



Date: 17 February 2009

Ref.: CESR/09-179

CALL FOR EVIDENCE ON POSSIBLE IMPLEMENTING MEASURES CONCERNING THE FUTURE UCITS DIRECTIVE

Background

On 13 January 2009 the European Parliament adopted in plenary session a proposal for a Directive containing amendments to the UCITS Directive (85/611/EEC)¹. This followed approval by the Council of an identical compromise text at a COREPER meeting of 17 December 2008 (the Council's final approval is expected in April/May). On the basis of the compromise text, the Commission has requested CESR's assistance on the content of the implementing measures to be taken pursuant to the revised Directive. As the Directive imposes a strict deadline (1 July 2010) for adoption of certain level 2 measures, the Commission feels it is important for CESR to start its work as soon as possible.

The request for assistance is split into three parts.

- Part I – Request for technical advice on the level 2 measures related to the management company passport²
- Part II – Request for technical advice on the level 2 measures related to key investor information – supplement to the Commission's April 2007 'request for assistance on key investor disclosures for UCITS'
- Part III – Request for technical advice on the level 2 measures related to fund mergers, master-feeder structures and the notification procedure

Part I of the request focuses on areas where the Commission is obliged to adopt implementing measures (and in some cases by a deadline of 1 July 2010). The issues covered in this section are primarily related to the management company passport and include provisions on:

- Organisational requirements and conflicts of interest for management companies (Article 12(3))
- Rules of conduct and conflicts of interest for management companies (Article 14(2))
- Risk management (Article 51(4))
- Measures to be taken by depositaries (Articles 23 and 33)
- On-the-spot verification and investigation (Article 101)
- Exchange of information between competent authorities (Article 105)

¹<http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P6-TA-2009-0012&language=EN&ring=A6-2008-0497>

² CESR delivered its level 1 advice to the Commission on the UCITS management company passport in October 2008 (Ref. CESR/08-867)



The Commission considers that the provisions on the areas set out above are essential for effective supervision of UCITS managed on a cross-border basis. CESR has been asked to deliver its advice on these issues by **30 October 2009**.

The second part of the request covers the implementing measures foreseen by the Directive in relation to key investor information (KII) disclosures. The Commission is under a legal obligation to adopt implementing measures on the detailed and exhaustive content of KII pursuant to Article 78(7). The Commission also has the option of complementing them by adopting provisions pursuant to Article 81(2) (specific conditions to be met when providing KII in a durable medium other than paper) and Article 75(4) (specific conditions when providing the prospectus in a durable medium). Regarding the detailed and exhaustive content of KII, CESR has been working on the basis of the initial request for assistance on KII sent by the Commission in April 2007; this resulted in the delivery of a set of advice to the Commission on the content and form of Key Information Document disclosures for UCITS on 18 February 2008. A consultation is planned on the full package of advice on KII disclosures in summer 2009; it will be important in that consultation to identify any additional issues raised by the final text of the Directive that CESR should consider before delivering its final advice. This call for evidence does not therefore seek views on issues related to KII as this will be handled under CESR's ongoing work and on the basis of the progress made so far. CESR has been asked to deliver its advice on KII by **30 October 2009**.

The third part of the request for assistance covers the other chapters of the UCITS Directive for which the Commission also received implementing powers in the areas of mergers (Article 43(5)), master/feeder structures (Articles 60(6), 61(3), 62(3) and 64(4)), and the notification procedure (Article 95(1) and 95(2)). Although the Commission is not under a legal obligation to adopt implementing measures under these articles, it considers them as an important complement to the level 1 provisions. The deadline for delivery of CESR's advice under this part of the request is also **30 October 2009**, although CESR is invited to reflect on the best way to organise its work should this prove not to be achievable. The request highlights the issue of the fund notification procedure as being a particularly important complement to the level 1 text.

The expected content of the advice on each area is described in more detail in the attached request for assistance from the Commission.

The advice will be discussed and developed by the Investment Management Expert Group, chaired by Lamberto Cardia, Chairman of the Italian Commissione nazionale per le società e la Borsa (CONSOB).

Call for evidence

CESR invites all interested parties to submit their views on what CESR should consider in its advice to the Commission.

All contributions can be submitted online via CESR's website (www.cesr.eu) under the heading 'Consultations' by **31 March 2009**.

CESR will provide further details in due course in relation to the public consultation it will carry out in light of responses to the call for evidence and its own deliberations.



EUROPEAN COMMISSION

Internal Market and Services DG

FINANCIAL SERVICES POLICY AND FINANCIAL MARKETS
Asset Management

Brussels, 13 February 2009

**PROVISIONAL REQUEST TO CESR FOR TECHNICAL ADVICE
ON POSSIBLE IMPLEMENTING MEASURES CONCERNING
THE FUTURE UCITS DIRECTIVE**

Part I - Request for technical advice on the level 2 measures related to the management company passport

Part II - Request for technical advice on the level 2 measures related to the key investor information – supplement to the Commission 2007 "request for assistance on key investors disclosures for UCITS"

Part III - Request for technical advice on the level 2 measures related to fund mergers, master-feeder structure and notification procedure

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General introduction

The Commission would like to request the advice of CESR on the content of the implementing measures to be taken pursuant to the soon to be adopted recast of the 1985 UCITS Directive. The provisional character of the present mandate stems from the fact that the Directive still awaits its formal adoption. However, considering that both the European Parliament (at his plenary session of 13 January 2009) and the Council (COREPER meeting of 17 December 2008) approved a compromise text in identical terms, it is now expected that the Council will formally adopt the measure in April/May. The present mandate is based on the version of the text as adopted by the EP (document P6_TA-PROV(2008)01-53) which should therefore not change in substance. It may however be adjusted at the stage of its legal revision and be renumbered. The Commission will keep CESR informed should this happen.

