

IFIA's comments on the Commission's initial orientations on possible adjustments to the UCITS Directive

The Irish Funds Industry Association (IFIA) is the industry organisation for the international investment fund community in Ireland, which includes the custodian banks, administrators, managers, transfer agents and professional advisory firms. Given that as at end of March 2007 there were 4,204 Irish domiciled funds, including sub-funds, with a Net Asset Value of €769 billion, (2,419 Irish domiciled UCITS funds, including sub-funds with a Net Asset Value of €617 billion), all developments in the European investment funds arena are of particular interest and relevance to the Irish industry.

The IFIA welcomes both the publication of and the opportunity to comment on the Commission's Initial Orientations on Possible Adjustments to the UCITS Directive (85/611EEC). Both privately and publicly we have acknowledged the substantive contribution the proposed developments as included in the exposure drafts, should make in providing for a truly integrated and competitive European market for investment funds. Furthermore, with the proposed enhancements to the UCITS framework and increased supervisory co-operation, Europe and the European funds industry can become the global thought leader in the investment funds industry, building upon the reputation and global acceptance, within Europe and beyond, of UCITS as a generally suitable investment product for precautionary savings.

Detailed below is our response to the various proposals;

THE UCITS NOTIFICATION PROCEDURE

The IFIA would generally be supportive of the notification regime set out in the Commission's preferred proposal, Option 2. However, it is felt that this proposal would benefit from some assurance/indicative timeframe within which the home State Regulator would check and transmit the file to the host Member State authorities. If there were to be any significant time lag between the filing of the documents with the home State Regulator and the transmission to the host State Regulator, this would make it more difficult for a UCITS to know within what timeframe they were operating.

We support the use of electronic filing and transmission as this properly reflects an effective and efficient use of current communication tools.

The existing translation requirements vary between Member States and can entail a significant time and cost for UCITS looking to utilise the registration regime. The proposal for a fund to have to only translate the key investor information document into the host Member State language is a positive step and realises the commercial reality of the marketing process i.e. the full prospectus is typically not read or requested by investors.

It is believed that the key to the success of this proposal is the proposed requirement in Article 44 that host member states could not impose any additional requirements or administrative procedures in respect of the field governed by the Directive. However;

it would be helpful if the final version emphasised this to be the case and identified the fields which the Commission believe are not covered by the Directive. In addition, confirmation should be provided that all changes after the initial notification should have an immediate effect, e.g. when introducing new sub-funds to an existing umbrella fund and/or introducing new share classes should not require a new notification process.

The powers/sanctions available where a host State Regulator carries out an ex post check and finds the documentation incomplete/flawed and/or that the marketing in the host State is not undertaken in accordance with national rules, would benefit from clarification. Particularly, when it is proposed that the marketing/distribution rules of the host country for making available compulsory information shall apply. In addition, it is believed there would be benefit if some guidance might be included as to how changes to local marketing requirements might be communicated so as to ensure funds do not fall foul of ex post checks, where changes to host marketing requirements have been introduced.

THE MANAGEMENT COMPANY PASSPORT

With respect to the management company passport we note the expressed preference for the introduction of what is referred to as the ‘partial’ management company passport; where some core administration activities are required to be undertaken in the jurisdiction of the fund. The preference for this proposal is explained by noting amongst other things, the need to address the regulatory challenges of split supervision and potential tax domicile issues. Whilst acknowledging and highlighting that the strong preference from the investment management/promoter community is for a full passport and the flexibility it provides, i.e. where a fund could be domiciled/authorised in one jurisdiction, the fund management company could be domiciled/authorised in another jurisdiction and the administration could be undertaken in a further jurisdiction, it is also noted that the flexibility afforded by a the full passport could generate opportunities for jurisdictions specializing in fund administration, as a full passport could provide the opportunity to receive full administration mandates from UCITS domiciled in all EU jurisdictions. However, the issues raised by the other industry stakeholders are also acknowledged.

We recognise that the best opportunity afforded by this consultative process is for realistic and achievable change, which balances the at times competing objectives of the multiple stakeholders involved. We welcome the recognition by the Commission of the overarching objective presented in the review of the Management Company Passport to achieve greater efficiencies across the European marketplace while preserving the global recognition of the UCITS product as a strongly regulated investment vehicle. Our experience in regulatory engagement favours pragmatic workable solutions where a consensus of interpretation can be quickly agreed and commercialised. We would view the partial passport proposal as the most likely to meet that condition. The partial passport will deliver a large proportion of the expected cost and resource efficiencies without compromise to the clarity of the regulatory remit. Given the compromise nature of the partial passport it should be possible for it to be introduced without delay.

