

1st Circular addressed to the financial services industry regarding the recast EU Directive on Undertakings for Collective Investment in Transferable Securities ('UCITS IV Directive')

22nd October 2009

Background

The purpose of this circular is to provide the financial services industry with:

- (a) a brief overview of the principal elements of the UCITS IV Directive and the recent developments relative to this European Directive; and
- (b) an indication of MFSA's intended approach regarding the implementation of the UCITS IV Directive.

What is UCITS IV?

The UCITS IV Directive was approved by the European Parliament in January 2009 and adopted by the Council in June 2009. The UCITS IV Directive has not yet been published in the Official Journal of the European Union. Once published, the MFSA intends to upload a copy of the UCITS IV Directive on its web-site. The text of the Directive as adopted by the Council is available through the following web-link: <http://register.consilium.europa.eu/pdf/en/09/st03/st03605-re01.en09.pdf>

The UCITS IV Directive is designed to make the UCITS market more efficient, in particular as regards the cross-border activities of fund management companies. The aim of the UCITS IV Directive is to modernise the regulatory framework applicable to these type of funds in order to: **[a]** offer the investing public a wider choice of financial products at a lower cost through further integration of the Internal Market; **[b]** enhance investor protection through better information and more effective supervision; and **[c]** preserve the competitiveness of the European funds industry by modifying the framework for the regulation of UCITS funds with a view of making it more suitable in view of recent developments in the global financial market. In order to achieve these objectives, the UCITS IV Directive:

[i] Creates an authentic EU passport for UCITS management companies – On the coming into force of the UCITS IV Directive, a UCITS management company located in a Member State will have the right to manage funds in other Member States. It is envisaged that this will generate significant economies of scale. Moreover, it should enhance diversity in the products available to investors;

[ii] Improves Investor Information – The UCITS IV Directive introduces a standardised summary information document which is entitled '*key investor information*' which is to replace

the currently required '*simplified prospectus*'. The KII is intended to be a concise and focused presentation of the information that is important for a prospective investor in a UCITS fund to have. This is considered as a ground-breaking approach aimed at assisting the consumer to comprehend and compare products;

[iii] Facilitates cross-border marketing of UCITS – The UCITS IV Directive does away with the administrative barriers to the cross-border distribution of UCITS funds;

[iv] Makes possible the cross-border mergers of UCITS – The original UCITS Directive did not provide the mechanism for the cross-border mergers of UCITS funds. This matter has been addressed in the UCITS IV Directive which creates a proper framework within which such mergers may take place;

[v] Provides for the application of master-feeder structures – The UCITS IV Directive smoothens the process of asset pooling by creating a framework for the operation of "*master-feeder*" arrangements whereby a UCITS fund invests more than 85 % of its assets in another UCITS fund; and

[vi] Strengthens the supervision of UCITS Funds and of management companies - This will be achieved through enhanced cooperation between supervisors. Indeed, the UCITS IV Directive *inter alia* enhances the provisions on exchange of information between Competent Authorities and provides for the harmonisation of their powers.

UCITS IV – Implementing Measures

UCITS IV is a Lamfalussy Directive and as such, it will be supplemented by technical implementing measures ('level 2 measures'), to be adopted by the European Commission. In this regard, the European Commission has asked the Committee of European Securities Regulators ('CESR') to make its recommendations on the measures which ought to be adopted. In terms of the European Commission's mandate, part of CESR's advice on the level 2 measures must be published by the end of this month. Once the CESR's advice on the level 2 measures is issued, the MFSA intends to upload a copy of it on its web-site.