The future Directive imposes on the Commission a very strict timetable (1st July 2010) for adopting certain level 2 measures, in particular in the area of the management company passport. Therefore, it is of utmost importance to start working on these measures as soon as possible. This provisional mandate may nonetheless have to be completed or supplemented following the adoption of the new Directive or where it would be useful to reflect new developments in areas covered by the mandate.

Due to the significant number of articles for which the Directive has established the need for implementing measures the Commission has decided to divide the provisional mandate into three parts.

First part of the provisional mandate focuses on priority areas where the Commission is under the obligation to adopt implementing measures, in some cases by a given deadline of 1st of July 2010. This part therefore covers provisions mainly dealing with the issue of the management company passport which are currently foreseen under Article 12(3) (rules on organizational requirements/conflicts of interest for management companies), Article 14(2) (rules of conduct/conflicts of interest for management companies), and Article 51(4) (risk management). Although they are not subject to the same legal obligation/deadlines, the Commission considers it necessary to join to the request for advice regarding those measures the examination of provisions to be adopted under Articles 23 and 33 (measures to be taken by depositaries; for reasons explained further in the text, this does not include the analysis to be carried out in response to the Madoff case which takes place in a different framework), Article 101 (on-the-spot verification and investigation) and Article 105 (exchange of information between competent authorities). These provisions are essential for effective supervision of UCITS managed on a cross-border basis.

The second part covers the implementing powers foreseen by the Directive as regards key investor information (KII). The Commission is also under a legal obligation to adopt some implementing measures in this field (pursuant to Article 78(7) on the detailed and exhaustive content of KII). It has the possibility to complement them by adopting provisions pursuant to Article 81(2) (specific conditions to be met when providing KII in a durable medium other than paper) and Article 75(4) (specific conditions when providing the prospectus in a durable medium). Regarding the detailed and exhaustive

content of KII due account should be taken of the important work already carried out by CESR on the basis of the request for assistance sent by the Commission on 14 April 2007 to which CESR replied with an advice on the content and form of Key Information Document disclosures for UCITS published on 18 February 2008. The present mandate can therefore be seen as a continuation of this work. CESR should however take due account of the final form and content of the level 1 provisions that will now govern the adoption of level 2 rules on the KII.

The third part of the mandate covers the other chapters of the UCITS Directive for which the Commission also received implementing powers in the areas of mergers (Article 43(5)), master/feeder structures (Articles 60(6), 61(3), 62(3) and 64(4)), and notification procedure (Article 95(1) and 95(2)). The Commission is not under a legal obligation to adopt these measures. It however considers them as an important complement to the level 1 provisions. In accordance with the Lamfalussy process, the Commission envisages adopting these measures, as far as possible, in time to allow Member States to undertake parallel transposition of level 1 and 2 measures.

The Commission is aware of the significant workload entailed by the elaboration by CESR of its advice to the Commission on these three parts. It therefore encourages CESR to focus in a first stage on part I and II above. For these parts, CESR is invited to provide its technical advice by 30 October 2009 at the latest.

As regards part III, the Commission believes that the implementing legislation foreseen should ideally be available before July 2010 to make the high-level principles of the Directive operational. The Directive has been conceived in conformity with the Lamfalussy process which implies that some technical but essential provisions for the good functioning of the new rules imposed at level 1 are to be determined at level 2. The latter measures should ideally become applicable at the same time as level 1 (i.e. 1st of July 2011). In view of this, the Commission requests CESR to endeavour to deliver its advice by 30 October 2009. Should this not be achievable, the Commission invites CESR to reflect on the best way to organise its work in such a way that all necessary level 2 measures are adopted in time for them to be implemented by Member States within the timeframe imposed by the level 1 Directive. In that context, implementing measures related to the functioning of the fund notification procedure (standard notification letter and electronic exchange of information) should be considered as a particularly important complement to the level 1 provisions.

This division of the mandate constitutes an attempt towards prioritisation. The Commission would like to encourage CESR to come up with its own proposals concerning prioritization of its work, e.g. it might be further examined whether or not all the implementing provisions are preconditions for making the level 1 principles work. It might be considered whether in some well defined cases, exercise of powers granted to the Commission could be postponed without having impact on consistent transposition and application of the new UCITS law in Member States. The Commission is ready to examine other possibilities that CESR may wish to suggest such as using regulations instead of directives or replacing level 2 provisions by level 3 work, for instance in the form of common guidelines.

An indicative timetable for the delivering of the level 2 provisions on the UCITS Directive is to be found in the Annex to this mandate.

According to its established policy on transparency, the Commission will publish this request for technical advice on the DG Internal Market website once it has been sent to CESR.