FUND MERGERS

We would support the arrangements set out in the Commissions preferred proposal, Option 1, where the Regulator responsible for the disappearing fund decides on the merger. Where a harmonised European merger regime exists, it is thought that the primary role of the Regulator is to ensure the regime is appropriately applied. The proposed involvement of the depositary in the process should mitigate any investor protection concerns of the surviving/receiving fund. It should be noted that it is likely a trustee/depositary would be unable to provide a “general” approval of the common draft terms of the merger, as a trustee/depositary cannot opine on the merits/impact of an amalgamation (this would be the role of the manager/promoter). The revised Directive should make it clear that the depositary’s written approval refers to the fact that the documentation is in conformity with the law and regulations and is in a form that can be put to the investors for approval. Should a statement/approval be required, then it should be to provide confirmation that they, the trustee/depositary, do not object to the scheme of amalgamation being put to a vote of unitholders, rather than any sort of approval of the proposal or opinion on the merits of the merger.

With regard to the proposal that “the valuation of the assets and the exchange ratio is audited by an independent auditor” it is felt that there should be sufficient safeguards in the obligations of UCITS to be properly administered and valued in the first instance so as not to require an additional independent audit of the valuation of assets and the exchange ratio. It would not appear to make sense to allow the valuations carried out by the fund administrators to be used for all other purposes but to insist that an independent audit report be produced solely in the context of a merger. It should be noted that the requirement for an independent audit would add to both the cost and time necessary to effect a fund merger.

It is believed that the unqualified statement that “*costs are not to be directly or indirectly borne by investors*” should be removed and a provision that, where it can be justified, some or all of the costs of the merger can be recovered from investors. There may be instances where the motivation for a merger is primarily driven by investor interests rather than those of the fund promoter, in which case it may be appropriate for all or some of the costs involved to be passed on to the unit holders. If the current proposed wording was retained, it may discourage promoters from considering merging their funds, as it would entail them incurring costs which would not be recoverable by them.

With regard to the investors voting rights we would strongly support the establishment of a maximum for the percentage of votes in favour required to approve the merger and strongly support the limit of 75% of the votes cast. Introducing a maximum requirement, for the percentage of votes in favour, will remove a significant challenge, an effective barrier, to merger activity.

It is a generally accepted fact that a large proportion of unitholders do not respond to circulars or attend general meetings. This, it is felt, is due to nothing more than unitholder inactivity. Non-response from unitholders means nothing more than they have not responded/voted. The current proposals do not suggest how investor inactivity might be treated, i.e. whether their holdings are automatically transferred to the surviving fund or whether their holdings are redeemed prior to the amalgamation.

We would note that the latter might unwittingly mitigate against the interests of both the non-voting unitholder and the scheme. In relation to the non-voting unitholder; a cash redemption could, in many cases, generate an unsolicited and unwelcome capital gains tax liability for the former unitholder. From the perspective of the scheme; any redemption requirement would negate the purpose/benefit of the proposed amalgamation; which is that the existing fund with the vast majority of its unitholders be included in the amalgamation. (Experience suggest that where investor inactivity results in compulsory redemption, that circa 80% of these investors are lost).

We note the Commission's proposal that the merging/dissolving fund should be a UCITS at the date of the merger. There should be clarification that this does not preclude the assets of a non-UCITS being transferred into the receiving fund, so long as the assets are UCITS eligible, the relevant spread limits are not breached and are compatible with the investment objectives and policy of the receiving fund.

POOLING & MASTER-FEEDER STRUCTURES

We agree with the Commission, that there is a need for an EU framework for pooling. However, while the Green Paper highlighted some concerns with the use of virtual pooling as a technique, the proposal that it would not be covered at this stage we believe is a significant lost opportunity. The reluctance to engage on the topic of virtual pooling does not seem to be grounded in any true regulatory concern but rather a lack of familiarity and understanding of the mechanics of virtual pooling among some Regulators. In both Ireland and Luxembourg, virtual pooling is an accepted market practice employed by the industry, which has proven benefits to both Investors and Investment managers alike. While we acknowledge that there is a certain level of system and technological investment that must be made, many providers in the market have already overcome these challenges. Developments in technology and the demands of promoters are likely to encourage the greater use of such pooling techniques and, if UCITS cannot avail of these techniques, this may again put them at a disadvantage to other competing financial products.

Additionally, virtual pooling techniques have some comparative advantages over entity pooling regimes, depending on the circumstances in which they are applied. Firstly, virtual pooling offers better transparency than a master-feeder regime. In virtual pooling the participating sub-funds directly hold securities and cash and can fulfil a richer informational array of regulatory and statutory reporting requirements. Secondly, because the sub-funds directly own securities, virtual pooling does not require additional diversification rules that restrict master-feeder regimes. This fully aligns virtual pooling with the diversification and cost efficiency requirements of the UCITS regime.

It is strongly argued that virtual pooling is a flexible and transparent solution that can address the needs of the investment community. We would both support and welcome a re-engagement by the Commission on the operational supports underlying virtual pooling and a demonstration that the key objectives of cost efficiency, harmonization of performance, operational and legal efficiencies and product structuring efficiencies can be met.

