

# Citi's Online Academy for Institutional Investors

## UCITS IV – What Next?

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Wednesday 18 February 2009

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- UCITS IV process
- The Management Company Passport (MCP)
- The new UCITS mergers regime
- Master-Feeder structures under UCITS
- Panel discussion and Q&As

# UCITS IV Process – Areas Covered

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- Management Company Passport
  - Giving reality to the MCP passport
- Mergers of UCITS
  - To promote consolidation
- Master Feeder
  - Introduced to facilitate asset pooling
- KID (Key Investor Documentation)
  - Replacing the simplified prospectus
- Notification
  - Moving from substantial re-approval to a real notification
- Supervisory cooperation
  - Improving co-operation

# UCITS IV Process – How We Got There

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- 2005: Green Paper on the enhancement of the EU framework for investment funds
- 2006: EC's White Paper on enhancing the single market framework for investment funds
- 2007: EC's initial orientations for possible adjustments of the UCITS Directive
- July 2008: Proposed UCITS IV package
- October 2008: CESR advice on the MCP
- December 2008: ECOFIN approval of UCITS IV
- January 2009: European Parliament's approval of UCITS IV

# UCITS IV Process – Current Status

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- The current text should be substantially definitive
- 3Q09: Expected adoption
- 2009–2010: Level 2/Level 3 activity
- 2011: Coming into force

# The Management Company Passport (MCP) – Background

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- What is the Management Company Passport (MCP)?
- Recent history of the MCP
  - Evolution from UCITS III to UCITS IV
  - Potential discord amongst Member States
  - EU Commission & Committee of European Securities Regulators (CESR)
  - Level 1 Directive agreed by European Parliament
  - Level 2 Measures
- CESR Advice

# The MCP – Definition of domicile

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- Management company:
  - Domicile
  - Home Member State regulator approval
- UCITS:
  - Contractual UCITS domicile
  - Corporate UCITS domicile
  - Home Member State regulation
- Depositary:
  - Must be either registered or established (branch) in the UCITS Home Member State.
- Local contact:
  - Management Company local representation

# The MCP – Applicable law and allocation of supervisory responsibilities

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Where a Management Company wishes to provide cross-border services to UCITS domiciled in another Member State, It will be required to follow 2 sets of Rules:

1. Rules established in the UCITS Home Member State:

Includes:

- Initial set up and authorisation of the UCITS
- Day-today operation of the UCITS
- Disclosure & Reporting
- Reconstruction, Winding up
- Relationship with unitholder

2. Rules established in the Management Company's Home Member State:

- Organisation of the Management Company, including delegation arrangements
- Risk management procedures
- Prudential Rules and supervision
- Administrative and accounting procedures
- Reporting requirements

# The MCP – Authorisation procedures

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## Authorising cross border UCITS:

- UCITS authorisation: Home State regulator approval of fund rules, choice of Management Company and choice of the Depositary
- Before refusing an approval, the UCITS Home State regulator is required to consult with the Management Company Home State regulator
- Limited scope for UCITS Home State regulator to refuse authorisation
- The UCITS regulator may take measures against a foreign Management Company, these must be effective, proportionate and dissuasive
- May include the withdrawal of the Management Company's authorisation

# The MCP – Operational arrangements

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## Information flow arrangements:

- Enhanced information exchange obligations between authorities
  - Approval
  - Non-Compliance
- Information flow between Management Company and Host State regulator
  - Periodical reporting to Host State regulator
  - Information necessary for the monitoring of rule compliance
- Information flows between Depositary and Management Company
  - A written agreement between the parties
  - The European Commission may take Level2/Level3 initiatives to clarify details to be included in such agreements.

# The MCP – Outsourcing

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Strictly speaking no new rules are introduced, however the MCP substantially modifies the appetite for delegating certain functions as economies of scale may now be generated.

- Delegating arrangements are under the responsibility of the Management Company Home State regulator
- Delegating arrangements (and amendments thereto) shall be notified to the UCITS Home State regulator
- However as under UCITS III, the fact that some activities are delegated by the Management Company shall not affect the depositary's liability, nor the Management Company shall delegate activities to the extent that it becomes a letter-box entity.