Principles and working methods

When elaborating its advice, CESR is invited to take due account of the following:

- The high level of investor protection and supervision that are the guiding principles of the UCITS Directive. This should also guide the design of its implementing provisions. CESR is invited to keep these overarching principles in mind when elaborating its advice.
- The principle of proportionality which any piece of EU legislation should respect. Solutions proposed by CESR should not go beyond what is necessary to achieve the objective of the new Directive. They should be simple, and avoid creating excessive administrative or procedural burdens either on UCITS or on the national competent authorities responsible for their supervision.
- CESR should not feel confined in its reflection to elements that it considers should be addressed by the EU binding measures at level 2 but, if it finds it appropriate, it may indicate level 3 work that it believes should accompany the level 2 measures to better ensure the effectiveness of the level 2 measures.
- While preparing its advice CESR should consider the extensive work it has already been carrying out, in particular on organizational requirements, conduct of business rules, conflict of interest and risk management when preparing its technical advice on the issue of the management company passport as well as on the implementing measures adopted pursuant to Directive 2004/39/EC on Markets in Financial Instruments and other requirements or advice in the areas of banking and financial services. CESR should seek as much consistency as possible among these rules.
- CESR should provide comprehensive advice on the subject matters described below covered by the delegated powers included in the relevant implementing provisions of the Directive, in the corresponding recitals as well as in the relevant Commission request included in the mandate.
- CESR should start working on the basis of the text of the new UCITS Directive as agreed to by the COREPER on 17 December 2008 and adopted by the European Parliament on 13 January 2009. Its final adoption by the ECOFIN Council is foreseen in April/May 2009. The Commission will inform CESR of any developments in respect of this Directive. CESR is invited to address to the Commission any questions it might have concerning the clarification on the text of the new UCITS Directive or other parts of Community legislation, which they should consider of relevance to the preparation of its technical advice.
- CESR will determine its own working methods, i.e. by extending the workload of existing expert groups or creating new expert groups depending on the content of the provisions being dealt with. Nevertheless, horizontal questions should be dealt with in such a way as to ensure coherence between different standards of work being carried out by the various expert groups.

- In accordance with its founding Decision, CESR is invited to widely consult market participants (practitioners, consumers and end-users) in an open and transparent manner. CESR should provide advice which takes account of different opinions expressed by the market participants during these various consultations. CESR should provide a feed-back statement on the consultation justifying its choices vis-à-vis the main arguments raised during the consultation. It is also invited to present appropriate impact assessments in support of its advice.
- The technical advice given by CESR to the Commission should not take the form of a legal text. However, CESR should provide the Commission with an “articulated” text which means a clear and structured text, accompanied by sufficient and detailed explanations for the advice given, and which is presented in an easily understandable language respecting current legal terminology used in the field of securities markets and company law at European level.

1. REQUEST FOR TECHNICAL ADVICE ON LEVEL 2 MEASURES RELATED TO THE MANAGEMENT COMPANY PASSPORT (PART I OF THE MANDATE)

1.1. Background

The new provisions on the management company passport (MCP) are to be accompanied by an extensive set of implementing rules. They cover issues which the co-legislators have considered to be essential to ensure that investors in funds that are managed on a cross-border basis are not exposed to additional operational risk or lower standards of investor protection in comparison to fund structures managed domestically. These include organisational requirements, risk management, conflicts of interest and rules of conduct. An appropriate level of harmonisation will help to build the mutual confidence between regulators that is necessary for the full implementation of the principle of the home Member State's supervision of management companies. It should also prevent regulatory arbitrage between Member States and ensure a high level of investor protection. The co-legislators have recognised this by requiring the Commission to adopt a large part of those measures before 1 July 2010.

These new implementing provisions are however not solely restricted to the situation where a management company exercises its right to manage a UCITS on a cross-border basis. Applying these new rules to all management situations (national and cross-border) could constitute an important contribution to the strengthening of the current EU regulatory framework. This is particularly important in relations to risk management processes, which can be considered essential in the context of the current financial crisis. CESR should therefore take due account of the general nature of the implementing powers conferred upon the Commission. It shall also carefully assess the impact of these provisions on the existing business models and organisation of the European fund industry.

When drafting its technical advice, CESR is encouraged to take full account of its previous extensive work on similar MiFID implementing measures, (including its experience of the implementation of this Directive and other acts in the area of financial services). CESR is however invited to take due account of the specificities of the UCITS area, including the different legal forms of UCITS and of the recent developments in the financial markets.

1.2. Detailed content of the request for advice

1.2.1. Prudential rules and conflict of interest (Article 12)

CESR called for, in its technical advice to the Commission on the UCITS Management Company Passport of October 2008, the adoption by the Commission of level 2 measures which would specify the organizational and operating conditions to be complied with by management companies in the performance of the activity of collective portfolio management. The European Parliament and Council have endorsed that position. They have introduced into the UCITS Directive implementing powers that will allow the Commission to adopt rules that will complement the high level provisions of Article 12. It has to be noted that these powers are similar to those granted to the Commission under

Article 13(10) of the MiFID Directive (2004/39/EC). In formulating its advice CESR is requested to seek maximum alignment with the relevant MiFID rules in this area. However, CESR should not restrict itself in suggesting provisions aimed at addressing specific characteristics of the UCITS/management companies and reflecting lessons drawn from the recent market developments.

CESR is requested to provide a comprehensive overview of the necessary conditions that should be fulfilled by management companies in order to ensure common understanding and uniform application of the obligations set out in Article 12.

