THE UCITS IV DIRECTIVE, THE NEED FOR RATIONALIZATION, AND MASTER-FEEDER STRUCTURES

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INTRODUCTION

THE UCITS IV DIRECTIVE (I)

- **The UCITS Directive 85/611/EEC (in force in 1988 and amended by UCITS III in 2002) has been the key driver towards the significant development and success of the EU investment fund industry over the last two decades. However, with the rapid evolution of the investment fund market, it was necessary to further enhance the UCITS market .**
- **To this end, the recent amendment of UCITS Dir ("UCITS IV") introduces five key modifications: three of them offer fund managers the opportunity to undertake a strategic reflection on their product range and management structure, two of them are compulsory measures to enhance speed-to-market and investor protection.**
- **The UCITS IV is designed to facilitate the sale of funds across the EU, it is expected to drive consolidation of a fragmented EU investment fund industry, both at fund and service provider level. It is hoped that this consolidation will boost the industry's competitiveness by increasing rationalization, economies of scale and lowering service provider costs.**
- **The UCITS IV Dir will become effective on July 1st, 2011.**

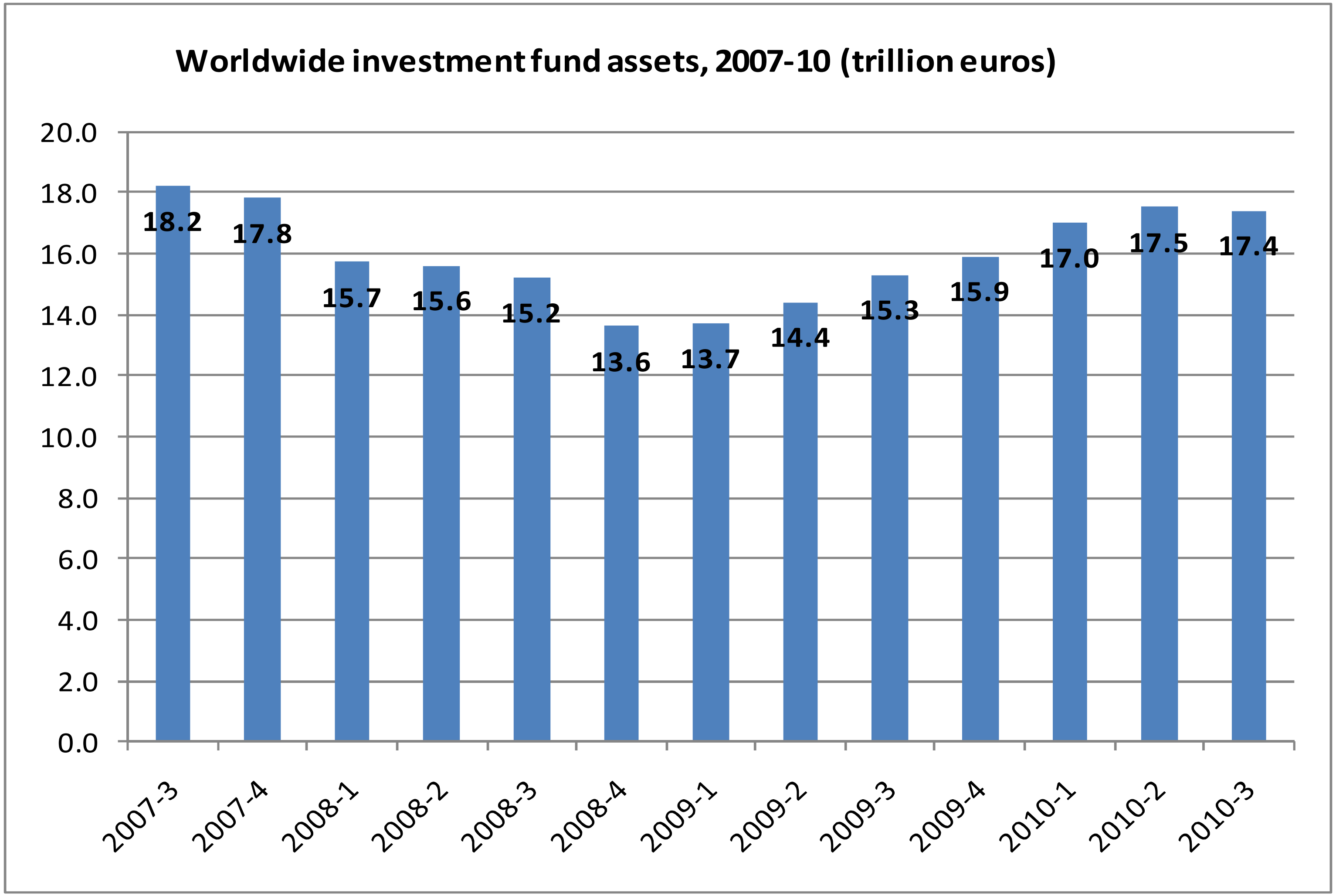
GOALS OF THE DIRECTIVE

THE UCITS IV DIRECTIVE (II)

- **The UCITS IV initiative was based upon the assumption that existing regulation and structure are barriers to increased concentration within the European asset management industry.**
- **In 2006 the EC wrote in its White Paper that regulation did "*not allow fund managers with funds or activities in different M-S sufficient flexibility to organize or restructure businesses. These inefficiencies and constraints are reflected in higher costs and lower returns that are borne by the fund investors*."**
- **Moreover, it is well-known that the average size of assets under management in European UCITS is very small. So, UCITS ranges must be rationalized to achieve economies of scale and decrease expense ratios.**
- **The new elements of UCITS IV DIR create new challenges, and opportunities, for service providers. Each key element is examined in turn before turning to the strategic considerations for asset management groups, which provides the key to understanding the new environment for service providers.**

