the current legislative framework allowing UCITS managers to more easily trade cross-border and drive down costs of management and improve investor protection.

UCITS are investment funds established and authorised in the EU which conform to the requirements of the 1985 UCITS Directive (and its more recent revisions) under a common structure covering the organisation, management and oversight of funds. The Directive defines a list of eligible assets in which a UCITS fund can invest and also imposes requirements on the diversification and liquidity of the fund's portfolio. UCITS can be traded cross-border to investors if the host regulatory authority is notified. The UCITS arrangements are seen as central to the successful development of the European market for investment funds.

The original UCITS Directive dates back to 1985 and has since been revised and amended. This process has meant considerable legislative complexity – involving nine revising directives in all. The most recent UCITS III Directive, came into force in 2004 and allowed UCITS fund managers to invest in a much wider range of eligible assets and to pursue new types of investment strategies. The UCITS model has also been highly successful within the EU – figures from June 2007 show that UCITS assets under management amounted to over €6 trillion¹ and represent about 75% of the EU investment fund market. Currently EU funds are on average 5 times smaller than US funds and the cost of managing them is twice as high as in the US. Currently 40% of UCITS originating in the EU are sold in third countries, mainly Asia, the Gulf region and Latin America.

1. KEY POINTS

The new Directive will replace the ten existing directives with a single text. The key changes are as follows:

1.1 Notification Procedures

Currently, UCITS wishing to be marketed in another Member State must notify that State's competent authorities. The procedure includes the submission of a number of documents, and the competent authorities of the host State have two months to approve the marketing into its territory of the foreign UCITS. The host regulator can also ask for additional documents and request changes which can slow the process down, and considerably increase costs, particularly if translation is required.

The new directive will aim to remove or reduce administrative barriers by setting up a new notification process. This is likely to be electronic, regulator-to-regulator communication. The aim is to help the cross-border distribution of funds and reduce the time taken to complete the notification procedure – which can currently take several months.

The proposals involve harmonising the current notification file – proposed changes will mean that the host competent authority/regulator will no longer have power to ask for additional documents or request changes. There will also be a reduction in the delay before marketing can start – marketing immediately after notification. The move will mean simpler and less costly translation and electronic transmission will also speed the process.

⁽¹⁾ source: EU Directive proposal provisional version COM (2008) 458/3

1.2 Mergers

Mergers between UCITS funds will be allowed both domestically and cross-border with a harmonised investor disclosure regime to affected investors. The new directive will establish a standardised set of requirements, which will apply across the EU, covering authorisation of a fund merger and on the information that will have to be made available to investors.

The result should be a reduction in the administrative steps required and the costs to fund managers (which the EU expects to filter through to investor costs) wishing to merge funds across borders. Harmonisation will remove the need to comply with different sets of national requirements and thus lead to a considerable reduction in the delays involved.

1.3 Investor Disclosure

The new proposals involve the replacement of the Simplified Prospectus with Key Investor Information (KII). This will be shorter and simpler, containing disclosure information in a clear and understandable manner. The content will be standardised – the EU says that the only change admitted to the content will be translation. In addition, the liabilities of the parties will be clarified and the possibility of using electronic delivery will be considered.

1.4 Master-Feeder Structures

The use of master-feeder structures will be allowed so that a fund (feeder) will be allowed to fully invest its assets into another fund (master).

1.5 Regulator Co-operation

This is likely to be through the use of implementing powers under the Lamfalussy approach and involving the Committee of European Securities Regulators (CESR).

2. MANAGEMENT COMPANY PASSPORT (MCP)

This is seen as the biggest area of contention, and no formal proposals have been put forward. Management Company Passporting (MCP) involves funds authorised in one Member State being managed remotely by a management company established in another Member State. The move would allow the centralised control of funds, so that a fund manager could create funds in another country without having to form a local management company. Support has come from fund managers, in favour of a full passport, but servicing centres such as Luxembourg and the Republic of Ireland opposed the idea during the consultation process, preferring a partial passport. Key concerns being raised are on investor protection and the possibility of fragmented supervision.

The EU has recognised that these issues need to be addressed before formal proposal and draft directive text can be developed. It has therefore passed the issue to the Committee of European Securities Regulators (CESR). CESR is a “Level Three” Committee under the EU’s Lamfalussy arrangements, and is made up of high level representatives from the national securities regulators. Its role is to advise the EU Commission on technical matters and deal with the preparation of implementing measures for EU framework directives in the relevant area of investment securities.

CESR will now hold discussions and a further consultation before concrete proposals are made before developing a structure which is acceptable to national regulators. It has undertaken to advise the Commission no later than 1st November 2008, after which the Commission will put forward an appropriate proposal in time to allow for its adoption during the current legislature.

3. IMPLICATIONS FOR FIRMS

The new UCITS IV should be seen in the overall context of changes to the financial services industry in the EU. High profile moves and directives, including MiFID (Markets in Financial Instruments Directive), the Basel II initiative, Solvency 2 as well as UCITS IV are revolutionising financial services in the EU, and the funds management industry, transfer agencies (TAs) and providers of services must respond to this if they are to keep their competitive edge.

The changes mean that asset managers will be able to choose their domicile for distributing funds internationally and will be able to sell their domestic fund ranges internationally, or consolidate their international fund ranges in offshore centres such as Luxembourg or Dublin. Firms which are in a position to capitalise on this and support either distribution model will be in a much better competitive position.

The current smaller EU funds will have an opportunity to achieve economies of scale through cross-border fund mergers and asset pooling. For example, EU funds are on average 5 times smaller than US funds and the cost of managing them are twice as high as in the US. Some providers will establish their own network across jurisdictions or develop a network of partners.

4. NEXT STEPS

If the proposal is adopted by the EU Council of Ministers and the European Parliament in the second quarter of 2009, its provisions will come into force mid 2011. CESR will conduct a consultation exercise and report further to the EU by 1st November 2008 on the MCP area, and further proposals can therefore be expected at the end of 2008 or beginning of 2009.

5. FURTHER INFORMATION

The provisional EU directive text is accompanied by an explanatory memorandum which sets out some further useful background and commentary.

http://ec.europa.eu/internal_market/investment/docs/legal_texts/framework/recast_en.pdf

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