

Irish Funds Industry Association's Response to CESR's Consultation Paper on technical advice to the European Commission on the level 2 measures relating to mergers of UCITS, master-feeder UCITS structures and cross border notification of UCITS

(Ref. CESR/09-785)

The Irish Funds Industry Association (IFIA) is the industry association for the international investment fund community in Ireland, representing the custodian companies, administrators, managers, transfer agents and professional advisory firms involved in the international fund services industry in Ireland. Given that as at the end of September 2009 there were 3,153 Irish domiciled UCITS funds, including sub-funds, with a Net Asset Value of €570 billion, all developments in the UCITS arena are of particular interest and relevance to the Irish industry. The IFIA welcomes both the publication of and the opportunity to comment on CESR's consultation paper on CESR's technical advice to the European Commission on the level 2 measures relating to mergers of UCITS structures, master-feeder UCITS structure and cross-border notification of UCITS.

Given the nature of the Industry in Ireland we felt unable to appropriately answer the questions which ask to quantify the costs/benefits of CESR's proposals, specifically questions numbered 13, 18, 27, 31, 35 & 37.

Please find below our response to the individual questions posed in the consultation paper.

SECTION I – MERGER OF UCITS

1.1 Contents and format of the information

Question 1

Yes we agree that there would be benefit in agreeing standard information that should be provided to investors. In relation to the question of whether there is any other information that is essential for unitholders to receive, as suggested by the IFIA in its March 2009 response, we are of the view that unitholders should receive a recommendation from the merging UCITS as to what action they should take. Unitholders should also receive details of any difference between the risk profiles of the two funds and should be informed of their right to request a copy of the prospectus or constitutional documentation of the receiving UCITS.

We note that the level 2 guidance provides that, in circumstances where a merger is approved by shareholder vote, unitholders who have voted against the proposed merger or who do not vote will be informed that they shall be issued units in the receiving UCITS. We would suggest that such unitholders should also be informed of their right to redeem their units, following the approval of the merger, before the merger is due to take place.

Unitholders should also receive information regarding what will happen if the merger is not approved. Finally, unitholders should receive details of whether any realignment of the portfolio will take place prior to the effective date of the merger.

Given the significant costs associated with communicating with unitholders it is felt that the appropriate method by which information is communicated to unitholders should be left to the discretion of the respective competent authorities. It has been suggested that often the impact of a merger on the unitholders of the surviving fund is minimal, as such it would be important that the medium with which details of the merger are presented to these unitholders be efficient and reflect the volume and means of communication. For example, to require individual notification to be sent to all unitholders in hard copy may make a merger proposal uneconomic and as such the proposal would not be taken forward. However, if/where notification is permitted by publication in National Media this would help defray the costs associated with a merger, particularly where there might be a large number of unitholders, and ensure the potential efficiencies of the merger are not lost on the process.

Question 2

Yes, however it is felt this option should be considered by the Management Company and not the Competent Authority.

Question 3

No, it is felt the proposed advice already requires sufficient detail to be provided regarding the description of the rights of unitholders. In addition, it is felt that the disclosure requirements listed in Box 1 is complete and no additional disclosures should be required.

With regard to the proposal at 4 (a) we would suggest that only material differences in the rights of unitholders should be required to be disclosed as part of the merger process. It may be worth noting, however, that this information should include without limitation, details of differences in distribution rights, voting rights or subscription and redemption rights.

Additionally, it is noted that some of the proposals in Box 1 would already be included in the KID e.g. 4 (b) & (c) and it is suggested that the advice might provide that 4 (b) & (c) are only required when not already disclosed in the KID.

With regard to CESR's proposal at 7 (b) it is suggested that the surviving funds unitholders could be informed of the outcome of the vote by a posting to a relevant website e.g. the Manager/Promoters/UCITS website.

Question 4

Yes, the Management Company should be free to include the KID as part of the merger proposal or as a stand-alone document.

Question 5

Whilst it is difficult to determine exact costs involved in implementing the level 2 guidance given the different circumstances that will apply to any one merger, the harmonisation of certain minimum standards across all jurisdictions will promote a level of certainty amongst UCITS/Management Companies and will ultimately, in our view, lead to a reduction in the costs involved in mergers under existing arrangements (particularly cross border mergers).