THE EU FUNDS INDUSTRY TODAY

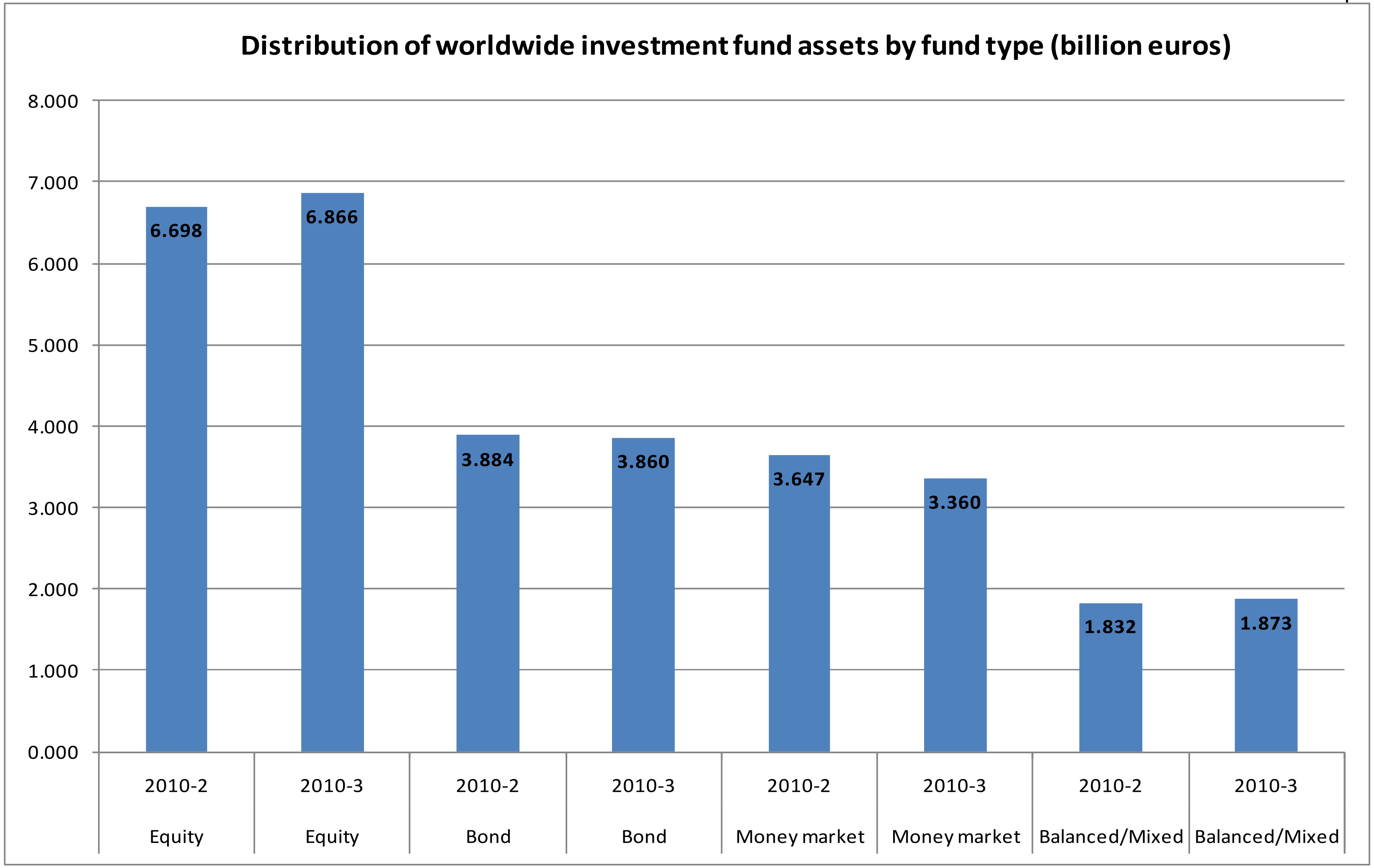
THE INVESTMENT FUND INDUSTRY TODAY 1



Source: EFAMA

THE EU FUNDS INDUSTRY TODAY

THE INVESTMENT FUND INDUSTRY TODAY 2



Source: EFAMA

THE EU FUNDS INDUSTRY TODAY

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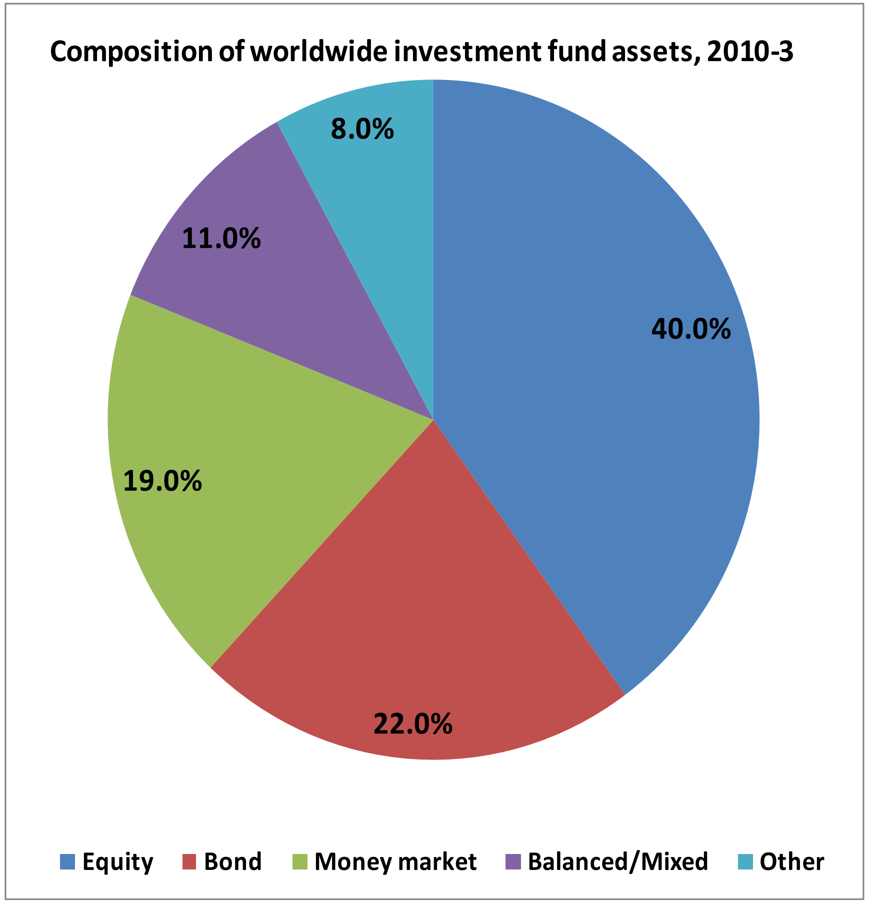
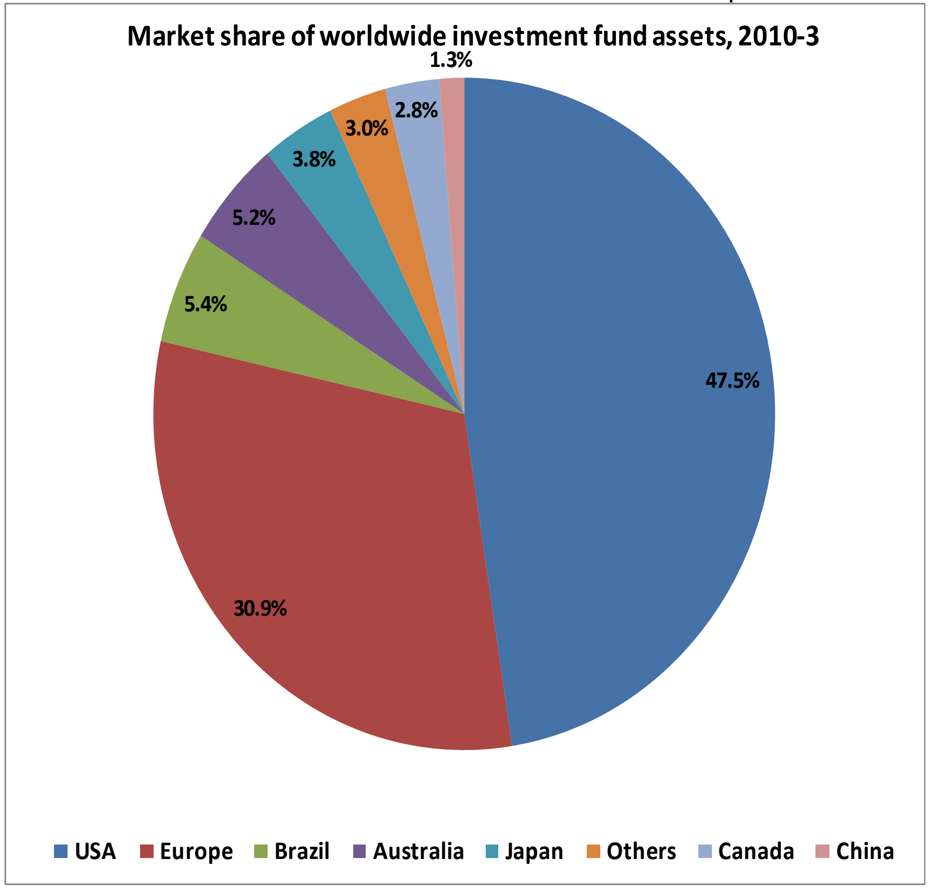




