

Undertakings for collective investment in transferable securities (UCITS)

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Objectives of the UCITS Directive 85/611/EEC

- A harmonised legal framework to facilitate cross-border offering of investment funds to the retail investor and to develop an integrated and competitive European single market for investment funds.
- To establish a defined level of investor protection through strict investment limits, capital, organisational and disclosure requirements, as well as asset safe-keeping and fund oversight (by an independent depositary).

History of UCITS legislation

- The UCITS Directive 85/611/EEC was adopted and published in late 1985
- Implementation by the Member States by 1st October 1989
- Significant amendments made by Directives 2001/107/EC and 2001/108/EC - implementation by Member States by 13th February 2004
 - Expansion of eligible assets
 - New investment techniques
 - Simplified prospectus for investors
 - Rules on management company
- Other (minor) amendments made by:
 - Directive 88/220/EEC (introducing mortgage bonds)
 - Directive 95/26/EC5 (post-BCCI)
 - Directive 2000/64/EC (exchange of information with third countries)
 - Directive 2004/39/EC (MiFID – not yet entered into force)
 - Directive 2005/1/EC (Lamfalussy directive)



Building blocks of the UCITS product:

Structural principles

- "Redeemability" at NAV
- Segregation of assets
- Separation of functions to limit conflicts/abuse

Investment rules

- List of eligible assets
- Diversification
- No borrowing/shorting
- No commodities, real estate

UCITS passport

- EU wide-marketing once authorised in home country
- Notification procedure
- Very limited host country involvement



Key provisions of the UCITS Directive

- **Scope (Article 1) :**

UCITS are undertakings the sole object of which is:

- investment in transferable securities and/or in other liquid financial assets referred to in Article 19(1)
- of capital raised from the public
- and which operates on the principle of risk-spreading (Article 22ss)

UCITS have to be open ended structures.

UCITS can be set up in different legal forms:

- as common funds (« contractual form ») managed by management companies
- as unit trusts (common law concept of trust law)
- as investment companies (« corporate form »)

Key provisions of the UCITS Directive

- **UCITS authorization requirements**

- (1) General requirements**

- For unit trusts: approval of management company, fund rules & choice of depositary
 - For investment companies: approval of instrument of incorporation & choice of depositary
 - Sufficient good repute and sufficient experience of the directors of the depositary and the management company

- (2) Specific investment requirements/limitations**

- Investment in « eligible assets » : securities, money market instruments, deposits, investment funds and derivatives
 - Compliance with fixed quantitative investment limits
 - Explicit exclusions or permission of certain investment techniques

Key provisions of the UCITS Directive

- **UCITS authorization requirements**

- (3) Disclosure requirements (Articles 27ss)**

An investment company and, for each of the unit trust/common funds it manages, a management company, must publish:

- Full prospectus (Schedule A of Annex 1)
- Simplified prospectus (Schedule C of Annex 1)
 - to be offered to the investor prior to the conclusion of the contract
 - can be used as a marketing tool
- Periodic reports

Key provisions of the UCITS Directive

- **Product Passport**

In 1985, the UCITS Directive introduced the concept of « product » passport to facilitate the cross-border circulation of (certain types of) investment funds. The product passport consists of the following two pillars:

(1) Authorization of UCITS: Home Member State principle (Article 4)

- Authorization granted by the competent authorities of the Member State where the UCITS is situated (“Home Member State”).
- Valid for all Member States.

Key provisions of the UCITS Directive

- **Product Passport**

- (2) **Marketing of units in other Member States notification procedure (Article 44ss)**

- notification to Host Member State (with attestation by the Home Member State that the UCITS fulfils the conditions of the UCITS directive) (**Article 46**).
 - UCITS can start marketing its units two months after such communication unless reasoned decision by Host Member State of non-compliance of marketing arrangements with **Articles 44(1) and 45** of the UCITS Directive.

Key provisions of the UCITS Directive

- **Management Company (Articles 5ss and 6)**

UCITS III amendments included:

- Reinforcement of the capital and risk control provisions applicable to management companies.
- Enlargement of scope of activities : apart from its core activity of collective investment management, a management company can now also perform individual portfolio management and some ancillary services (investment advice & safekeeping of fund units) (Article 5).
- Introduction of the management company passport, i.e. the right to carry on the activities for which it has been authorised in its Home Member State (Article 5a) in another Member State either through the establishment of a local branch or under the freedom to provide services cross-border (Article 6).

Key provisions of the UCITS Directive

- **Depositary (Articles 7 and 14)**

- Functionally separate depositaries are one of the pillars of the UCITS framework.
- The depositary has a double mission of (1) safekeeping of the funds assets and (2) carrying out a number of oversight functions to ensure that the assets are managed legally by the management company.
- No changes made to 1985 regime – currently no depositary passport available : depositary must be located in the same Member State as the fund.

Current issues of implementation of UCITS Directive 85/611/EEC

- UCITS Directive and UCITS III amendments have been implemented in all 25 Member States. However, some problems remain.
- The Commission has adopted two Recommendations to ensure a common interpretation of certain provisions of the UCITS Directive in the different Member States:
 - Recommendation 2004/383/EC of 27 April 2004 on the use of financial derivatives
 - Recommendation 2004/384/EC of 27 April 2004 on some contents of the simplified prospectus as provided for in Schedule C of Annex 1 of the UCITS Directive

Current issues of implementation of UCITS Directive 85/611/EEC

- The Commission is working on a clarification of the definition of « eligible assets » on the basis of its comitology powers under Article 53a of the UCITS Directive (Commission working document published on website).
- On-going work to clarify the notification procedure and the operation of the product passport (Level 3 measures).
- The Commission has launched a public consultation by its Green Paper on the enhancement of the EU Framework for investment funds, published on 14th July 2005. A feedback statement on this consultation was published in February 2006.
- The Commission intends to publish a White Paper on asset management in the autumn of 2006.

UCITS Directive 85/611/EEC

For further information :

http://europa.eu.int/comm/internal_market/finances/securities/ucits/index_en.htm