It is argued that the main cost in any merger is the communication with unitholders and in this regard the medium with which this communication takes place is key, with individual written communication to all unitholders being far more expensive than publication in local media and/or posting on a website. As such it would be difficult to provide an assessment of potential costs. It is however important to note that while incurring some additional costs may be acceptable as part of a merger process, costs would be an important factor in the decision to merge or not.

1.2 Providing the information

Question 6

It is difficult to comment on whether the lack of level 2 guidance on the manner of providing unitholder information is advantageous or not without knowing the specific issues required to be addressed in other jurisdictions. However, if CESR ensures that the minimum information set out in other parts of the level 2 guidance is implemented across all jurisdictions, we do not believe harmonisation is required as to the method by which the merger proposals are communicated to unitholders. This is more appropriately a matter between the respective Management Companies and Competent Authorities, given the circumstances pertaining i.e. the number of unitholders, potential impact of merger on unitholders and potential cost of communicating to unitholders. It would be disappointing if potential efficiencies (post merger) were not available to unitholders due to the cost of communicating the merger proposals to all unitholders.

General Comments on the Mergers section

Aside from the specific queries raised by CESR, we also note certain other issues relating to the mergers of UCITS which would, in our view, merit Level 2 guidance.

These are as follows:

1. Unitholder Approval Procedures

In our view, an important point to highlight and clarify at CESR level is the required procedure for unitholder approval of a merger resolution. Procedural issues such as notice periods, required quorums and percentage of votes necessary to pass a resolution should be harmonised in order to facilitate cross-border mergers.

2. Participation of Non-Voting unitholders

Paragraph 7(a) of Box 1 provides that investors should be informed that non-voting unitholders who do not redeem voluntarily will be carried across to the receiving UCITS. It would be helpful if CESR could confirm that it is their view that non-voting unitholders should participate in the merger if they have not exercised their right to redeem.

3. Nominee Holdings

It is our understanding that CESR's proposed advice on the merges provisions is with regard to registered unitholders and it is not CESR's intention, nor is it felt necessary to expand these proposals beyond those unitholders.

4. Cross-Border Mergers

One final point is that it would be useful to see proposals regarding how to provide for appropriate compromise/resolution mechanisms in cross border mergers in circumstances where one regulatory authority objects to the proposal.

SECTION II – MASTER-FEEDER STRUCTURES

2.1 Agreement between feeder and master UCITS

Question 7

It is suggested that the content of the agreement proposed is complete and should be limited to the proposals identified in CESR's advice.

Question 8

It is suggested that the proposals contained in paragraphs 2, 3, 4 & 5 of Box 2 are operational in nature and as such might be better contained in a separate service level agreement or similar document. Including such operational provisions in the proposed Master – Feeder agreement would potentially require regular amendment and re-filing of the agreement as these provisions would be subject to regular amendment.

If this proposal is acceptable Box 2 should give flexibility to include paragraphs 2, 3, 4 & 5 in the Master – Feeder agreement or in a parallel service level agreement.

Question 8 (b)

We believe it may be beneficial to include material correspondence from the Master UCITS Competent Authority and proposed changes to domestic legislation which may impact the Funds as elements to be included in the agreement.

CESR's advice should also introduce the "materiality" concept in details of breaches by the master which will be made available to the feeder.

Question 9

We would support Option B, as this would allow the master and feeder UCITS the flexibility to agree the appropriate applicable law governing the agreement.

Question 10

Yes, the measures to protect the interests of other unitholders in a master UCITS should be left to national law and regulation.

Question 11

While we are unable to quantify the additional costs, however we believe harmonisation of the requirements across Member States should give a level of certainty in the requirements and should not result in material differences between the structuring and operation of the Master Feeders in one jurisdiction versus another.

Question 12

Yes we agree with CESR's proposal in relation to internal conduct of business rules.

Question 14

Yes, we agree with CESR's proposed approach to the prevention of market timing.

2.3 Liquidation, merger or division of a master UCITS

Question 15, 16 & 17

While a feeder UCITS may become aware of the master UCITS intention to liquidate, merge or sub-divide before receiving formal notice any Level 2 provisions must be drafted on the basis that they will only become aware at the time of formal notification.

The proposals do not appear to take account of the actions/potential redemptions by other/direct unitholders in the master once the master advises its intention to liquidate¹. It is felt that as the feeder must submit proposals to its competent authority

¹ Where there is no suspension of redemptions.

as to what action it intends to take following the liquidation of the master and must also advise its unitholders of this, other/direct unitholders in the master may be in a position to redeem their holdings in the master more quickly than the feeder, which could potentially place the feeder at a disadvantage. It would not appear equitable that other/direct unitholders in the master would be placed at an advantage where a master advises its intention to liquidate.