Source: EFAMA

THE EU FUNDS INDUSTRY TODAY

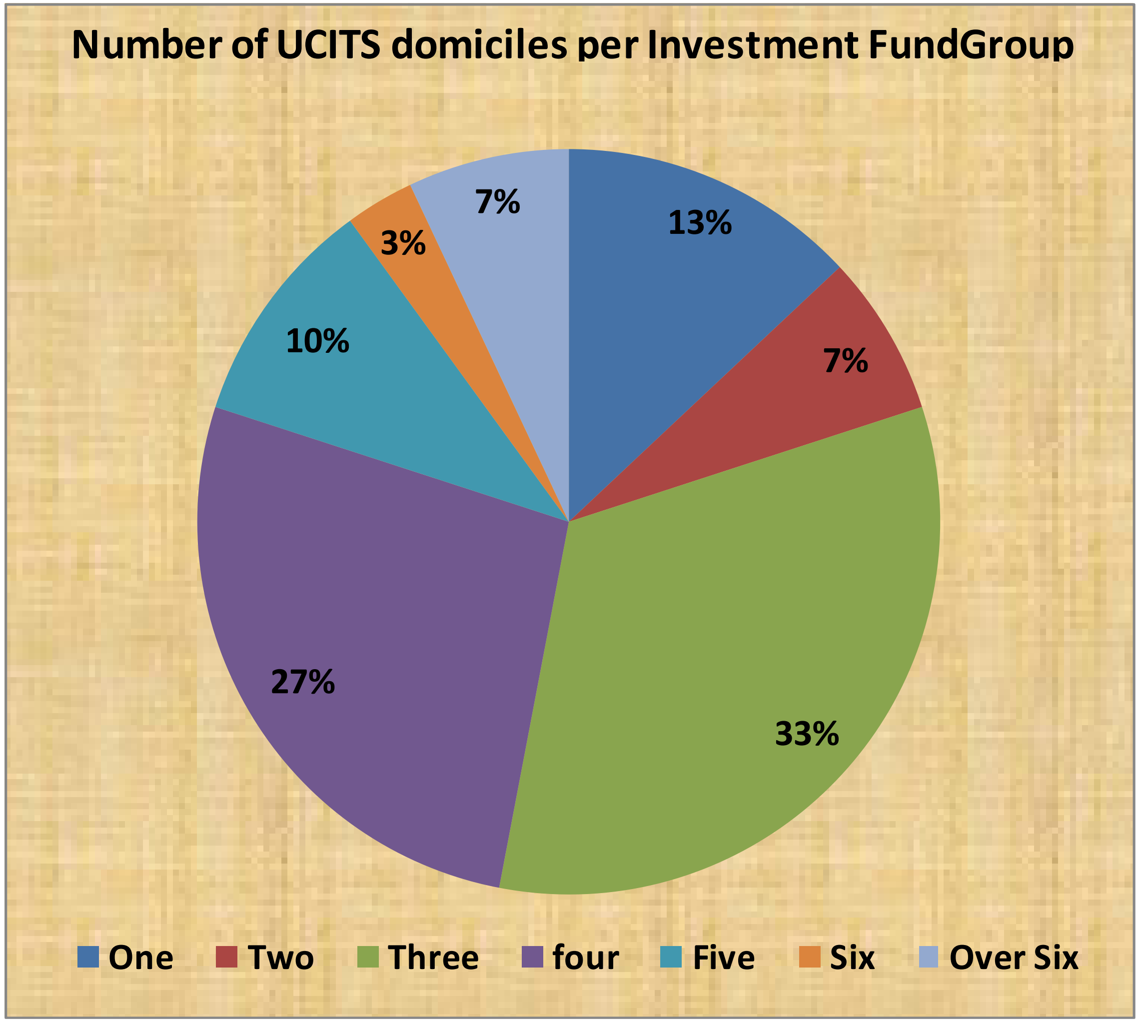
THE INVESTMENT FUND INDUSTRY TODAY 4

COUNTRY	OVERALL FUND INDUSTRY			UCITS market			NON-UCITS market		
	Number of funds	*Assets (million euro)*	*Assets (million USD)*	*Number of funds*	*Assets (million euro)*	*Assets (million USD)*	*Number of funds*	*Assets (million euro)*	*Assets (million USD)*
Austria	2,189	146,660	200,162	1,421	85,679	116,934	768	60,981	83,227
Belgium	1,905	95,475	130,304	1,872	89,375	121,979	33	6,100	8,326
Bulgaria	93	200	273	92	197	270	1	2	3
Czech Rep	112	4,878	6,657	109	4,820	6,579	3	57	78
Denmark	855	124,009	169,248	507	64,699	88,301	348	59,311	80,947
Finland	487	59,440	81,124	362	51,276	69,112	58,164	11,143	
France	11,762	1,406,409	1,919,467	7,842	1,223,059	1,669,231	3,920	183,350	250,236
Germany	5,991	1,106,153	1,509,677	2,100	236,937	323,372	3,891	869,215	1,186,305
Greece	246	8,299	11,326	238	7,222	9,856	8	1,077	1,470
Hungary	438	13,448	18,354	334	9,680	13,212	104	3,768	5,142
Ireland	4,718	885,710	1,208,817	2,857	708,472	966,922	1,861	177,238	241,894
Italy	1,022	239,973	327,515	658	182,173	248,630	364	57,799	78,885
Liechtenstein	632	28,786	39,287	433	24,964	34,070	200	3,822	5,216
Luxembourg	12,755	2,083,740	2,843,888	9,239	1,786,332	2,437,986	3,516	297,408	405,902
