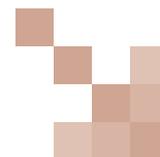


UCITS and the cross-border registration process



Karen L Anderberg, Dechert LLP*

www.practicallaw.com/2-384-8117

The European investment funds industry has grown to be a major player in capital markets and has significant potential for growth in the years ahead. The most common investment fund in Europe is known as undertakings for collective investment in transferable securities (UCITS), which account for 75% of assets under management in the fund industry in Europe and a growing percentage of assets under management in the fund industry worldwide (*EFAMA Quarterly Statistics Release No. 35 (Third Quarter of 2008), European Fund and Asset Management Association*).

Against this background, this chapter discusses:

- The benefits, costs and intricacies of offering UCITS for sale globally.
- Cross-border registration of UCITS within the EU.
- Cross-border registration of UCITS outside the EU.
- The impact of proposed changes to the UCITS regime (UCITS IV) on cross-border registration.

THE UCITS REGIME

The UCITS directives, the first of which was introduced in 1985 (UCITS I) and later amended by two directives (collectively referred to as UCITS III) aimed to establish a product known for investor protection, through strict investment limits, capital and disclosure requirements, and independent oversight procedures. The directives also allow a UCITS to operate under a passport system, whereby it can be offered for sale throughout the EU once it has been authorised in any EU member state.

UCITS I was part of an early effort to create a uniform retail market for investment funds in EU member states. The objective behind UCITS I was to establish a common market for a fund that met certain criteria:

- Its sole objective must be collective investment in transferable securities.
- Its capital must be raised through the public offering of interests in the fund.
- Its securities must be subscribable and redeemable out of fund assets (that is, it must be an open-ended fund).
- It must comply with certain prudential investment limits and investor safeguards.

A fund that qualifies as a UCITS and is authorised by an EU member state (the home jurisdiction) can then be marketed to the public in any other EU member state following proper notification in the relevant EU member state (each a host jurisdiction). Although this is in theory fairly straightforward, it is sometimes more difficult in practice. Under the UCITS Directive, each EU member state can enact its own regulatory and advertising regimes for the marketing of a UCITS. As a result, each UCITS has to comply with the different regulatory regimes of each EU member state in which it sells shares.

In part because of limitations on the ability to market on a cross-border basis and limits in available investment techniques, UCITS had limited initial success. UCITS I succeeded in laying the groundwork for a single European market for investment funds and their registration and sale in other EU member states. However, UCITS did not achieve the level of participation in the investment community that the European Commission had envisioned. One reason was that the process for registering a UCITS was left to the discretion of each EU member state, which led to considerable variance not only in the documentation required by regulators of a particular member state but also the time regulators took to review and consider the product for approval in the respective member state.

This variance resulted in frustration for investment firms, especially those with UCITS umbrella funds that launched new sub-funds. In many cases, it was possible to be one or even two prospectuses behind the home jurisdiction prospectus in those countries that took the longest to approve passported UCITS for sale.

There have been calls to simplify the notification procedures for passporting UCITS to other member states within the EU (*see, for example, the Green Paper on the Enhancement of the EU Framework for Investment Funds (COM (2005) 314) (12 July 2005), at page 4*). The Committee of European Securities Regulators (CESR) has worked to develop common guidelines to streamline and simplify the cross-border registration process to sell UCITS across EU member states' borders.

CROSS-BORDER REGISTRATION OF FUNDS WITHIN THE EU

Under the UCITS passporting procedure, a UCITS must submit its prospectus, simplified prospectus, latest annual report (and, if it has a subsequent semi-annual report, the semi-annual report), and constitutional documents, as well as evidence of authorisation by the home state regulator. These documents are usually required to be translated into the national language of the host state. Once filed with the host state's regulator, the review period is two months.

A host state regulator should not comment on the substance of a UCITS which has been authorised by another EU member state. The host state regulators can, however, implement their own regulatory and advertising requirements for UCITS. As a result, UCITS are subject to differing regulatory regimes in practically each jurisdiction, making the registration process, and subsequent compliance, time-consuming and expensive.

Many host state regulators require additional documentation to be submitted with the application to passport the UCITS, for example:

- **Italy.** To passport a UCITS into Italy for sale to retail investors, it is necessary to prepare an Extended Application Form, which is an application form with supplemental information for Italian retail investors investing in a UCITS. Certain institutional Italian investors must receive an informative note (*nota informativa*) also containing additional information for Italian investors.
- **France.** To passport a UCITS into France, a UCITS must prepare and distribute to French investors a supplement to the prospectus called the French Addendum or French Marketing Memorandum containing additional information for French investors. In part, the French Addendum is meant to provide additional information to French investors so they receive the same information about a UCITS as a French investor investing in a French fund would receive.

