

UCITS IV on its way to the European Parliament!

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On December 2, 2008, the ECOFIN Council has endorsed the latest draft of the new UCITS Directive, opening the door to its final review and likely adoption by the EU Parliament in the early months of 2009.

Despite the robust opposition of certain countries to the inclusion of one of the components of this otherwise long-awaited reform, i.e. the Management Company Passport (“MCP”), driven primarily by a perceived risk to sound investor protection, a working group of the EU Council currently presided by France has continued to work on the Commission’s July 2008 proposal for a Directive and drafted entirely new sections on the MCP.

The Management Company Passport

By its very nature, the MCP will create situations where the management company is located in country A and sets up funds, even in contractual form, in country B. Under the UCITS IV draft, this contractual fund will take the nationality of the Member State (“MS”) where it is authorised (i.e. B) and the concept of central administration is dropped. But with two countries A and B in play, one needs to determine which law and which regulator rules the activities of the fund and its management company.

The MCP provisions organise an allocation of applicable laws and of responsibilities between regulators to supervise such situations. Remote management companies will have to comply with the laws and regulations of the UCITS Home MS regarding the constitution and the functioning of the UCITS (including set up and authorisation, rules on fund accounting of the UCITS, rules on NAV errors...) and regarding compliance with the obligations set out in the fund rules and the prospectus.

The organisation of the management company (including the risk management procedures for the funds it manages and the possibility to delegate certain activities forming part of collective portfolio management) will be regulated by the laws of the management company Home MS.

The text confirms that the custodian of a UCITS managed by a remote management company will have to put in place appropriate measures (to be determined through implementing measures) and enter into “information flow agreements” with the management company in order to fulfil its duties towards the UCITS. The UCITS and its custodian must remain in the same MS – this principle is not affected by UCITS IV.

Despite intense discussions regarding the need for a local point of contact in the UCITS Home MS and a proposal by CESR in that direction in its October advice, no local agent will finally be required. The text also indicates that there will be very restricted possibilities for the UCITS competent authority to challenge the management company during the authorisation of the UCITS, favouring instead cooperation mechanisms between regulators for the ongoing supervision including compliance breaches resolution.

Other measures of UCITS IV include:

The notification procedure

The Council's UCITS IV draft goes even further than the Commission proposal of July in terms of speed of the notification process. The notification will be a quick regulator-to-regulator process, with the UCITS' Home MS regulator having only 10 working days to review a very standardised (in form and content) notification file and to transmit it to the Host Member State(s), thereby triggering the right of the UCITS to be marketed in that/those country(ies). There will no longer be a prior possibility for the Host MS to block marketing. Instead, regulators' attention will shift to the local distribution channels, focussing on arrangements taken for the marketing of the fund locally and on the content of the marketing material.

Fund merger and entity pooling

These measures aim at tackling the proliferation of funds of sub-optimal size, with the hope that they would trigger greater economies of scale that could then be passed on to investors.

The proposal creates a framework for mergers between UCITS on both a domestic and cross-border basis and allows master-feeder (pooling) structures where a UCITS (feeder) will be allowed to fully invest its assets into another UCITS (master).

The Key Investor Information

Last but not least, the failed simplified prospectus will be replaced by a short document containing Key Investor Information (KII). The content, form and presentation of such KII will be fully harmonised to make it easier to understand for retail investors and to facilitate comparison between products.

In line with the Lamfalussy process, the new UCITS Directive, whose adoption is expected early 2009, will be followed by a "Level 2" Directive, with the entire package entering into force by July 2011. Further details will be provided by the Level 2 Directive, notably on management companies' organisation in general and prevention of conflicts of interests in particular; on the KII; on the notification procedure; and on risk management.

It now seems certain that UCITS IV as envisaged will become reality and, although many details still need to be determined, industry players should now start considering the likely implications on their business.

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