It should be noted that structural and organisational aspects of the management company, sound administrative and accounting procedures, control and safeguarding arrangements for electronic data processing as well as adequate internal control mechanisms constitute (amongst other things) an organisational and procedural basis for the overall risk management process. Therefore conditions imposed on the basis of Article 12 should complement obligations provided for in Article 51 and seek to strengthen the overall risk management process of UCITS. This should particularly be the case as regards the organisational requirements a fund manager should put in place in order to define how investments decisions are made, recorded and reported to the competent authorities.

Also conditions for the structure and organisational requirements of a management company that are necessary to minimize conflicts of interests as referred to in Article 12(1)(b) and obligation imposed under Article 14 should be regarded as complementary. Together, they should ensure that a management company has sound systems and procedures for avoiding or minimising conflicts of interest.

Detailed questions:

I. Scope of the Commission's implementing powers (Article 12(3))

"3. Without prejudice to Article 116, the Commission shall adopt by, 1st of July 2010, implementing measures specifying procedures and arrangements as referred to under point (a) of paragraph 1 and the structures and organisational requirements to minimize conflicts of interests as referred to under point (b) of paragraph 1.

..."

II. Questions

CESR is invited to advise the Commission on the content of the rules that are proportionate and necessary for specifying the general obligations placed on management companies by Article 12(1)(a) and (b).

In particular CESR is requested:

- a) to define procedures and arrangements to be implemented by the management company, having regard to the nature of the UCITS managed by the management company (its characteristics and complexity), that meet requirements of Article 12(1)(a),
- b) to define the conditions for the structure and organisational requirements of a management company that are necessary for minimizing conflicts of interests as referred

to in paragraph 1(b).

1.2.2. Rules of conduct including conflict of interests (Article 14)

Article 14 of the new Directive requires Member States to draw-up rules of conduct which management companies authorised in that Member State shall observe at all times. Points (a) to (e) of this Article 14 specify the principles that should govern the conduct of management companies exercising their activities.

By introducing a new Article 14(2) the European Parliament and the Council have endorsed CESR's opinion of 31 October 2008, according to which the principle-based measures should be supplemented by more detailed rules on the prevention of conflicts of interests, conduct of business rules for management companies and the resources and procedures necessary for management companies to be able to properly perform their activities.

In its advice of October 2008, CESR recommended that further regulatory guidance should be provided in particular on such issues as "churning, soft commission arrangements, timely allocation of transactions/market timing, late trading, underwriting."

CESR is requested to provide a comprehensive overview of the necessary conditions that should be fulfilled by management companies in order to ensure a common understanding and uniform application of the obligations set out in Article 14. The implementing powers granted to the Commission by Article 14(2) are similar to those foreseen in Article 18 of the MiFID Directive. In formulating its advice CESR is requested to seek maximum alignment with MiFID rules in this area. However, CESR should not restrict itself in suggesting provisions aimed at addressing specific characteristics of the UCITS/management companies and reflecting lessons drawn from the recent market developments.

Detailed questions

I. Scope of the Commission's implementing powers (Article 14(2))

"2. Without prejudice to Article 116, the Commission shall adopt, by 1 July 2010, implementing measures, with a view to ensuring that the management company complies with the duties set out in paragraph 1, in particular to:

(a) define the steps that management companies might reasonably be expected to take to identify, prevent, manage and/or disclose conflicts of interest as well as to establish appropriate criteria for determining the types of conflicts of interest whose existence may damage the interests of the UCITS;

(b) establish appropriate criteria for acting honestly and fairly and with due skill, care and diligence in the best interests of the UCITS;

(c) specify the principles required to ensure that management companies employ effectively the resources and procedures which are necessary for the proper performance

of their business activities"

..."

II. Questions

CESR is invited to advise the Commission:

- a) on the rules that should specify the steps management companies should be expected to take pursuant to Article 14(2)(a),
- b) on the criteria according to which the conduct of its business by a management company should be assessed by the competent authorities (according to Article 14(2)(b)),
- c) on the conditions and principles that will ensure that a management company employs effectively the resources and procedures necessary for the proper performance of its business activities.

1.2.3. Measures to be taken by a depositary of a UCITS managed by a management company on an investment company situated in another Member State (Articles 23 and 33)

The co-legislators have considered that, in cross-border management situations, there is a need to provide for additional safeguards as regards the relationship between the management company and the depositary. In such scenario, these two entities will be located in two different Member States. This concern is reflected in the obligation to sign a written agreement between the management company and the depositary regulating the flow of information deemed necessary to allow the depositary to perform its functions.

The co-legislators have also considered it necessary to allow the Commission to detail the particulars that need to be included in such an agreement, and more generally to decide on the measures to be taken by a depositary in order to fulfil its duties. This broadly reflects CESR's advice that it is necessary to ensure that a management company provides the depositary with "information on the investment activities carried out on behalf of the UCITS (the composition of the assets invested and all information on the calculation of the value of units, all information necessary to verify continuous compliance with the risk profile of the UCITS and information disclosed to the public in the fund rules and other disclosure documents)". CESR also underlined that the depositary must have guaranteed access to the books and records of the fund, and that ensuring this should be covered in particular.

It should be noted that the scope of these measures is limited to those situations where the UCITS is managed on a cross-border basis. They do not apply to situations where the three entities (UCITS, a management company and a depositary) are located in the same Member State.

As the provisions of Article 23 are mirrored in Article 33, the Commission proposes to treat these two implementing provisions together. CESR is however free to indicate whether investment companies should be treated differently for the purpose of these provisions.

