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UCITS IV News

A Pan-European Newsletter

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While our previous edition of this newsletter a year ago was still cautiously called "UCITS III / IV" News, we can now safely go for a bold "UCITS IV" in our title! While technically not fully complete (the Council still has to vote the text adopted by the EU Parliament on January 13, 2009), the adoption of this Directive, which has fuelled so much heated debate, has eventually turned out to be the natural thing to do.

The main novelties of UCITS IV should now be known by anyone working in the investment management industry: cross-border mergers of UCITS become possible, as will a pooling of assets via master feeder structures. The notification process for funds becomes easier and transparency towards the investor will be improved through the mandatory use of a "Key Investor Information" document replacing the simplified prospectus. Finally, the management company passport will permit the remote set up and management of UCITS funds in countries without the management company disposing of any presence in there. Fund managers will have the choice to centralise their asset management, administration, risk management operations in one domicile, thereby potentially creating significant cost savings, the most obvious of which being the cost of capital and resources triggered by having one management company per country. Indeed, out of the top 30 asset management groups in terms of cross-border distribution of UCITS, 50 % have management companies in 4 countries or more!

The Commission has until July 2011, which is the date on which UCITS IV has to be fully implemented into national legislation of the 27 Member States, to work out implementing measures on several topics of UCITS IV. It has until July 2010 to detail those issues that the EU Parliament and the Council have found crucial, in particular on the organisation, conduct of business and conflict of interest rules for management companies and on risk management.

In its "*Provisional request to CESR for technical advice on possible implementing measures concerning the future UCITS Directive*", dated February 13, 2009, the Commission has added a few issues, for which there was originally no stringent deadline foreseen. One of them concerns the measures to be taken by the depositary of a UCITS managed by a management company situated in another Member State.

Depositary control over the management company ("MC")

UCITS IV has not changed the duties of a depositary (yet). While one can not exclude that, as a consequence of the Madoff scandal, the Commission will propose changes to the definition and interpretation of a depositary's roles and responsibilities, such proposal will not change the text of the new directive. Hence, a depositary will still safe keep the assets of the UCITS and will control the proper issuance and repurchase of fund units, the proper NAV calculation, the investment compliance, the utilisation of the fund's income, as well as the timely receipt of consideration related to portfolio trades (see article 22.3. of the recast directive).

In order to be able to do so when the MC is located in another domicile, the depositary will enter into an information flow agreement with the MC, the details of which will be drawn up with CESR's help. The information so received should permit the depositary to perform its monitoring function on the five aspects mentioned in article 22.3.

We have tried to find out how this control task is being exercised today in the UCITS world, where MCs and depositaries of UCITS are by definition located in the same country. While most European countries have more or less faithfully transposed the wording of the 1985 UCITS directive on depositaries' monitoring functions, the translation into practice shows great discrepancies!

In Spain, the depositary has, by law, the right to request, on a monthly basis, reporting from the MC on any topic or information the depositary deems relevant. The monthly reporting also to be made by the MC to the CNMV should be in compliance with the information received by the depositary from the MC (the custodian must pre-clear the information reported to the CNMV). In addition, a semi-annual compliance report on the results of its monitoring of the MC must be prepared by the depositary and sent to the authorities. In the UK, the onus is put on the review of the fund's pricing, the depositary having to periodically (which means at least once a year) review the actual pricing and all the systems and processes surrounding that function. The reviews are duly communicated to the fund manager and, if any discrepancies are found, to the FSA.

The French go very far in their understanding of the depositary's role in terms of its monitoring functions. According to their regulation, the depositary must *"control the regularity of the fund's decisions".* This control entails, in particular, a (a posteriori) supervision on compliance with investment and asset structure rules, the minimum asset amount, the frequency of valuation of the fund, the rules and procedures for determining the NAV. The procedures of control are formalised in a periodic *"plan de contrôle"* which is made available to the AMF. The depositary must also be informed and must approve many changes in the life of the fund (new asset manager, merger, liquidation etc…).

Ireland uses the depositary agreement to list in details the various tasks of the depositary as regards MC controls. Once a year, the depositary must report to the shareholders of the fund the results of its "*enquiring into the conduct of the management company*", which includes a.o. a verification of whether the MC/fund has complied with its investment and borrowing powers.