CESR's advice on the implementing measures will split into three parts as follows:

Part I – Technical advice on the level 2 measures related to the UCITS management company passport

CESR's draft technical advice on the level 2 measures relating to the UCITS management company passport deal with the following:

[i] Organisational requirements and conflicts of interest – This section sets out technical advice on: **[a]** general organisational procedures and arrangements; **[b]** internal control mechanisms, including responsibility of senior management and the application of a remuneration policy; **[c]** electronic data processing and record-keeping; and **[d]** conflicts of interest. In drafting these technical implementing measures, CESR sought to maximise the alignment with the requirements on this area which emanate from the EU Markets in Financial Instruments Directive ('MiFID');

[ii] Rules of conduct – With respect to this area, CESR recommends the application of requirements to the direct sale of UCITS by management companies, and also suggests

requirements on best execution, order handling and inducements. CESR's advice in this area also seeks to replicate the relevant MiFID requirements;

[iii] Measures to be taken by a depositary of a UCITS managed by a management company situated in another Member State – This section of CESR's advice, focuses on additional requirements that should apply to the relationship between the management company and the depositary when these two entities are located in different Member States. Further to consultation with the industry, this advice has been extended to domestic arrangements where the fund management company and the depositary are located in the same jurisdiction;

[iv] Risk management – CESR's advice on risk management focuses on the adequacy of the risk management process, and on risk measurement for the purpose of calculating UCITS' global exposure; and

[v] Supervisory co-operation – This section of CESR's advice focuses on two key elements of supervisory co-operation: **[a]** on-the-spot verification and investigation; and **[b]** exchange of information between competent authorities.

Part II – Technical advice at level 2 on the format and contents of Key Information Document disclosures for UCITS

CESR's draft advice on the implementing measures on the KII covers the detailed and exhaustive content of the KII which will be provided to investors and also the specific details of the form and presentation of that information.

Part III – Technical advice on the level 2 measures relating to mergers of UCITS, master-feeder UCITS structures and cross-border notification of UCITS.

Part III of CESR's draft advice focuses on implementing measures relating to mergers of UCITS, master-feeder structures and the notification procedure for cross-border marketing. The European Commission requested CESR to first focus on its advice relating to Part I and Part II as the European Commission is under a legal obligation to adopt implementing measures in these areas. With respect to Part III, the European Commission requested CESR to organise its work such that all necessary Level 2 implementing measures, are adopted in time to be implemented by Member States within the timeframe imposed by the UCITS IV Directive. In this regard, CESR has published a call for evidence and has also issued a consultation paper on Part III of the Level 2 implementing measures. The deadline for contributions to the said paper is set for the 17th November, 2009. Following receipt of stakeholder feedback, the advice will be finalised for submission to the European Commission by the end of 2009.

Familiarisation

As outlined above, the UCITS IV Directive is an EU Directive with respect to which on-going changes are currently taking place. The MFSA encourages Licence Holders and Practitioners to keep abreast with these changes by referring to the web-sites of the Committee of European Securities Regulators [www.cesr.eu], that of the European Commission [http://ec.europa.eu/internal_market/investment/ucits_directive_en.htm] as well as that of the MFSA.

MFSA - Approach

MFSA is of the view that the UCITS IV Directive is an important step forward for Europe's fund industry, and should have a positive impact on the business model of promoters of UCITS funds. The transposition and implementation of the UCITS IV Directive poses a considerable challenge and it is the MFSA's intention to ensure that this is undertaken in an appropriate and reasonable manner. In this regard, consultation with Malta's financial services industry is considered by the MFSA as a key element in ensuring that the UCITS IV Directive is transposed and implemented in the right manner. In order to facilitate our communication with the industry on the transposition of the UCITS IV Directive, the MFSA has created a section on its web-site which is entirely dedicated to UCITS IV. This is available under the section of the web-site entitled '*Securities*' and contains the consultation documents issued by CESR on the level 2 measures. Moreover, MFSA plans to issue a separate circular/consultation document to the industry on each of the substantial aspects of the UCITS IV Directive. The first circular which MFSA intends to issue in this regard, will outline the manner in which the Authority plans to transpose the requirements on the *key investor information document*.

The deadline for the transposition of the UCITS IV Directive is 30th June 2011. The laws which transpose the directive must be adopted and implemented by the 1st July 2011.

Contacts

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