Netherlands	522	80,800	110,276	458	67,700	92,397	64	13,100	17,879
Norway	507	54,258	74,051	507	54,258	74,051	0	0	0
Poland	532	27,170	37,081	228	18,766	25,612	304,404	1,469	
Portugal	547	26,955	36,788	191	9,354	12,767	356	17,601	24,021
Romania	72	2,864	3,909	53	1,219	1,664	19	1,645	2,245
Slovakia	81	3,669	5,007	76	3,484	4,755	5	185	252
Slovenia	134	2,179	2,974	131	1,927	2,630	3	252	344
Spain	2,505	177,310	241,992	2,440	169,953	231,952	65	7,357	10,040
Sweden	568	150,443	205,324	540	147,047	200,689	283,396	4,635	
Switzerland	850	240,451	330,340	637	189,226	260,428	213	51,225	69,912
Turkey	**362**	**17,567**	**23,975**	**309**	**14,510**	**19,803**	**53**	**3,057**	**4,173**
UK	2,945	741,192	1,011,579	2,443	624,983	852,977	502	116,209	158,603
Europe	**52,831**	**7,728,037**	**10,549,397**	**36,077**	**5,777,312**	**7,887,048**	**16,754**	**1,950,725**	**2,662,349**

Source: EFAMA

THE EU FUNDS INDUSTRY TODAY

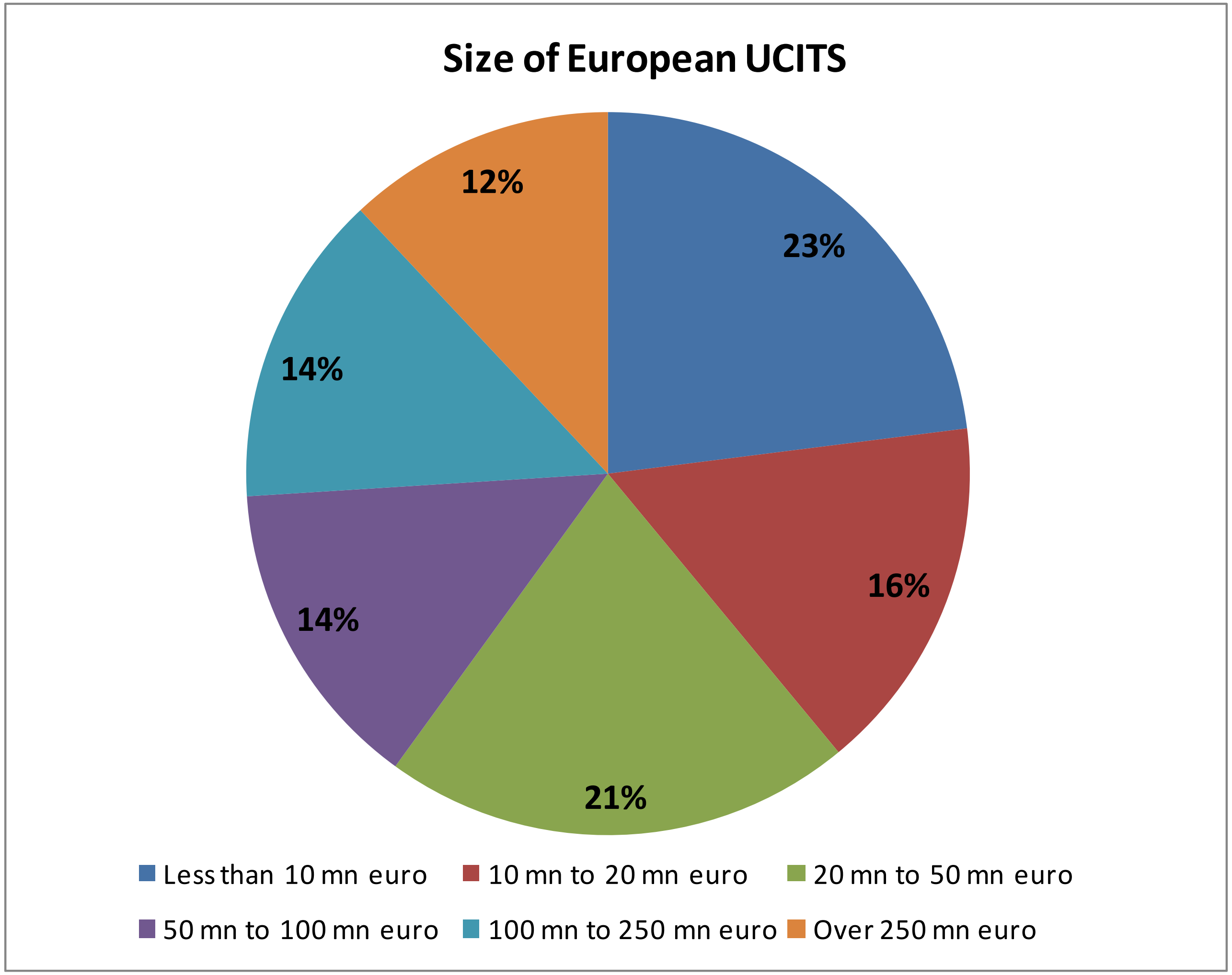
THE INVESTMENT FUND INDUSTRY TODAY 5



Source: Lipper-Reuters – top 30 cross-border groups – end of 2009

THE EU FUNDS INDUSTRY TODAY

THE INVESTMENT FUND INDUSTRY TODAY 6



Source: Lipper-Reuters – top 30 cross-border groups , based on 19,735 portfolios – end of 2009