The implementing powers granted to the Commission in this field are not subject to a compulsory deadline.

The Commission services consider that depositaries play a very important role in safeguarding the interests of investors who have placed their trust in UCITS by ensuring safe-keeping of the assets held by UCITS as well as a general oversight of their investment policies. The recent Madoff case has confirmed the key role played by these entities as well as the need to make sure they fulfil their responsibilities according to the UCITS Directive. CESR is invited to keep this important dimension of the UCITS legislative framework in mind when drafting its advice. As regards the specific case mentioned above, the Commission consider that the mapping that CESR is currently carrying-out of the way the obligations imposed by the UCITS Directive on depositaries have been implemented by the Member States is a very important contribution to the analysis of the appropriateness of the existing regulatory framework. The Commission services do not consider this analysis as part of the present mandate, since it goes further than the issues that can be dealt with under Articles 23 and 33 of the new Directive. On the basis of the mapping of requirements by CESR, the Commission will determine whether there is need to supplement existing provisions of the Directive. It will take the lead in coming forward with the necessary actions (which may include further CESR involvement).

Detailed questions

I. Scope of the Commission's implementing powers (Articles 23(6) and 33 (6))

"5. The Commission may adopt implementing measures on the measures to be taken by a depositary in order to fulfil its duties regarding a UCITS managed by a management company situated in another Member State, including the particulars that need to be included in the standard agreements to be used by the depositary and the management company as referred to in paragraph 4.

... "

II. Questions

1. CESR is requested to advise the Commission on the specific conditions that a depositary must meet to fulfil its duties regarding a UCITS managed by a management company situated in another country.
2. CESR is requested to advise the Commission on standard arrangements between the depositary and management company and identify the particulars of the agreement between them that are required under Articles 23(6) and 33(6) and the regulation of the flow of information deemed necessary to allow the depositary to discharge its duties.
3. CESR is invited to consider the need to regulate through level 2 measures the law applicable to the agreement in order to remove legal uncertainty (whether the agreement should be governed by law of UCITS home Member State, management company home Member State or of any other Member State).

1.2.4. Risk management (Article 51)

Article 51 (no change compared to the existing Article 21 of the 1985 Directive) of the new Directive defines the general principle that the management company shall employ a risk-management process which enables it to monitor and measure at any time the risk of different positions and their contribution to the overall risk profile of the portfolio. The UCITS Directive also sets out general rules according to which UCITS should measure their exposure to derivatives and manage the risk associated with such investments. This provision has been supplemented by the Commission Recommendation on the use of financial derivatives for UCITS of 27 April 2004 (2004/383/EC) which outlines basic principles for risk measurement. The recommendation also underlines the principle that all material risks incurred by the UCITS should be accurately measured. According to point 1 of the Recommendation management company should employ risk management systems which are adapted to the relevant risk-profile of a UCITS in order to make sure that they accurately measure all material risks related to the UCITS. The CESR survey on the implementation of the Commission Recommendation 2004/383/EC revealed discrepancies between Member States in the way the Recommendation is applied and different approaches to risk management.

Recent turmoil in the financial markets has underlined the vital importance of adequate risk management. Risk management systems and procedures have been tested against extraordinary market conditions. Faced with these situations, fund managers must employ sufficiently robust and effective procedures and techniques, along with the associated resource commitments, to adequately manage the different types of risk a UCITS might face – such as market risk, operational risk, legal and documentation risk, counterparty risk, liquidity risk etc. Strengthening risk management systems and procedures and setting out a common approach to risk management is crucial to maintaining mutual confidence and delivering high standards of investor protection throughout the EU.

As is the case for prudential rules, conflicts of interest, and rules of conduct, the co-legislators have considered that existing rules of the UCITS Directive on risk management and the assessment of exposures to derivatives need to be reinforced and further clarified in order to ensure an appropriate level of investor protection and supervision. The Commission is therefore subject to an obligation to adopt implementing measures in this field before the 1 July 2010.

The Commission services believe that the powers given to the Commission to specify criteria for assessment of the risk management processes should be exercised to the greatest possible extent as is necessary to ensure such processes are fit-for-purpose. They consider that level 2 measures should seek to establish a uniform and consistent approach to the whole risk management process for UCITS, spanning all the risks associated with portfolio positions (e.g. possible impact of future market developments, counterparty risk, the time available to liquidate positions) and the contribution of these to the overall risk profile of the portfolio. Based on Article 51(1), requirements to capture, measure and manage risks shall not be limited to derivative instruments and instruments embedding derivatives but a robust risk management framework for UCITS should cover all portfolio positions.

The Commission requests CESR's advice on developing a structured approach to ensuring adequate risk management processes are in place for all UCITS. To deliver this

robust risk management framework, all relevant risks related to the activities of UCITS must be duly and accurately identified, managed and monitored.