In addition, most EU jurisdictions require a local supplement to the prospectus to be prepared, containing information of relevance to investors in that jurisdiction, including information about how to contact a representative of the UCITS in that jurisdiction and the tax ramifications of investing in the UCITS. The preparation, translating and updating of these documents creates additional costs for UCITS. The integration of these supplements into the prospectus of the UCITS can also create difficulties; on occasion, host state regulators and home state regulators have disagreed on the appropriate place to include this information, either within the prospectus or appended to the prospectus, leaving the approval of the passporting UCITS unresolved until the host state regulator and the home state regulator can reach agreement.

Most host states also require a UCITS to have a local presence. This may range from a local paying agent (which serves as a repository for the UCITS' documentation and directs investors' queries to the UCITS' home state service providers), to local distribution agreements, and to use of a local firm which by law must act as nominee for all investors from that jurisdiction. The requirements for local contracts can differ from jurisdiction to jurisdiction. For example:

- **Germany.** A UCITS cannot submit an application to passport into Germany until it has a finalised, executed paying agency agreement with a German paying agent. Other jurisdictions also require the submission of the local documentation, but are willing to review draft documents and do not require signed, translated agreements to initiate the application process.
- **Italy.** In Italy, a correspondent bank agreement with an Italian bank is required if the UCITS is registered for sale to retail investors. The correspondent bank agreements typi-

cally contain many detailed provisions based on complex local requirements for the nominee arrangements, and these agreements can be time consuming to negotiate.

The translation of relevant documents can also be time-consuming and expensive for UCITS. The general requirement in many EU jurisdictions is that the prospectus, simplified prospectus, annual report and other documents of the UCITS must be translated into the national language of the host jurisdiction before filing the documents to passport the UCITS. This can be time consuming, often taking more than six to eight weeks, as well as expensive.

Another problem can arise with the two-month review period for the host state to review and accept the passporting of the UCITS. Although the host state is supposed to approve the passporting of the UCITS within two months, in some jurisdictions the host state regulator asks questions during the review period and "toll" the two-month review period starting from when it requests additional information from the UCITS until it has received and approved the additional information requested. This can change the two-month review period into a much longer period of four to five months. When this timeframe is added to the time for the translation of the documents, it makes the total time period required to passport into a jurisdiction much longer, and it has been argued that this timeframe makes UCITS uncompetitive with certain other vehicles.

Finally, although in most jurisdictions the UCITS is the entity to prepare and file all documents with the host state regulator, in a few jurisdictions (such as Portugal) the filings are actually submitted by the distributor for the UCITS, with the result that the UCITS does not control the process of submitting its own initial filing to the local regulator.

Other topics that can differ from jurisdiction to jurisdiction are ongoing compliance requirements, including:

- The filing of periodic sales reports in various jurisdictions.
- Differing requirements for annual general meetings (AGMs) or extraordinary general meetings (EGMs) (including publications of notices in journals or filings with the regulators).
- Varying tax filing requirements.
- Various translation and mailing requirements for filings with the host state regulators and communications with local investors in the UCITS.

THE IMPACT OF UCITS IV ON THE CROSS-BORDER REGISTRATION PROCESS WITHIN THE EU

On 16 July 2008, the European Commission released proposed changes to the UCITS Directive (known as UCITS IV), and the European Parliament approved UCITS IV on 13 January 2009. The changes should come into effect in mid-2011 and bring much anticipated reform to the European retail investment funds sector. It is hoped that these changes will increase the efficiency of the cross-border registration process in a number of key areas.

The European Commission asserts that the UCITS Directive has been key to the successful development of the European market

for investment funds. However, critics observe that the cross-border registration process is long and bureaucratic. The cross-border flow of funds is reduced and the cost of managing remains high: ultimately these costs are passed on to investors.

Under UCITS IV, the cross-border notice registration procedure would be simplified. Under the reforms, a UCITS intending to register in another member state would file a notification letter with its home state regulator. The notification letter would contain information on how the UCITS proposes to market its shares in the intended host member state. Along with the notification, the UCITS would be required to submit to its home member state:

- The fund rules or instruments of incorporation.
- The prospectus.
- Where appropriate, the latest annual and semi-annual report.
- The Key Investor Information document (which would replace the simplified prospectus), also translated if required.

From the time the notification letter is received by the home member state, the home member state would have five working days to transmit the complete documentation along with a UCITS attestation or certificate to the host member state. Once all documentation has been sent by the home member state to the host member state, the home member state would immediately notify the UCITS. The UCITS would then be permitted to start marketing its shares in the host member state as of the date of this notification. Therefore, the two-month waiting period before the UCITS could commence marketing in the host member state would be eliminated under UCITS IV. However, the reforms would allow a host member state to impose local marketing rules on UCITS, but only after the UCITS has placed its shares on the market of a host member state. In addition, the host member state would not be permitted to request any additional documents, certification or information other than those provided by the home member state.