Notwithstanding the above, we are encouraged by the Commission's decision to create a framework for entity pooling; however, we believe that a more ambitious framework should be pursued, as the proposed approach, which is limited to master/feeder structures, is too narrow inflexible. The opportunity should be taken to provide as broad and flexible a framework as possible to allow UCITS funds achieve the full potential benefit of this efficiency technique. If the restrictive approach as proposed is adopted, it is likely to require amendment in the relative short term.

Within the proposed framework for entity pooling the acknowledgement that under specific circumstances a Master UCITS can pass its diversification and investment and borrowing compliance to a Feeder UCITS is a positive development. However, we are disappointed that the Commission's recommendation does not go further, as we believe the significant possibilities that a UCITS-based "many to many" Master Feeder provision could bring about have been overlooked. The limitations of the recommendation, e.g. only one master per feeder and at least two feeders per master, artificially constrain the practical application of the proposal to a very narrow product set. In addition, a requirement that a master UCITS must have two feeders would lead to significant difficulties in the event that one feeder withdrew its investment. The proposed master-feeder approach requires a feeder to invest at least 85% of its assets in the master, leaving up to 15% to be managed at feeder level. It may be however that a feeder fund finds it more appropriate to maintain say 20% (or more) at feeder level and there is no prudential reason not to permit this. Imposing such restrictive requirements in legislation is unnecessary.

We do not believe that a definition of master UCITS should be required, nor should it be required that a UCITS be authorised as a "master UCITS". A feeder UCITS should be able to select investments from the universe of authorised UCITS and a master should be able to accept investments from individual investors. In the event that investment in a UCITS (the master UCITS) is sourced solely from another UCITS (feeder UCITS), the capital raised by the master is still capital which is (indirectly) raised from the public.

We do not understand why the risk profile of the master and feeder must be "sufficiently similar" as this should simply be a matter of appropriate disclosure. Risk management by a master UCITS is carried out at the level of the master and similarly, risk management for the feeder will be carried out by the feeder.

The current proposed requirement for a formal agreement between a master and feeder UCITS is unnecessary, as the master UCITS must itself be an authorised UCITS, and as such it will be subject to the requirement to act in the best interests of its investors. A feeder fund will have the same rights as other investors in a master, including the right to vote on material changes to investment objectives and policies. It is difficult to understand why a formal agreement is necessary in these circumstances.

The question has been posed as to why it should be necessary to include specific measures in relation to mergers, de-mergers, liquidations or takeovers particularly as the master will be a regulated UCITS and subject to all of the UCITS regulatory requirements. Moreover, a feeder UCITS should have the same possibility as any other UCITS to amend its investment policy, including a change from feeder fund to

directly investing fund, with unit-holder approval, where for example, the feeder fund believes the master is not performing as expected.

The proposed requirement where master and feeder funds have different depositaries/auditors, the depositaries/auditors should enter into information sharing agreements is both unnecessary and excessive. Depositaries of feeder UCITS, like all parties to a feeder, have a more limited role than in directly investing funds. Likewise, why would an auditor of a feeder UCITS not rely on the audit of the master UCITS, without being required to review the information and documents relating to the audit report and discussing these with the master auditor.

Furthermore, the proposed requirements with regard to existing UCITS converting to feeder funds appear unnecessary and convoluted. Currently any UCITS that proposes a material change in investment policies must disclose the impact of the proposed change when seeking approval of investors. The proposed inclusion of these provisions in the Directive appears excessive. In addition, as it is our view that a UCITS should be able to select any UCITS as a master fund we do not consider it appropriate to prohibit master funds from charging fees, including subscription and redemption fees.

We strongly urge the Commission to reconsider its position and recommend allowing entity pooling in a much broader sense, e.g. feeders can own many masters. This option has the most potential for application across the industry. It will help to provide solutions and benefits for both sophisticated investment managers and ordinary investors.

THE SIMPLIFIED PROSPECTUS

We support the Commissions preferred option, to introduce a new approach to investor disclosures (option 2). It is generally accepted that the current Simplified Prospectus regime does not work and it is believed that a full overhaul rather than simple amendments to the current requirements is needed. In addition, we particularly welcome the recognition that professional and institutional investors invest in UCITS and the acknowledgement that these investors would not and do not require the same information that may be appropriate for a retail investor. Furthermore, we support the recognition of the role that electronic communications can play in the delivery of information to the end investor and the cost savings and efficiencies afforded current methods of communication.

SUPERVISORY COOPERATION

Mutual trust between Member State competent authorities will be key to a number of the proposals and, in particular, the cross border notification proposal. We would broadly welcome any proposal that, at a practical level, will enhance and facilitate the level of supervisory cooperation.

It should be remembered that the UCITS brand/badge is globally recognised and any and all improvements through efficiencies and co-operation will only serve to strengthen the UCITS brand.

IFIA

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