# The MCP – MCP Level 2 Measures

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- CESR Call for evidence issued 17<sup>th</sup> February 2009
- Part I requests technical advice on areas where the Commission is obliged to adopt implementing measures:
  - Organisational requirements and conflicts of interest for management companies
  - Rules of conduct and conflicts of interest for management companies
  - Risk management
  - Measures to be taken by Depositaries
  - On the spot verification and investigation
  - Exchange of information between competent authorities

Responses due by 31<sup>st</sup> March 2009

# The MCP – Opportunities

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MCP will provide Fund Managers / Sponsors with a number of opportunities:

- Structural Cost Efficiencies
  - Consolidation
  - Outsourcing
- Fund Range Consolidation
- Pooling, Master Feeder Structures

# The New UCITS Merger Regime – Transactions Covered

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Three possible techniques for merging UCITS

- Merger by absorption
- Merger by creation of a new fund
- Scheme of amalgamation

# The New UCITS Merger Regime – Right to Merge and Merger Process

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- Introduction of a a “right to merge”
- Approval of a merger under national laws
- Merger process

# The New UCITS Merger Regime – Contents of the Merger File

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## Composition of the Merger File

- Common draft terms of the merger
- Prospectus and key investor information
- Unitholders information
- Depositaries statement

No additional information may be required by Member State regulators

# The New UCITS Merger Regime – Role of the Depositaries

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## 1. Merger file

- Statement from the Depositaries
  - Type of the merger and UCITS involved
  - Effective date of the merger
  - Applicable rules for the transfer of assets and the exchange of units

## 2. Validation by a Depositary (or alternatively, an Auditor) of

- The criteria adopted
- Cash payment per unit
- Exchange ratio

# The New UCITS Merger Regime – Investor Information

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- Information on the proposed merger
- Right to repurchase/redeem/convert existing units
- Availability of merger information

# The New UCITS Merger Regime – Opportunities and Costs

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- Simplification of existing structure
- Distribution considerations
- Legal, advisory and administrative costs
- Past performance to be addressed

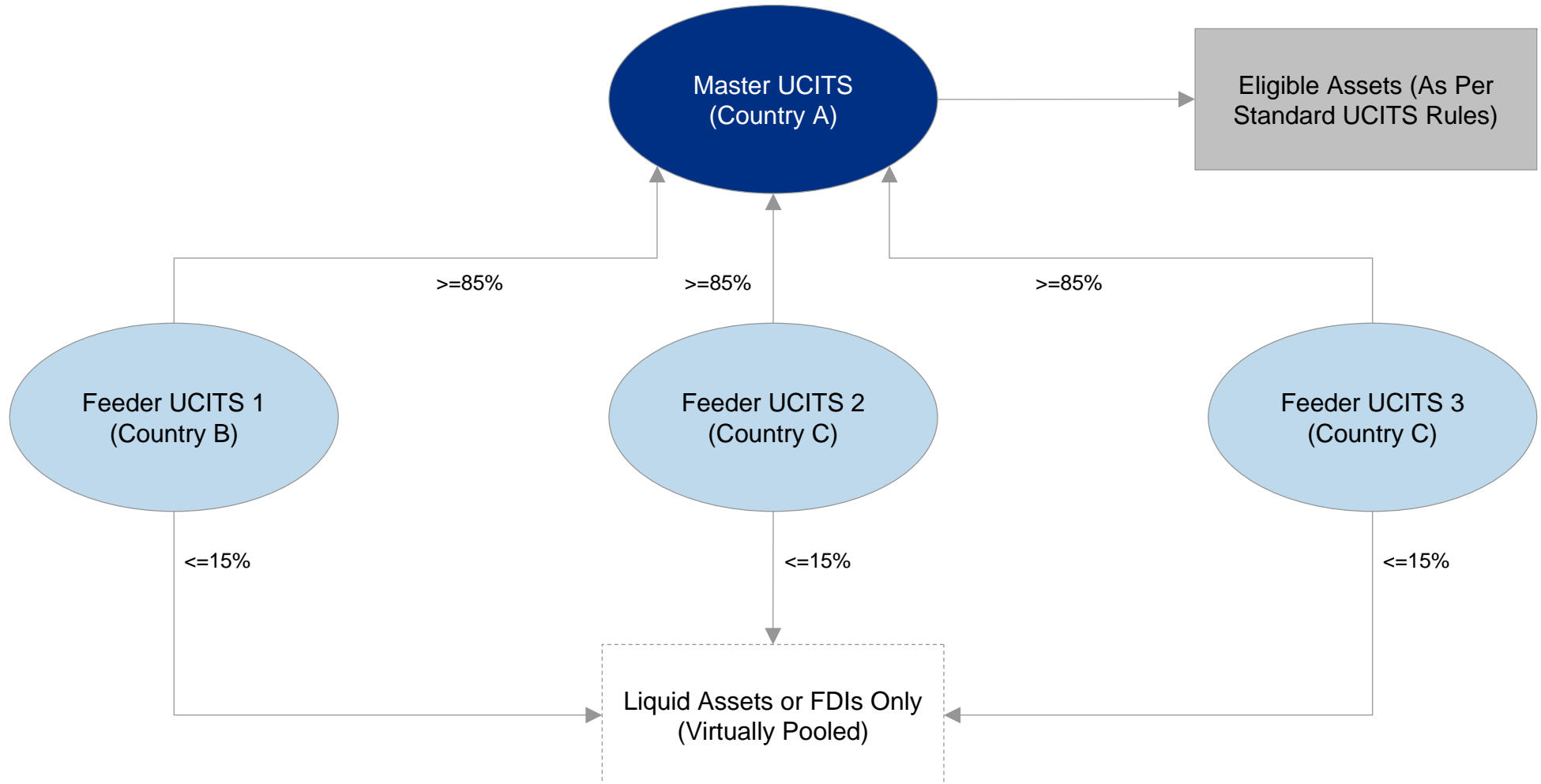
# Master-feeder Structures Under UCITS IV – Basic Principles