This procedure would simplify the cross-border registration process considerably by shortening the time period which UCITS must currently wait in certain host state jurisdictions. It is difficult to tell, however, how this would work in practice. As noted above, many host jurisdictions require additional documentation before allowing a registration to proceed, such as country supplements required in so many jurisdictions. It is difficult to see how the host jurisdictions would permit the sale of the UCITS without them. In practice, it may prove difficult to implement this proposal.

It has also been proposed, under UCITS IV, to eliminate the translation requirements for all documents in English (and perhaps certain other languages), except for the Key Investor Information document. This would save a considerable amount of time (as noted above, it can take up to six to eight weeks to translate the necessary documentation for a registration in a new jurisdiction). In addition, it would save money for a UCITS incurred in translating documents, legal reviews of translations, and mailing translations of documents when often the host language document is mailed to all investors in any event.

CROSS-BORDER REGISTRATION OF FUNDS OUTSIDE THE EU

UCITS have become an increasingly popular investment in countries outside the EU. UCITS registering on a cross-border basis have increased dramatically. A large percentage of investment in UCITS comes from outside the EU. The European Fund and Asset Management Association (EFAMA) has commented, following a survey of large asset management firms, that 90% of net sales of UCITS promoted by those firms originated in Asia in 2007. UCITS as a brand has been recognised across the world, and many UCITS are registered in non-EU countries such as Switzerland, Hong Kong, Singapore, Taiwan, Bahrain, the UAE, Chile and Peru.

It is important to remember when considering registration in a non-EU jurisdiction that the passporting regime is not available. A UCITS must therefore be registered under the local regime and comply with all local registration and compliance requirements.

In particular, local regulators have the authority to impose additional restrictions on the way a UCITS is managed. In certain jurisdictions, there are a number of substantive limitations on a fund's ability to manage various kinds of assets. For example, Taiwan used to require (until a recent easing of these regulations) that a fund registered in Taiwan could invest no more than 0.4% of its assets in Mainland Chinese securities, and no more than 10% of its assets in China-related securities traded in Hong Kong or Macau. It was necessary to consider that by registering in Taiwan, a fund's portfolio managers might be restricted in the future from investing in Chinese securities. The requirement impacts all investors in the fund, not just Taiwanese investors, and if the portfolio managers subsequently determined that investment in Chinese securities was attractive for the fund as a whole, it would be necessary to de-register the fund in Taiwan, to act in the best interests of all investors in the fund.

In addition, non-EU regulators may have statutes and regulations which are different from or actively conflict with the regulations of the UCITS home state. At times, registration in these non-EU jurisdictions may result in the need to approach the home state regulator to request permission to change the UCITS prospectus to comply with the other jurisdictions' requirements. For example, the Swiss Financial Market Supervisory Authority (FINMA) requires funds to comply with the "Swiss Names Rule", which requires each fund registered in Switzerland to invest at least two-thirds of its assets in accordance with the name of the fund. The Swiss Names Rule is very specific. For example, a bond or equity fund may be limited in the amount it can invest in derivatives, or a fund with a geographical name (such as a Developing Markets Fund) must only invest in securities with a certain nexus to the geographic area which may differ from the nexus allowed for UCITS. Therefore, it is necessary to revert to the home state regulator and attempt to determine disclosure which is permissible to the home state regulator and the Swiss FINMA, while still preserving the ability of the portfolio manager to manage the fund in accordance with its desired strategies.

When dealing with regulators in multiple jurisdictions (and it is not unusual for a UCITS to be registered for distribution in over 25 jurisdictions, both within and outside the EU) it can take a long time to implement changes across many different regulators. A number of regulators can take weeks or months to consider and approve potential changes in prospectus disclosure; it may be necessary to engage in

three-way or four-way negotiations between regulators to ensure all accept the final disclosure. In addition, many jurisdictions have special notice publication requirements (in a journal or by notice to investors) which may differ from the requirements of the home state regulator. In spite of these difficulties, however, the UCITS brand name is growing strongly in acceptance across many jurisdictions globally.

UCITS IN THE FUTURE

The goal of creating an environment in which UCITS can be passported effectively across a single market is making progress. The European Commission and CESR are working together to deliver consistent implementation of UCITS law. The approval of UCITS IV by the European Parliament continues to move the EU in the right direction toward this goal, although much work remains.

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CONTRIBUTOR DETAILS

Karen L. Anderberg
Dechert LLP
T +44 20 7184 7313
F +44 20 7184 7001
E karen.anderberg@dechert.com
W www.dechert.com

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