

The European Commission has issued clarification on a number of points regarding the UCITS III Directive, as Dr David Doyle explains.

UCITS – improving the efficiency of the EU investment fund market

■ In its White Paper on Undertakings for Collective Investment in Transferable Securities (UCITS) issued at the end of November 2006, the European Commission examined the challenges facing cross-border EU investment fund investments and proposed ways of simplifying and clarifying the UCIT III Directive. The resulting 'targeted amendments to the UCITS directives' focused on the need to:

- simplify the notification period
- create a framework for cross-border merger of funds
- create a framework for asset pooling
- enable fund managers to manage funds domiciled in other EU member states
- improve the quality and relevance of key disclosure documents destined for the end client
- strengthen supervisory cooperation to monitor and reduce risk of cross-border investor abuse.

passport to trade

The UCITS directive seeks to provide fund managers with a 'passport' to trade across borders. That is to say, if funds are registered in one EU country, they would have unrestricted access to any other EU Member State.

Thus for example, a Swedish investment fund company in possession of a passport approved by the Stockholm-based FSA regulator only had to ensure that this regulator notified the host country's regulator, FSA in the UK for instance, of the company's intention to offer the product in its jurisdiction, and

could then start selling the fund there within two months. However, problems occurred in complying with the two month notification period as a result of the complexity of national rules, exacerbated by different administrative practices and varying interpretations of the directive.

In March 2007, the Commission focused on two specific areas of malfunction associated with the EU investment fund market:

- the adoption of legally-binding guidance (Implementing Directive) on whether new financial instruments can be included in such investment funds
- guidance (Interpretative Communication) on how host country regulators should exercise limited scrutiny powers when UCITS are notified for sale in their jurisdiction.

The Implementing Directive sought to clarify the definition of eligible assets for UCITS with regard to certain classes of assets. Instruments that can now be included in such investment funds include asset backed securities, listed closed end funds, Euro commercial paper, index-based derivatives and credit derivatives, transferable securities and money market instruments embedding derivatives, and financial indices.

In addition, while liquid instruments with a value that can be accurately determined at any time were allowed, derivatives based on a single commodity remained outside the scope of this Directive.

EU member states now have one year following the issuing of this Directive to adopt these regulations and implementing rules, and four months beyond 23 March 2008 to align their national legislation.

clarifying responsibilities

The Interpretative Communication sought to clarify the respective powers retained by the home member state and the host member state in the marketing of UCITS (section VIII of the UCITS directive).

The Commission identified the specific responsibilities as follows:

- the home member state:
 - fund authorisation
 - fund structure, i.e. obligations regarding management companies and investment companies etc
 - management, i.e. operating conditions, mandatory conditions related to investment policies and eligible assets, limitations on borrowing etc
 - compulsory information to be provided to the unit holders
- the host member state:
 - distribution infrastructure, including the use of an authorised or supervised intermediary
 - marketing techniques and channels used; this covers rules on canvassing, cold calling, direct selling, internet selling
 - advertising – much detail is provided on this aspect to ensure that a clear distinction is made between advertising and compulsory information
- the availability of facilities for making payments to unit-holders, repurchase or redemption of units and access to information on UCITS for unit-holders.

In the event that the UCITS provider uses a third party to market the units in the host member state, there is an explicit requirement that the host member authority should:

- ask that the UCITS provider comply with certain standards in respect of the choice of its local partner, such as the necessity that the latter is an authorised and supervised intermediary in the host market

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- insist that the UCITS management company, in the case of advertising campaigns implemented by the local partner in that state, provide fair, clear and non-misleading information on the products to the local entity.

The Commission also introduced safeguards preventing host member states from imposing disproportionate restrictions on UCITS’ providers in that state:

‘...when imposing restrictions...the relevant host member state has to demonstrate that the restrictions are objectively necessary to attain investor protection and that the latter could not be achieved by less stringent rules’.

information requirements

The respective roles of the host and home authorities in policing information being proposed in a simplified prospectus is examined in the interpretative communication, with clearer distinctions made with respect to advertising and compulsory information.

- in the case of a simplified prospectus, both pre-contractual information and marketing information provided by the UCITS provider falls under the responsibility of the home member state
- a host member state may impose additional information requirements to UCITS offered in their jurisdiction. Examples include a decision by the host state authority that the proposed investments entail new or high level investment risks, thus requiring more information or risk warnings
- disclosure of costs and fees associated with the individual UCITS falls under the exclusive competence of the home member state, whereas the disclosure of such information relating to the provision of

services by third parties, i.e. intermediaries, local agents, distributors, etc, falls under the provisions of article 34 of the 2006 MiFID Directive

- a host member state reserves the right to check the translation of the full and simplified prospectuses, and the annual and interim reports
- compulsory information is vetted by the home member state, whereas advertising per se (including information in a marketing campaign) is the responsibility of the host member state.

The EU economic ministers meeting at ECOFIN on 8 May endorsed the amendments to the existing UCITS legislation. The Council also underlined the need for enforcement of conduct of business rules provided for under MiFID and the coherence of application between the MiFID and UCITS directives.

The Council invited the EC to ‘review the consistency of EU legislation in respect of different types of retail products, such as unit-linked life insurance, investment funds, certain structures notes and certificates etc, with a view to ensuring a coherent approach to investor protection and avoiding mis-selling possibilities’.

future steps

Over the next year, the Commission has signalled that it will be:

- undertaking an assessment of the case for EU action in the area of private placement to be ready by autumn 2007
- examining the cross-border distribution potential for non-harmonised funds, i.e. funds of hedge funds, open-ended real estate funds etc, expected in mid-2008. ■

Dr David Doyle – Head of EU Parliamentary Affairs, ACCA