CROSS-BORDER CIS ACTIVITY

TYPES OF CROSS-BORDER CIS ACTIVITY

- **The main ways in which the cross-border activity of CIS occurs is by:**
  - ***Direct marketing of foreign funds to investors in a foreign country (****under similar protection rules and sales conditions)*
  - ***Delegation of functions to or seeking assistance from foreign advisers or foreign fund managers through subsidiary establishment or remote service provision, depending on regulation and regulatory relationships***
  - ***Other types of cross-border activity*** *(independent of regulatory concern):* ***establish desired investment and asset allocation policies and structures, taxation, culture and bureaucracy.***
- **A number of alternative fund structures have also been developed to overcome some of the more onerous legal, regulatory and other restrictions imposed on operators that wish to market CIS abroad.**
- **The UCITS Dir has facilitated cross-border activity, by applying certain schemes in EU MS.**
- **Where no multilateral agreement exist whilst restrictions exist preventing CIS being marketed abroad, CIS operators face various obstacles.**

CROSS-BORDER CIS ACTIVITY

IMPEDIMENTS TO CROSS-BORDER CIS MARKETING OF CIS 1

- **Regulatory and Legal Issues:**

- ✓ ***Recognition or authorisation of CIS (authority allocation, mutual recognition)***
- ✓ ***Investigation, monitoring and enforcement of CIS by Foreign Regulators (authority allocation, participation in investigation, exchange of information)***
- ✓ ***Surveillance or routine inspections of CIS by Foreign Regulator (permission, joint or not, remote or not)***
- ✓ ***Sovereignty issues (broader home-host jurisdiction issues)***
- ✓ ***Ability to exchange information (quantity and quality as well as confidentiality of information exchanged)***

CROSS-BORDER CIS ACTIVITY

IMPEDIMENTS TO CROSS-BORDER CIS MARKETING OF CIS 2

- **Other factors affecting cross-border activity:**
- ✓ ***Resources (availability in different jurisdictions, manner of use by different jurisdictions)***
- ✓ ***Recovery of losses (ability to recover losses abroad, collateral, bankruptcy issues, domestic enforcement of foreign court judgments, foreign compliance with domestic rules/guidances)***
- ✓ ***Cultural Issues (barriers affecting foreign fund attractiveness to domestic investors, degree of comfort with different investment vehicles and regulatory/compliant structures,***
- **To a certain extent, the master-feeder fund structure overcomes this problem as the feeder fund which is marketed domestically will be tailored to meet the needs of domestic investors and the regulatory regime.**

CROSS-BORDER CIS ACTIVITY

SOME STATS ON THE LEVEL OF ACTIVITY (after UCITS I)

Cross-border activity 1: Number of regulated foreign CIS authorised or registered in each jurisdiction

AU	FR	DE	HK	IT	JP	LUX	MEX	NL	SP	SWE	SWI	UK	USA
170	201	548	691	81	182	125 *121 UCITS*	8	100 *70 UCITS*	70	123	810	262	19

Cross-border activity 1: Number of registered CIS advised or sub-advised or managed under delegation by foreign investment advisers

AU	FR	DE	HK	IT	JP	LUX	MEX	NL	SP	SWE	SWI	UK	USA
n/a	36	n/a	n/a	n/a	n/a	n/a	2	50	11	n/a	n/a	90-100	109

Cross-border activity 1: Number of CIS sell units outside your jurisdiction

AU	FR	DE	HK	IT	JP	LUX	MEX	NL	SP	SWE	SWI	UK	USA
n/a	92	253	n/a	n/a	n/a	813 *762 UCITS*	81	80	10	33	n/a	180	n/a

Source: RiskInstitute

INNOVATIONS AND CHALLENGES OF UCITS IV

SCOPE OF APPLICATION

- **UCITS INCLUDE UNDERTAKINGS:**
  - ✓ ***with the sole object of collective investment in transferable securities or liquid assets, capital raised from the public, and which operate along risk-spreading;***
  - ✓ ***Whose units are repurchased or redeemed out of these undertakings' assets.***
- **UNDERTAKINGS MAY BE CONSTITUTED UNDER THE FOLLOWING LAWS:**
  - ✓ ***contractual law (as common funds managed by management companies);***
  - ✓ ***trust law (as unit trusts);***
  - ✓ ***statute (as investment companies).***
- **HOWEVER, THIS DIRECTIVE DOES NOT APPLY TO UCITS:**
  - ✓ ***of the closed-ended type;***
  - ✓ ***which raise capital without promoting the sale of their units to the public in the European Union;***
  - ✓ ***the units of which may be sold only to the public in third countries;***
  - ✓ ***categories of collective investment undertakings prescribed by regulations.***

INNOVATIONS AND CHALLENGES OF UCITS IV

THE NOTIFICATION PROCEDURE

- **The notification procedure is the procedure to be followed before shares/units of a UCITS domiciled in one EU M-S can be distributed to investors in another.**
- **The new notification procedure is simplified and accelerated. This will reduce time-to-market and administrative burden for funds distributed cross-border, boosting cross-border distribution.**
- **The new notification procedure is not expected to present significant new challenges for the industry. Service providers must nevertheless be ready to meet the challenge of increased cross-border distribution of UCITS, and in particular increases in the number of countries of distribution.**
- **The new notification process will be a regulator-to-regulator process, where the Home MS regulator having only 10 working days to review a standardized (in form & content) notification file and to transmit it to the Host MS, thereby triggering the immediate right to start marketing activities in that country.**
- **Main challenges:**

✓ ***Regulator facing cross-border management companies***

✓ ***Adequate internal process to benefit from the reduced time-to-market opportunity***