One possible solution would be for the Master and Feeder to enter a confidentiality agreement which would allow the master to advise the feeder UCITS of its intention to liquidate, which would then allow the feeder to identify and seek the required approval from its competent authority so as to be in a position to act in parallel with all other investors in the master, once the master formally signals its intention to liquidate.

One additional aspect that needs to be considered is that currently certain non-EU regulators require any changes to a UCITS fund's Prospectus (and the necessary supporting documentation such as a notice of an EGM) to be approved by such Regulators either in advance of, or simultaneous to, the home regulator's approval. With the proposed timeline, it would be almost impossible to secure such approval in the 3 weeks allowed for home regulator approval.

Merger or subdivision of the master UCITS

Question 19

It is unclear what CESR is seeking to achieve with the proposal contained in Box 6, 2 (a) (i) & (ii), which proposes that a feeder UCITS should be required to advise its competent authority where there is a merger and the master is the receiving UCITS or there is a sub-division of the master in which the master is to continue materially unchanged as one of the resulting UCITS. A feeder is not required to advise its competent authority when a master receives a subscription/investment (significant or otherwise) and it is unclear why a feeder should be required to advise its competent authority when its master receives a subscription/investment due to a merger, where the master is the surviving fund.

Question 20

The proposed procedures in box 6 would not appear to have a significant impact one way or the other.

2.4 Agreements between depositaries

Question 21

It is suggested that the proposed content of the agreement is complete and should be limited to those areas identified in Box 7.

Question 22

Yes, box 7 appears to cover the right issues however, with respect to “other” issues, we believe it may be beneficial to include material correspondence from the Master UCITS Competent Authority and proposed changes to domestic legislation which may impact the Funds as elements to be included in the agreement.

Question 23

We would support Option B, as this would allow depositaries the flexibility to agree the appropriate applicable law governing the agreement.

2.5 Reporting by the master UCITS depositary

Question 25

To avoid a potential situation where there may be excessive reporting, it has been suggested that CESR’s advice should require the master to report “material” irregularities, otherwise there exists a potential for the master to have to report all breaches, errors, etc with no consideration of the actual impact to the feeder, particularly where a breach or error would not be material.

Question 26

Yes, it is felt that the interest of other unitholders in a master UCITS will be adequately protected under national laws if these provisions are implemented.

2.6 Agreements between auditors

Question 28

It is suggested that the content of the agreement proposed in the advice should be exhaustive and CESR’s advice should introduce the concept “materiality” in identifying the matters that should be treated as irregularities.

Question 29

We would prefer Option B, as this would allow auditors the flexibility to agree the appropriate applicable law governing the agreement.

Question 30

Yes, it is agreed that feeder UCITS will generally try to align their accounting periods with those of their master.

2.7 Change of feeder UCITS objective

Question 32

Yes, we agree that it is not necessary for CESR to provide advice on level 2 measures on this issue.

2.8 Transfer of assets in kind

Question 33

Yes, we agree that it is not necessary for CESR to provide advice on level 2 measures on this issue.

SECTION III – NOTIFICATIONS

3.1 Scope of the information to be published by each Member State

Question 34

We would agree in general with CESR's proposals in relation to marketing information. However, the suggestion at point 2 in Box 10 that information be provided by way of a "narrative description" is potentially problematic in that even with a narrative description of a source document it may still be difficult to identify the appropriate source document. Additionally, there may be instances where documents are updated and it may be difficult from a narrative description to identify the appropriate version of the document. It is possible that if/where source documents have been updated and previous versions have been downloaded and/or are still available on a website, that a user may not be aware they are working from an old/outdated document. It is suggested that information be given in the form of a short but comprehensible narrative description together with references and links to source documents.

3.2 Facilitating host State access to notification documentation

Question 36

Yes, we would support the development of a centralised IT system to facilitate the notification procedure and provide a central repository for fund documents. In the absence of more detail as to what such centralised IT system would contain and how it might operate, it is difficult to provide a more comprehensive response. In the interim period, a standardised procedure should be introduced across all Member States. In our view, this should be along the lines of requiring each home State authority to make all relevant documentation available on its own website rather than giving Member State competent authorities discretion to either publish the information themselves or impose a requirement on each outwardly marketing UCITS to publish the information itself (whether on its own or its manager's website or some other common location).