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- Minimum investment thresholds: 85% plus 15% “free” assets
- Aggregated derivatives exposure
- No “circular” structures
- Distinct notification processes

# Master-feeder Structures Under UCITS IV – Example

## Cross-border Structure Combined with Virtual Pooling



# Master-feeder Structures Under UCITS IV – Approval Process

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- Regulatory approval prior to the Feeder investment into the Master
- Initial investment approval subject to some basic requirements
  - Documentation requirements
  - Contractual requirements
  - Investor information requirements

# Master-feeder Structures Under UCITS IV – Common Provisions

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- Information sharing between Master and Feeder to enable them complying with the Directive
- Rules to avoid market timing/arbitrage opportunities
- Rules on suspension of issues or redemption of units
- Special rules in case of Master's liquidation
- Special rules in case of Master's merger

# Master-feeder Structures Under UCITS IV – Depositaries and Auditors

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- Information share agreement between Depositaries
  - Not subject to secrecy/data protection laws
  - Support by the Feeder's Management Company
- Information/reporting obligations
  - On the Depositary of the Master
  - Possible EC regulatory initiatives
- Information share agreement between Auditors
  - Consideration of the Master's audit report
  - Ad-hoc Master's audit report may be required

# Master-feeder Structures Under UCITS IV – Communication and Information

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- Feeder's prospectus
  - Must contain compulsory information/disclosures
  - Must include indications on aggregated charges and tax implication of the structure
- Feeder's Annual report
  - Focus on charges
- Other information
  - Period updates
  - Marketing communication
  - Ad-hoc information

# Master-feeder Structures Under UCITS IV – Conversions

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1. Normal UCITS converting into a Feeder
2. Feeder changing Master of reference