✓ ***Compliance of the marketing arrangements with local regulations***

INNOVATIONS AND CHALLENGES OF UCITS IV

UCITS MERGERS 1

- **MS <u>may</u> allow UCITS to perform cross-border and domestic mergers. The techniques used must be provided for under the laws of the MS.**
- **When a merger takes place, the merging UCITS must communicate information concerning the proposed merger, the common draft terms of merger, and a statement by each of the depositaries of the UCITS concerned.**
- **MS shall require that the common draft terms of merger include the following particulars:**

✓ ***the background to and the rationale for the proposed merger;***

✓ ***the expected impact of the proposed merger;***

✓ ***the calculation method of the exchange ratio;***

✓ ***the planned date.***

INNOVATIONS AND CHALLENGES OF UCITS IV

UCITS MERGERS 2

- **In the case of a merger of a UCITS, the unit-holders must be informed of the conditions of the merger and of its potential influence on the receiving UCITS. The unit-holders shall receive other information including in particular:**
  - ✓ ***their rights before and after the proposed merger takes effect;***
  - ✓ ***a comparison of charges, fees and expenses for both UCITS;***
  - ✓ ***whether the management of the merging UCITS intends to undertake any rebalancing of the portfolio before the merger takes effect;***
  - ✓ ***details concerning any accrued income in the respective UCITS.***
- **The merging and receiving UCITS shall provide unit-holders with information on the approval procedure for the proposed merger and the date at which the merger is to take effect.**
- **Key investor information of the receiving UCITS shall be provided to the unit-holders of the merging and receiving UCITS.**

INNOVATIONS AND CHALLENGES OF UCITS IV

UCITS MERGERS 3

- **The established procedure for UCITS mergers facilitates fund mergers, particularly cross-border, and enables the creation of larger, more cost effective, funds. This may accelerate the trend of merging smaller UCITS into "mega" UCITS in a single domicile, distributed cross-border.**
- **A merger can take place between one or more UCITS, or sub-funds (compartments) thereof , and a receiving UCITS, or sub-fund thereof.**
- **It may be difficult to benefit fully from the merger provisions unless specific measures are implemented to ensure that mergers are tax neutral.**
- **The challenges of UCITS mergers include:**

✓ ***Evaluating the tax implications of the merger on the funds, on investors and on the management company of the merging fund(s)***

✓ ***Drawing up common draft terms of the potential merger***

✓ ***Drawing up the information to be provided to investors on the possible impact of the proposed merger***

✓ ***Valuing assets and establishing methodology for calculation of the exchange ratio***

INNOVATIONS AND CHALLENGES OF UCITS IV

MASTER-FEEDER UCITS STRUCTURES 1

- **In master-feeder UCITS structures, the *feeder* UCITS invests most of its assets in a *master* UCITS. Therefore, the management of a significant portion of the portfolio of the feeder fund is effectively <u>delegated</u> to the manager of the master fund. The master, or one or more of the feeders, can be located in different Member States.**
- **To be deemed as a master-feeder under the UCITS Directive, the feeder fund should invest at least 85% of its assets into a single master fund.**
- **Master-feeder UCITS structures will facilitate the channeling of investments into a single master fund.**
- **Mega UCITS in one domicile will likely be the "master"; whilst "feeders" in other countries may facilitate tax efficiency and better serve certain local distribution channels (e.g., for cultural reasons).**
- **An existing UCITS may become a feeder; a feeder UCITS may also change its master.**

INNOVATIONS AND CHALLENGES OF UCITS IV

MASTER-FEEDER UCITS STRUCTURES 2

- ***Agreements and internal CoB rules between feeder and master UCITS***
- **The master UCITS shall provide the feeder UCITS with:**
  - ✓ ***a copy of its fund rules or instruments of incorporation and key investor information;***
  - ✓ ***information on the delegation of investment management and risk management functions to third parties;***
  - ✓ ***internal operational documents.***
- **The master UCITS shall provide certain information with regard to the basis of investment and divestment:**
  - ✓ ***a statement of which share classes of the master UCITS are available for investment by the feeder UCITS;***
  - ✓ ***the amount of charges and expenses to be borne by the feeder UCITS;***
  - ✓ ***the terms on which any initial or subsequent transfer of assets in kind may be made from the feeder UCITS to the master UCITS.***

INNOVATIONS AND CHALLENGES OF UCITS IV

MASTER-FEEDER UCITS STRUCTURES 3

- ***Procedures in the case of liquidation of the master UCITS***
- **Where the feeder UCITS intends to invest at least 85% of its assets in units of another master UCITS, it shall provide:**
  - ✓ ***its application for approval of that investment;***
  - ✓ ***its application for approval of the proposed amendments to its fund rules;***
  - ✓ ***the amendments made to its key investor information.***
- **If a feeder UCITS intends to convert into non-feeder UCITS, it will provide:**
  - ✓ ***its application for approval of the proposed amendments to its fund rules;***
  - ✓ ***the proposed amendments to its key investor information.***
- **If a feeder UCITS intends to be liquidated, it shall provide notification of it**
- **The authorities shall be responsible for informing within 15 days past documentation the feeder UCITS if it intends to invest at least 85% of its assets in an master UCITS or to convert into a non-feeder UCITS. Once the feeder UCITS obtains approval, it shall inform the master UCITS.**

INNOVATIONS AND CHALLENGES OF UCITS IV

MASTER-FEEDER UCITS STRUCTURES 4

- ***Procedures in the case of merger or division of the master UCITS***
- **The feeder UCITS shall provide the competent authorities with its application for approval in the following cases:**
  - ✓ ***where it intends to continue to be a feeder UCITS of the same master UCITS;***
  - ✓ ***where it intends to become a feeder UCITS of another master UCITS;***
  - ✓ ***where it intends to convert into a non-feeder UCITS;***
  - ✓ ***where it intends to be liquidated.***
- **As with the liquidation procedure, the authorities shall inform the feeder UCITS 15 days after the documents have been received. Once the feeder UCITS has obtained approval, it shall inform the master UCITS.**
- **The law of the MS applying in the case of liquidation, merger or division shall also apply to information sharing between the two depositaries.**