Therefore, the Commission seeks advice on the conditions necessary for ensuring risk management frameworks are effective, relative to the size and scale of operations of UCITS, so as to ensure the effective identification, monitoring and management of risks. This should include in particular:

- The identification of the different categories of risk that should be covered by risk management processes;
- The organisation of risk management processes and controls at the level of the individual UCITS, including risk identification, monitoring, and reporting;
- To the extent possible, the appropriate risk measurement methods that should be used for monitoring identified risks, or the criteria that could be used to clarify when particular risk measurement methods could be appropriate. CESR is asked, to the extent possible, to advise on particular types of risk measurement methods, or any other requirements or conditions CESR considers necessary for ensuring that UCITS deploy effective and proportionate risk management processes;
- Any procedure, organisational measure or method to be employed for ensuring the accurate and independent valuation of OTC derivatives. To the extent possible, CESR is invited to advise on particular types of valuation methods or any other requirement or conditions necessary for ensuring valuation in conformity with the Directive; and
- To the extent possible, any measures that could be taken for mitigating or managing identified risks.

When preparing its technical advice, CESR is encouraged to take into account its extensive work carried out on issues related to risk management principles and risk measurement to the extent that this is compatible with the provisions of the new Directive and as far as it falls within powers delegated in Article 51(4). In particular the conclusions of the consultations on risk management principles for UCITS (Consultation paper CESR/08-616 of August 2008) and results of on-going discussion on specific technical and quantitative issues regarding UCITS portfolio parameters for measuring global exposure, leverage and counterparty risk could be taken into account. CESR is also requested to consider to what extent the Commission Recommendation 2004/383/EC should be taken into account in the content of level 2 implementing measures.

Management companies when engaging in individual portfolio management are also subject to risk management requirements imposed by MiFID. CESR is therefore invited to consider the possibility for increasing coherence between systems put in place by both directives.

For the definition of the various risks and their appropriate categorisation, as well as the means for their assessment, CESR should take account of any relevant provisions of the European Community law as well as similar work carried out in the field of financial services in other European and international fora.

Detailed questions

I. Scope of the Commission's implementing powers (Article 51(4))

"4. Without prejudice to Article 116, the Commission shall adopt, by 1 July 2010, implementing measures specifying the following:

- criteria for assessing the adequacy of risk management process employed by the management company in accordance with the first sentence of paragraph 1;*
- detailed rules regarding the accurate and independent assessment of the value of the OTC derivatives;*
- detailed rules regarding the content and the procedure to be followed for communicating the information to the competent authorities of the management company's home Member State referred to in the third sentence of paragraph 1.*

... "

II. Questions

CESR is invited to advise the Commission on the following questions:

1 What should be the conditions that govern risk management processes that can be employed by management/investment companies?

CESR is invited to establish the criteria that competent authorities should take into account when determining whether the risk management process employed by the management company is adequate for monitoring and measuring at any time the risk of a position and its contribution to the overall risk profile of the portfolio.

In particular CESR is requested:

- a) to advise on the categories of material risks that are relevant for UCITS (the identification of types of risks that should be addressed),
- b) to advise on principles governing the identification of the particular material risks relevant for a particular UCITS related to each portfolio position and their contribution to the overall risk profile of the portfolio,
- c) to advise, to the extent possible, on requirements concerning risk measurement methods, such as the conditions for the use of different methodologies in relation to the identified types of risk and the specific criteria under which these methodologies might be used,
- d) to establish principles for risk management processes to be employed in order to mitigate or otherwise manage and monitor the identified risks related to each portfolio position and their contribution to the overall risk profile of the portfolio. This could include requirements for management companies to ensure proper functioning of risk management processes, establishment of criteria for assessing the effectiveness of risk management processes, setting out principles for systems for operating risk limits, and / or the definition of reporting and monitoring obligations. This list is not intended to be exhaustive or a final indication of the necessary elements, and CESR should consider the best overall packaged of measures necessary for ensuring sound risk management

processes are in place for UCITS.

In relation to derivative instruments, CESR is in particular requested to recommend principles for calculating the global exposure related to derivative instruments, and measures that UCITS must undertake to ensure that global exposure relating to derivative instruments does not exceed the total net value of its portfolio.

2. What should be the content of the detailed rules regarding the accurate and independent assessment of the value of OTC derivatives as referred to in Article 51(1)?

3. What detailed rules should govern the content and the procedure to be followed by the management company for communicating the information mentioned in Article 51(1) to the competent authorities of its home Member State?

1.2.5. *On-the-spot verification and investigation (Article 101)*

Effective on-going supervision of a UCITS fund and its management company by relevant competent authorities is essential for the smooth functioning of the UCITS's market. In this respect, the adoption of more detailed rules regarding the powers of the competent authorities, including the possibility to carry-out on-the-spot verifications and investigations in another Member State, was seen by the co-legislators as an essential element of the new UCITS Directive, in particular from the perspective of a well-functioning management company passport (although not limited to it). This possibility is particularly essential as regards the ability of the competent authorities of the UCITS home Member State to supervise, on a cross-border basis, compliance by the management company with respect to the matters that fall within the responsibilities of the competent authorities of the UCITS home Member State (Article 19(5) of the new Directive).

In its advice on the management company passport of 31 October 2008, CESR recommended that "*the procedure to be followed in the course of on-the-spot verifications be the procedure applicable in the country of the inspected entity*".

By introducing a new Article 101(9) the co-legislators have granted powers to the Commission to adopt implementing measures defining concerning procedures.

Considering that similar provisions and implementing powers exist in other financial services directives, in particular the MiFID and Market Abuse Directive, CESR is invited to take into account its previous work done in this area in order to avoid duplication of procedures and achieve a maximum level of coherence across the different areas of financial services. CESR is also invited to avoid imposing procedures which might be considered too bureaucratic on Member States such that they would effectively render cross-border verifications and investigations less efficient.