In both cases, the following applies

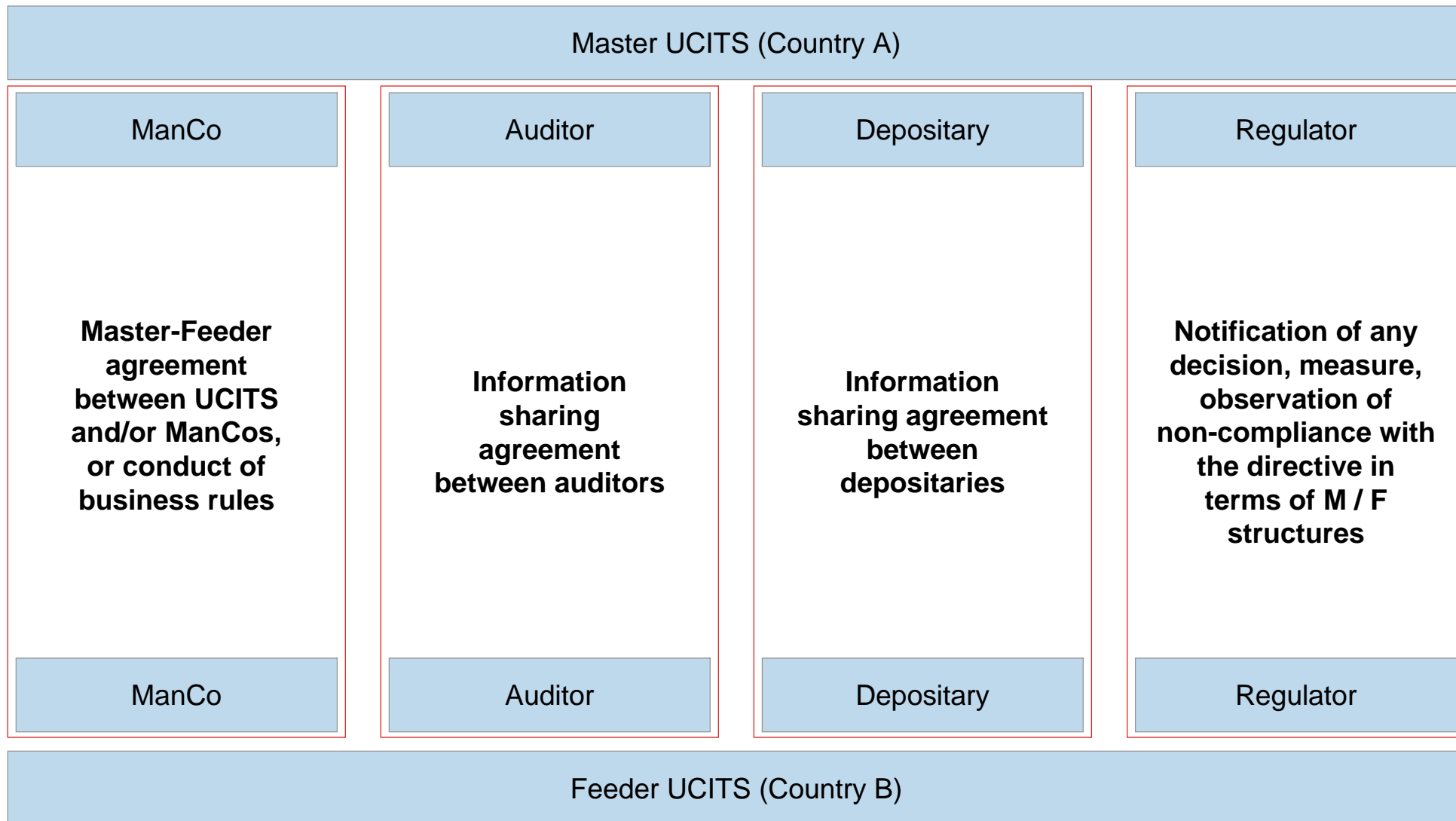
- Investor information requirements and exit rights
- Regulatory notifications for funds distributed in multiple jurisdictions

# Master-feeder Structures Under UCITS IV – Obligations and Authorities

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- Monitoring
  - The Feeder shall monitor effectively the Master
- Fees, commissions, benefits
  - Must be paid into the Feeder's assets
- Regulatory reporting
  - Notification to the Regulators and procedures in cross-border structures
- Information
  - The Master must make information available to the interested parties
- Breaches and issue of non-compliance
  - In case of single-country structures
  - In case of cross-border structures

# Master-feeder Structures Under UCITS IV – Information Flows in Cross-border Structure



# Master-feeder Structures Under UCITS IV – Final Considerations

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1. Pooling technique only
2. Not for all promoters, complex
3. Cost effectiveness to be assessed
4. Some areas still require clarifications

## UCITS IV – Concluding Remarks

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1. Considerable step forward and move from a pure product-focused Directive to a more service-focused Directive
2. Tools are available to facilitate the consolidation of funds and reduce their manufacturing costs
3. However implementation costs may still be an issue, and distribution costs may not be materially reduced
4. Requires significant clarification exercise also in areas not directly impacted by UCITS IV amendments

Questions

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