INNOVATIONS AND CHALLENGES OF UCITS IV

MASTER-FEEDER UCITS STRUCTURES 5

- **The challenges of implementing master-feeder structures will include:**
- ✓ ***Drawing up the agreement between the master and feeder UCITS, or the internal C.o.B. rules where both are managed by the same management company***
- ✓ ***Definition of target set-up (fund range, local management company, distribution, etc)***
- ✓ ***Migration of funds (marketing & distribution issues, accounting and tax reporting, contractual arrangements, risk management process, corporate governance, etc)***
- ✓ ***Implementing appropriate measures to avoid market timing***
- ✓ ***Valuing the contribution in kind where the feeder transfers all/part of its assets to the master in exchange for shares/units*** *(e.g., conversion of existing UCITS into a feeder)*
- ✓ ***Establishing flow of information and documents between Custodians to ensure fulfillment of their duties, in particular when the master & feeder are in different MS***
- ✓ ***When converting an ordinary UCITS into a feeder UCITS, a feeder into an ordinary UCITS, or on change of master UCITS:***
  - ➢ Evaluating the tax implications of the change on the funds, on investors and on the management companies: the pre-restructuring and post-restructuring tax impact
  - ➢ Providing information to investors

INNOVATIONS AND CHALLENGES OF UCITS IV

KEY INVESTOR INFORMATION – K.I.I. 1

- **UCITS IV foresees a new document, replacing the simplified Prospectus, entitled Key Investor Information (K.I.I.) for every UCITS.**
- **KII must contain fair, clear and understandable information about the UCITS. It must be brief and nontechnical. It should be comparable and presented in an understandable way.**
- **The K.I.I. document will be a short document containing Key Investors Information, the content, form and presentation of which being fully harmonized so as to facilitate its understanding and direct comparisons between UCITS.**
- **In the case of umbrella UCITS, a separate K.I.I. must be produced each sub-fund. In the case of multiple share classes, a separate K.I.I. must be produced for each share class, except where a share class can be selected to represent other share classes and certain conditions are met. In the case of master-feeder structures, a separate K.I.I. must be produced for each feeder UCITS.**

INNOVATIONS AND CHALLENGES OF UCITS IV

KEY INVESTOR INFORMATION – K.I.I. 2

- **For existing UCITS, simplified prospectuses must be replaced with K.I.I. in 12 months of the implementation of the related implementing measures.**
- **The challenges of the K.I.I. will include:**

✓ ***Implementing the risk and reward indicator***

✓ ***Disclosing charges: presentation of charges and information on performance fees, new funds and funds changing their charging structure***

✓ ***Illustrating past performance: issues include calculation method, treatment of charges, use of a benchmark and simulated data (in the cases of new share classes and master-feeders)***

✓ ***Sourcing information to feed the KID and fund documentation management***

✓ ***Consistency between the various information sources (prospectus, KID, website, factsheets, etc.)***

✓ ***Review of distribution contracts***

INNOVATIONS AND CHALLENGES OF UCITS IV

THE UCITS MANAGEMENT COMPANY PASSPORT 1

- Today, 50% of the top 30 asset management groups in terms of cross-border distribution have existing management companies in 4+ jurisdictions. The UCITS IV management company passport will permit the remote establishment and cross border management of UCITS funds and the centralization of their asset management, administration and risk management operations.
- The m.c. of a UCITS domiciled in one EU MS may be located in another MS; it may also provide its services through a branch. Furthermore, the m.c. will not be required to appoint service providers in the domicile of the UCITS, apart from the custodian which must always be in the domicile of the UCITS.
- The UCITS must comply with its home MS rules on the constitution and functioning of the UCITS.
- The management company must implement procedures and arrangements to enable the UCITS home MS authority to monitor the UCITS' compliance with the rules under its responsibility.
- Where a UCITS is managed cross-border, the UCITS management company and custodian must enter into a written agreement on the flow of information between them to enable custodian to carry out its duties.

INNOVATIONS AND CHALLENGES OF UCITS IV

THE UCITS MANAGEMENT COMPANY PASSPORT 2

- **Key considerations exist when deciding where to domicile a management company: the domicile(s) of the fund(s) to be managed, the impact on distribution channels, direct and indirect tax, operational costs, regulation**
- **In the context of a UCITS managed cross-border, the challenges include:**

✓ ***For the custodian:***

- Entering into and implementing the agreement covering such flow of information between the management company and custodian to enable the custodian to carry out its duties
- Implementing measures in order to enable it to fulfill its duties regarding a UCITS managed cross-border
- As a point of contact for providing information to the UCITS home MS authority, and, potentially dealing with investor complaints

✓ ***For service provider to which the m.c. has delegated an activity (i.e. administration) or function (i.e. compliance or risk management) outside the UCITS home MS:***

- complying, on an ongoing basis, with the management company's home MS rules relating to the delegated activity or function and, where applicable, the rules of the UCITS home MS regarding the constitution and functioning of the UCITS

INNOVATIONS AND CHALLENGES OF UCITS IV

REINFORCING EXISTING EU REQUIREMENTS

- **UCITS IV will raise minimum EU regulatory requirements to be complied with by management companies and their service providers. The same requirements should be applied to *self-managed* UCITS, relating to:**
- ✓ ***Organizational requirements and conflicts of interest***
- ✓ ***Rules of conduct***
- ✓ ***Risk management***
- **For management companies or self-managed UCITS, the challenges of the reinforced regulatory requirements will include:**
- ✓ ***Complying with organizational & conflicts of interest requirements and rules of conduct:*** *The application of MiFID-like requirements to m.c. may be an additional burden.*
- ✓ ***Complying with risk management requirements:*** *The impact of these measures will depend on the level of current Member State requirements.*
- ✓ ***Applying similar standards to non-UCITS: ESMA recommends that the same regulatory requirements be applied to the management of non-UCITS by UCITS management comp.***
- ✓ ***Performing due diligence when delegating activities or functions to a third party***
- ✓ ***Service providers may offer compliance & risk management support services to m.c.***

IMPLEMENTATION AND CHALLENGES OF UCITS IV

STRATEGIC CONSIDERATIONS 1

- UCITS IV creates the opportunity for asset management groups to rationalize their UCITS product ranges and optimize their service provider set-up. Asset management groups will try to develop a holistic strategy that optimizes tax, regulatory, operational efficiencies of their entire operations.
- The key considerations for asset management groups will include:
- **Rationalizing and enhancing of product ranges**
- Asset management groups will consider rationalizing and optimizing their product ranges to create funds of sufficient size to benefit from economies of scale. They may also consider consolidating funds from other promoters into their own range.
- **Rationalizing cross-border distribution of funds**
- Asset management groups may also take advantage of the simplification of the notification procedure to increase the number of countries, particularly EU countries, of distribution of their UCITS.