Article 93.7, second sentence of the Directive provides that it is the UCITS itself which is responsible for notifying any amendments to relevant fund documents to the host State authority. Notwithstanding this, we would suggest that in addition to a standardised procedure being put in place regarding the notification of amendments of the relevant fund documentation by the UCITS to the host Member State, that the competent authority of the home Member State be obliged to cause the amended documentation to be made available on its website. If it is not possible to propose this measure at level 2 then we suggest that it be dealt with in level 3 guidelines. Many UCITS funds amend and update their prospectus documentation/supplements quite regularly and the reality is that much of the original documentation required to be

notified to the host Member State under Article 93(2) is, in many cases, likely to become quickly out of date. It is important, in the overall context of Articles 93(7) that host state competent authorities have easy and uncomplicated access to a UCITS most up to date relevant documentation.

Question 38

The proposal which recognises and supports the use of electronic communication is to be welcomed.

3.3 Standard notification letter and attestation

Question 39

We would suggest the following amendments to the proposed notification letter;

- On the first page of the Model notification letter to market units of UCITS in an EEA Member State (Annex 1) we would suggest after “Details of company’s website” inserting “(if applicable)” as not all management companies/UCITS companies have websites. On the top of the second page after “Details of contact person at management company” insert reference to self managed investment companies so it should read “Details of contact person at management company/self managed investment company).
- Part B Non-harmonised part. We would suggest that a detailed description of the distribution channels should not be required Part B Non-harmonised part).
- Part B – Non harmonised part. In some countries, the person providing the facility under Article 92 is not called a “paying agent”. We would suggest that reference be made “Details of paying agent or other mandatory representative...”
- Presumably, Member State competent authorities will require that a UCITS send the notification together with the accompanying documentation in electronic format. Will electronic signatures be acceptable or pdf format copies of the notification letter? This point is also true of the attestation letter (see question 40) and the electronic transmission of notification files and confirmations and envisaged by Section 3.4.

Question 40

Article 93(3) requires that the competent authority of the home Member State enclose with the documentation being transmitted to the competent authority of the host Member State an attestation that the UCITS fulfils the conditions imposed by the Directive. The model attestation letter does not appear to address this specific point. Whilst we have no difficulty with the current text of the current Annex II (apart from the fact that the reference on page 1 should be to Article 93(3) rather than Article 93(1)), we would suggest that it also contain the actual wording required by Article 93(3) i.e. that the UCITS “fulfils the conditions imposed by” the Directive.

Question 41

In general it is felt that the use of standardised letters would be welcomed.

3.4 Electronic transmission of notification files

Question 42

While it would be difficult not to support the development of an efficient, secure electronic communication tool, given the potential time and costs associated with the development of such a system, it is felt that normal e-mail communication should be sufficient.

Question 43

We would agree in general with the proposed procedures in Boxes 11 and 12 subject to the following comments:

- (a) In Box 11, paragraph 5 we would suggest, to provide greater certainty in terms of timing to the outwardly marketing UCITS, that this be amended to read as follows:

“As soon (*and at least on the same day*) as the home Member State has sent the email it should inform the UCITS *by email to the email address provided in the letter from the UCITS to the home competent authority under Article 93.1*, (see Annex 1) of its right to access the market of the host Member State with immediate effect” (new wording in italics).

- (b) Explanatory paragraph 38 provides, in relation to the acknowledgement of a notification, that the host Member State must issue the acknowledgement within 5 working days of receipt “(an automated receipt generated by the host authority’s email is sufficient)”. However, as the host authority is required to ensure that the notification is complete, (see e.g. Box 12, para 3) then an automated receipt will not be sufficient and we would suggest that any reference to an automated receipt be deleted.

Question 44

It is disappointing that Box 11 at points 6 and 8 appear to penalise a UCITS for an error or omission that is beyond the UCITS influence or control. We would suggest that CESR’s advice should recognise and take account of situations where an error/omission occurs in good faith and where immediate steps have been taken to rectify the problem, so that the UCITS is not penalised. This is especially the case where the documentation supplied by the UCITS to its home State authority is such that if it had been supplied directly by the UCITS to the host State authority, it would have been correct and acceptable (in other words, where the error or omission is at the level of the home State authority).

Question 45

It is not felt that further level 3 guidelines are required in this area.

IFIA

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