Detailed questions

I. Scope of the Commission's implementing powers (Article 101(9))

"8. The Commission may adopt implementing measures concerning procedures for on-the-spot verifications and investigations.

..."

II. Question

CESR is invited to define the content of the procedures to be followed when competent authorities intend to carry-out verification or an investigation on the territory of another Member State.

1.2.6. Exchange of information between competent authorities (Article 105)

As in the case of on-the-spot verification and investigation, the powers granted to the Commission concerning information sharing between competent authorities are not solely related to the management company passport. Information sharing between competent authorities underpins all cross-border actions involving UCITS and will *inter alia* assure smooth functioning of MCP. Therefore the Commission decided to include this delegation into part I of provisional mandate.

CESR has already provided a technical advice on possible implementing measures with regard to Article 58 of MiFID. It may therefore wish to reflect on any meaningful differences and similarities with regard to the content and procedure of information-sharing between competent authorities in the light of the recast of the UCITS Directive and MiFID with a view to ensure a consistent approach.

CESR is also encouraged to take into account all exchange of information mechanisms covered by other Directives (e.g. Market Abuse Directive, Prospectus Directive) or CESR Multilateral Memorandum of Understanding and the practice developed and experience gained within the EU in this respect.

Detailed questions

I. Scope of the Commission's implementing powers (Article 105)

"The Commission may adopt implementing measures relating to the procedures for exchange of information between competent authorities.

..."

II. Questions

1. CESR is invited to define the content of the procedure to be followed when competent authorities intend to exchange information.
2. CESR is also requested to indicate if there are areas which could be more effectively regulated at level 3.

2. REQUEST FOR TECHNICAL ADVICE ON THE KEY INVESTOR INFORMATION LEVEL 2 PROVISIONS (PART II OF THE MANDATE) – SUPPLEMENT TO THE COMMISSION 2007 "REQUEST FOR ASSISTANCE ON KEY INVESTORS DISCLOSURES FOR UCITS"

2.1. Background

The Commission in its White Paper of 2006 undertook to launch remedial work on the simplified prospectus as it fell short of its purpose as an understandable and consistent disclosure allowing investors to properly assess the risk-reward profile, features and costs of funds and compare these between UCITS. Evidence suggested it was a costly disclosure which varied significantly between different jurisdictions across the European Union and fell short in effective communication.

The new UCITS Directive clarifies the fundamental objectives and guiding principles of the key investor information (KII) as a first step to improving the effectiveness of the disclosures. As part of this modification the Directive foresees the adoption of level 2 measures to give effective and uniform expression of these principles across the EU.

The objective is to replace the existing simplified prospectus with explanations of the risks, costs and expected outcomes associated in investment in a UCITS fund that are focused on the needs and capabilities of investors (by being short, comprehensive and understandable by them), and which are consistently produced so as to enable effective comparisons.

CESR's technical groundwork on elements to be covered by level 2 measures was initiated in early 2007 by the Commission "Request for Assistance on Detailed Content and Form of Key Investor Disclosures for UCITS" – a fore-runner to the present mandate. In February 2008 CESR provided the Commission with its provisional advice on the content and form of Key Information Document disclosures for UCITS. The Commission, on the basis of this advice and in close co-operation with CESR has launched a testing process broken into two phases, with phase I focusing on variants of different specific elements of the KII, and phase II, which has just started, focusing on mock-ups of the entire KII for a number of sample funds.

The Commission recognises that an impressive body of work has been already completed by CESR notably in respect of:

- KII format;
- Identification of key items to be disclosed and methods for consistent disclosure of these for different funds: investment objectives and investment policy, past performance presentation, performance scenarios, costs and associated charges, risk/reward profile of the investment, including appropriate guidelines on and warnings of the risks associated with investments in the relevant UCITS;
- Consideration of different sales channels and methods for distributing UCITS;
- Identification of and specific KII requirements due to particular fund structures (funds of funds, umbrella funds, unit/share classes, and feeder funds).

In the light of the valuable work already completed, part II of this mandate can be seen as a supplement to the former request. It essentially fine tunes the earlier mandate so that it reflects the wording of the political agreement on the new UCITS Directive.

The Commission would in particular like to draw CESR's attention to the elements of new UCITS Directive with regard to the KII which may lead CESR to consider adjustments to its advice of February 2008. Special attention should be given to the changes introduced to the Directive in the last phase of the negotiations, such as:

- the words "key investor information" are to be mentioned on this document in the language understood by investors;
- all the essential elements of the KII have been spelled out within the Directive;
- a new clause has been added to the Article 78(3) stating that "These essential elements shall be understandable by the investor without any reference to other documents".

With regard to the last point it should be clarified that in the co-legislators' views the use of references in the essential informational part of the document might undermine the extent to which the KII functions effectively in a standalone manner, particularly where referenced material can be considered essential for understanding the investment proposition. Co-legislators are of the opinion that the drafting does not exclude the possibility of having references or signposts in the part of KII relating to information about where additional information can be found. This view seems to be supported by Article 78(4) indicating that KII "*shall clearly specify where and how to obtain additional information on the proposed investment, including (...) where and how the prospectus and the annual and half-yearly report can be obtained (...)*".