IMPLEMENTATION AND CHALLENGES OF UCITS IV

STRATEGIC CONSIDERATIONS 2

- **Rationalizing service provider set-up**
- **Asset management groups and promoters will reconsider their current service provider set-up, with a view to determining the optimal structure to service to their fund range. The options open relate to:**

✓ ***Design*: *choice of optimal combination of own and third-party or joint venture management companies and service providers.***

✓ ***Delegation*: *choice of activities that will remain in-house, and those that may be outsourced by management companies and service providers. Management companies and self-managed investment companies may delegate activities*** *(portfolio management, administration or marketing)* ***or functions*** *(such as compliance, internal audit and risk management)* ***where permitted by the regulations of the m.c's home MS. Service providers may be permitted to delegate certain activities.***

✓ ***Domicile*: *choice of domicile of the m.c.s and service providers. The management company passport enables a m.c. in one MS to manage UCITS in another, directly or indirectly. If permitted by the regulations of the m.c.'s home MS, the m.c. may also delegate activities or functions to service providers cross-border. In the case of self-managed investment companies, cross-border delegation will depend on the rules of the UCITS home MS.***

ASSESSING THE NEW BUSINESS ENVIRONMENT

THREATS AND OPPORTUNITIES

- **The streamlining of UCITS fund ranges and optimization of asset management groups' service provider set up creates new opportunities and challenges for service providers. These may include:**

- ✓ **Gaining and losing business. For example:**
  - ***Streamlining of UCITS ranges will tend to concentrate assets to be serviced in a few domiciles***
  - ***Groups are likely to outsource more activities and functions to remain competitive, benefiting third party and joint venture service providers***
- ✓ **Mergers, acquisitions and liquidations. For example:**
  - ***Groups deciding to sell service provider businesses or set up joint ventures will create targets for acquisitions and mergers respectively.***
  - ***Underperforming service providers may be taken over or liquidated***
- ✓ **Outsourcing**: ***service providers may themselves delegate certain activities or functions to other service providers, for example to reduce costs.***

ASSESSING THE NEW BUSINESS ENVIRONMENT

KEY CHALLENGES

- The key challenge for service providers will be meeting the quality of service requirements at a competitive price. Service providers will therefore need to attain critical size and implement robust and efficient processes and procedures. Competition in the service provider space is likely to be fierce, and a shake-out is to be expected.
- This may also lead to concentration and consolidation in the most attractive jurisdictions. The choice of domicile for services providers will depend on factors such as:

✓ *Quality and cost of service*

✓ *Reputational issues relating to the appointment of service provider and its domicile*

✓ *Ability to work with other service providers*

✓ *Direct and indirect tax considerations*

✓ *Regulatory environment, such as delegation/outsourcing rules*

✓ *Proximity considerations (e.g. clients for distribution, m.c. for administration)*

✓ *Qualifications and knowledge of the workforce*

SOME VIEWS OF THE MARKET

WHAT SOME FUND MANAGERS SAY 1

- Key questions arising from UCITS IV implementation: (a) *Is the industry ready for the new dir?* (b) *What impact will it really have on industry participants' businesses?* (c) *What stance have they taken in preparation?*
- To help address these questions, a 2010 survey by Bluerock and Eurogroup Consulting of 78 professionals in 10 European countries, showed that:
- 1. UCITS IV may not achieve its objective. The EC has set the objective of a 3% increase in nominal investment returns, but the proposed measures may not achieve this goal. Professionals mostly see this Dir as offering opportunities for optimization without any major disruption of the existing market structure. They react positively to the opening of certain commercial barriers, but are just as concerned that distribution costs will skyrocket.
- 2. Asset managers acknowledge the Dir with caution. Despite their service providers offering new services to assist them with taking up the objectives of the directive, asset managers continue to take a 'wait and see' stance.
- 3. While the Dir is a step in the right direction, the lack of provisions on the depository function and on tax matters makes its use uncertain.

SOME VIEWS OF THE MARKET

WHAT SOME FUND MANAGERS SAY 2

- **Professional managers argue that the potential for new distribution opportunities within Europe should not be overestimated. Given existing markets and level of sophistication, few clear opportunities for significant growth within European markets seem to exist. Local management is frequently focused on local needs, be it through local or foreign vehicles (mainly Luxembourg).**
- **In most cases, national preferences seem to prevail when determining positioning within the EU market. Asset managers may not use UCITS IV as a tool for reorganizing on a pan-European basis. Many are already more structured than was assumed by the EC. Already management is concentrated in a few countries, and a distribution hub is already set up (i.e. Lux), with relevant know-how available.**
- **The challenges facing the EU fund industry may not be primarily caused by existing UCITS regulations. Other barriers to cross-border distribution remain: investor reporting, status & constraints on fund administration, differences in tax systems.**
- **Most distribution remains concentrated in the hands of insurance and banking groups. Pan-European distribution platforms allow asset management companies to diversify their distribution across EU, but costs for cross-border distribution are still high, especially for small- and medium-sized managers. A preference for own nation funds seems to prevail, especially within the retail segment.**

SOME VIEWS OF THE MARKET

WHAT SOME FUND MANAGERS SAY 3

- UCITS IV only brings a partial answer. A quicker notification procedure will help to reduce time-to-market and a more understandable version of the prospectus (KII doc) will increase transparency for the end-investor, but these improvements only indirectly contribute to increased sales.
- The directive does not significantly address distribution costs: KIID-specific regulation on advertising material will remain (and the KIID itself still has to be translated into the language of the country of distribution).
- Potential threats to the future growth of the fund industry remain, and these won't be addressed by the directive. Market performance may not improve. Although UCITS funds can borrow and use derivatives, they are not as flexible as hedge funds in exploring emerging markets trends.
- Real opportunities for further distribution only partially arise from the dir. The best way to access new distribution networks is the takeover of a local participant to use its existing distribution facilities. This consolidation will be related as much to the financial crisis as to UCITS IV. Most likely, master-feeder structures will be helpful in this process.

CONCLUSIONS

- **The UCITS IV Directive has the potential for many benefits in the EU investment funds industry.**
- **It is hoped that the management company passport provisions, the cross-border merger and master-feeder arrangements, and the simplified cross-border notification provisions will result in a simpler and rationalized cross-border regulatory environment, greater economies of scale for many UCITS, and the ability to pool assets and reduce costs.**
- **However, a great deal of work remains to be done in order to implement the UCITS IV provisions, both at the EC level and within each Member State.**
- **In the meantime, asset managers, promoters of UCITS, and other UCITS service providers should keep in mind now how these changes may impact their business plans and provide increasing opportunities going forward.**

THANK YOU