# UCITS IV – the new regime

## Background to the new Directive:

The adoption of the UCITS IV directive was the culmination of a long process of reform, beginning with a review of the existing UCITS regime in 2005. This review had raised concerns about the increasing fragmentation and complexity of the retail funds industry. UCITS IV takes the form of a recast of the UCITS framework – rather than another set of amendments to the 1985 Directive (UCITS I). The origins of the new directive pre-date the financial crisis and the primary objective is to enhance the single-market framework for investment funds. This contrasts with the controversial draft Alternative Investment Fund Directive (the AIFM proposal) that would apply to non-UCITS funds; this was more heavily influenced by the desire for a pan-European response to the financial crisis.

The funds sector faces many difficulties after the global downturn. Fund managers will want to consider the range of new opportunities provided under UCITS IV when reviewing their structures and operating models.

## Improvements to the UCITS regime under UCITS IV:

The main improvements to the UCITS regime are

1. **Improvements to investor information** - a new key information document (KID) will replace the simplified prospectus. KIDs will take the form of a short, pre-contractual disclosure documents containing only the key elements of information that investors need to compare the investment opportunities offered by different funds. According to CESR's technical advice, KIDs should include a brief statement of the fund's investment objectives, a risk and reward indicator and information on the past performance of the fund. For structured UCITS, CESR proposes that the KID considers the performance of the firm in a variety of prospective scenarios, under a range of market conditions.

2. **A genuine European passport for UCITS management companies –** UCITS funds already enjoy a single market passport under the UCITS legislation; this passport applies to the product enabling it to be sold across the EEA. The passport for a UCITS management company (i.e. for the firm itself) is restricted because currently the manager of a UCITS fund (if one is appointed) must be domiciled in the same member state as the fund. Under UCITS IV, this restriction is removed and a UCITS manager in one member state will be able to manage funds in any other member state on a cross-border basis (either on a services basis or via a local branch). This will facilitate the running of cross-border operations and reduce costs as managers will be to operate across member states without establishing separate domestic subsidiaries in each one. Some may consider using the passport to establish operations in 'fund friendly' member states.

3. **Rules for UCITS management companies –** the new firm passport above is based on additional EU requirements for UCITS management companies, with some harmonisation based on MiFID standards. The extended rules cover organisational requirements, conflicts of interest, risk management (including remuneration), senior management responsibility, complaints, general conduct of business and inducements. The UCITS requirements for depositaries fell under the spotlight as a result of the debate on the AIFM proposal; further legislation is expected following the Commission's recent consultation on depositary rules and liabilities in member states.

4. **Simplification of the notification procedure for UCITS -** administrative procedures for the passport system will be simplified, so that UCITS funds have immediate market access throughout member countries once authorised in their country of origin.

5. **A framework for domestic and cross-border UCITS mergers –** this framework allows for three forms of merger: merger by absorption, merger by formation and the amalgamation of funds. In the case of cross-border mergers, the merger must be approved by the home state regulator of the fund that is merging and communicated to the national regulator of the acquiring fund.

6. **Measures to facilitate asset pooling –** there will be a new framework for "master-feeder" arrangements by which one UCITS fund (the feeder fund) invests 80% or more of its assets in another UCITS fund (the master fund). The feeder and master funds may be in different member states – e.g. the feeder may be in the investor's state but the master fund may be in another state. Residual funds may be held in the feeder fund for liquidity and

hedging purposes, whilst the main fund management is delegated to the master fund, which the feeder manager is required to monitor.

7. **Improved supervision of UCITS and the companies that manage them** – UCITS IV focuses on enhancing co-operation and information exchange between national supervisors and harmonising supervisory powers throughout member states. The new Directive also provides for on-the-spot investigation of UCITS and UCITS managers and considers mechanisms for co-operation between member states in implementing penalties.

## Timetable for implementation:

The new UCITS Directive was adopted by the Council of the European Union on 22 June 2009 and the final text was published in the Official Journal of the European Union on 17 November 2009.

CESR published its technical advice on Level 2 implementing measures relating to the UCITS management company passport and the format and content of KIDs (or Key Investor Information) in October 2009 and on measures relating to fund mergers, master-feeder structures and cross-border notification of UCITS in December 2009. CESR also published its level 3 guidelines on 28 July 2010 on risk measurement and the calculation of global exposure and counterparty risk for UCITS. The guidelines set out methodologies for calculating global exposure, new guidelines on assets used as collateral to reduce counterparty risk and cover rules for transactions in financial derivative instruments.

Level 2 implementing measures were adopted on 1 July 2010 and UCITS IV should be implemented by all member states by 1 July 2011.

In the UK, FSA and HMT produced a joint consultation document on the transposition of UCITS IV on 20 December 2010; the deadline for responses was 21 March 2011.

## The European regulatory agenda for funds:

The UCITS IV Directive forms part of the broader EU regulatory agenda for funds. Other important developments include the European Commission's work on Packaged Retail Investment Products and the AIFM proposal.

Click here for an overview of the Commission's recent work of Packaged Retail Investment Products (PRIPS).

For more information on the Alternative Investment Fund Managers (AIFM) Directive, visit the funds page at CMS Cameron McKenna's RegZone at http://www.law-now/regzone.

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