German legislation remains fairly vague about the actual manner in which the control by the depositary over the MC is being exercised and practices in that respect vary greatly from one depositary to another.

The following chart provides a short overview of existing reporting obligations, by the depositary, of the controls it exercises over the MC, without however detailing the controls themselves:

	AT	ES	FR	DE	UK	IE	BE	SE	LU
Reporting on controls done?	N	Y	Y	N[1]	Y	Y	Y	Y	N
To whom?	n/a	CNMV	- MC - AMF if breaches only	N[1]	- Fund manager - FSA if breaches only	- IFSRA - Shareholders	MC	- MC - FSA	n/a
Reporting frequency	n/a	Semi-annual + monthly reporting	Ad hoc + annual	N[1]	Periodically (annual at least)	Annual	Periodically	Annual	n/a
On-site visits done by custodian?	N	N	Y	N[1]	Y	Y	Y	Y	N
Difference in treatment for corporate or contractual funds?	N	N	N	N	N	N	N	n/a	Y

[1] The depositary function is however subject to an annual external audit of the depositary bank.

Another interesting issue, not yet harmonised by any European legislation, is the potential delegation of any tasks covered by Collective Portfolio Management, as defined in Annex II of UCITS IV.

Delegation of administrative tasks by the management company

Indeed, new divergences between EU Member States are already appearing, in particular as regards the controversial MCP and delegation arrangements! Today, MCs of UCITS vehicles are as a general rule allowed to delegate asset management and marketing functions even outside the EU, provided they do not become simply letter boxes.. It is different for administration functions, where the concept of "head office" (to be in the same domicile as the UCITS) has prevented many countries to outsource these functions outside of their boundaries. UCITS IV puts an end to the requirement of having administration in the domicile of the fund: it provides that the MC of a UCITS is in charge of its funds' administration and that the national rules of the MC will determine the rules applicable to delegation – including any potential outsourcing in another Member State!

The future could hence look as follows: UCITS in country A, MC in country B and administration service provider in country C! This complex scenario assumes, however, that the laws of country B allow an outsourcing of administration tasks abroad. Again, this is where Europe is not quite harmonised yet!

Country		AT	BE	DE	ES	FR	IE	IT	LU	NL	SE	UK
Which administrative functions can, according to law/regulation, be delegated *abroad* by a MC domiciled in this country?	**Accounting**	**Y**	**N[1]**	**Y**	**Y**	**N[3]**	**N**	**Y**	**N**	**Y**	**Y**	**Y**
	Customer inquiries	**Y**	**N[1]**	**Y**	**Y**	**N**	**N**	**Y**	**N**	**Y**	**Y**	**Y**
	Valuation / Pricing	**N**	**N[1]**	**Y**	**Y**	**N[3]**	**N**	**Y**	**N**	**Y**	**Y**	**Y**
	Compliance monitoring	**Y**	**N[1]**	**Y**	**Y**	**N**	**Y**	**Y**	**Y**	**Y**	**Y**	**Y**
	Maintenance of register	**N**	**N[1]**	**N/A[2]**	**Y**	**N**	**N**	**Y**	**N**	**Y**	**Y**	**Y**
	Unit issues / Redemptions	**N**	**N[1]**	**N/A[2]**	**Y**	**N**	**N**	**Y**	**N**	**Y**	**Y**	**Y**
	Contract settlements	**Y**	**N[1]**	**Y**	**Y**	**N**	**N**	**Y**	**N**	**Y**	**Y**	**Y**
	Record keeping	**Y**	**N[1]**	**Y**	**Y**	**N**	**N**	**Y**	**N**	**Y**	**Y**	**Y**

[1] Delegation as a whole is prohibited, but Belgian management companies can be assisted for the performance of "technical tasks" by third parties in and outside of Belgium.

[2] There is no "register" for German funds and issue and redemption handling is a duty of the depositary.

[3] The MC can however outsource certain non essential functions (support tasks) in and outside of France.

Now obviously, practice can look quite different from what is foreseen by laws and regulation! German KAGs do not in reality delegate their administration abroad, while Luxembourg or Irish funds frequently use providers abroad, generally part of the group, to perform certain of these tasks. It will be interesting to verify in the future if countries will either start, or continue, to restrict, by law, the ability of MCs located in their territories to delegate administrative functions outside of their borders.

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