When possible, CESR should specify the areas where binding level 2 legislation might be effectively complemented by action at level 3. CESR may also provide reflections on the legal form of the level 2 measures, taking into account the underlying principle of maximum harmonisation of the disclosure and time constraints with regard to the implementation of level 1 and level 2 measures.

Key investor information remains an essential part of the Commission drive to improve point of sale transparency and increase investors' confidence in the market. This is a flagship project in the area of investment funds and investor protection and is likely to act as a benchmark for comparable product disclosures. This means that the Commission can foresee certain aspects of the CESR technical advice serving as starting points for disclosures for other similar products.

The Commission also would like to note that future developments may also impact on the final form of CESR's advice, notably the results of the consumer testing exercise at phase II, including the Contractor's recommendations on the basis of these results and the outcome of the discussion with stakeholders following the presentation of the results.

2.2. Detailed content of the request for advice

2.2.1. Content and presentation of KII (Article 78(7))

Co-legislators have agreed that the KII should be a short document, easily identifiable, containing the key information that is necessary and sufficient for investors to make informed decisions about an investment and allow for comparison between products of different UCITS.

With regard to the harmonisation of the presentation or form of the KII, CESR is invited to reflect on this point (given the overall aim that the KII is a harmonised document that can be effectively used cross-border once translated), and the most appropriate legislative approach which should be taken. For instance, the Commission can envisage a variety of different approaches with pros and cons (for instance, a detailed description of the KII's exhaustive content and form could be contained in the level 2 measures, or templates of KII layouts could be annexed to the level 2 measure to act as pro-formas, or some other approach might be adopted). The Commission expects CESR to include such supportive material consistent with the recommended approach as is necessary to provide a clear indication of what should be harmonised and how this should be achieved. The Commission would also welcome for purely illustrative purposes the inclusion of mock-ups for sample funds alongside CESR's recommendation, as an aid in visualising how the proposal will work for different funds.

According to Article 78(7)(b), due regard must be given to UCITS having different investment compartments, offering different share classes, or having fund of fund structures, master-feeder structures or where the UCITS is structured, capital protected or takes some other comparable form. KII should properly reflect these specificities.

Article 78(5) of the new UCITS Directive imposes additional challenges requiring KII to be written in a brief manner, in non-technical language, drawn up in a common format, allowing for comparison. Information should be presented in a way likely to be understood by retail investors. The aim is to ensure that KII is consistently and effectively produced by different fund managers across different jurisdictions by harmonising the standard or quality of these documents. CESR is therefore encouraged to reflect on possible ways to assist the KII producers in practically observing these rules. The Commission considers this to be a very important aspect in ensuring the effectiveness of the KII proposals.

The implementing powers granted to the Commission in this area are not subject to any specific deadline, however there is a clear obligation for the Commission to deliver them ("the Commission shall adopt"). Moreover taking into account the projected added value for investors' protection and additional one year for its implementation by the industry foreseen in the Directive, and considering the importance of minimising the disruption to the industry and stakeholders that can be generated by a series of incremental changes to legislation with differing effective dates, the Commission considers that it is indispensable that the level 2 measures enter into force at the time of the expiry of the transposition period for level 1 provisions.

Detailed questions

I. Scope of the Commission's implementing powers (Article 78(7))

"7. The Commission shall adopt implementing measures which define the following:

a) the detailed and exhaustive content of the key investor information to be provided to investors as referred to under paragraphs 2, 3 and 4;

b) the detailed and exhaustive content of the key investor information to be provided to investors in the following specific cases:

i) for UCITS having different investment compartments (...),

ii) for UCITS offering different share classes (...),

iii) for funds of funds structures (...),

iv) for master-feeder structures (...),

vi) for structured, capital protected and other comparable UCITS (...),

c) the specific details of the form and presentation of key investor information to be provided to investors as referred to under paragraph 5.

..."

II. Questions

CESR is invited to advise the Commission on the following questions:

1. What is the KII to contain and how should this be harmonised at level 2? How should level 2 measures fulfil the requirements of the UCITS IV Directive to specify the content and form of KII in a detailed and exhaustive manner such that the document is sufficient for investors to make informed decisions about planned investments? This should be taken to include the methodologies CESR considers necessary for delivering the information disclosures CESR proposes for the KII (e.g. the methodologies for risk, performance and charges disclosures). CESR should be clear as to the requisite degree of harmonisation it considers necessary for these supporting methodologies.

2. What sort of cross-references to other documents or "signposts" might be permitted, apart from those which are directly referred to in the Directive, given that Article 78 states that *"These essential elements shall be understandable by investor without any reference to other documents"*?

3. To what extent and in what way should level 2 measures harmonise the detailed presentation of key investor information (such as the layout of the document, its length, headings to be used for sections, etc.)? (Detailed supporting material should be provided relevant to the approach proposed; for instance if CESR considers templates should be used in the implementing measures to harmonise presentation of the KII, then CESR should provide such templates as it thinks necessary in its advice). What supporting work does CESR consider necessary at level 3? How should the measures at level 2 balance the flexibility necessary for allowing the KII to effectively cover the specific characteristics of particular funds or groups of funds, with the necessary harmonisation of the document?

4. How should the KII reflect all the characteristics of the special cases outlined under Article 78(7)(b) that are relevant for the retail investor making an investment decision, for instance the characteristics of master feeder structures?

2.2.2. *Specific conditions to be met when providing KII in a durable medium other than paper (Article 81(2))*

Since the KII is intended as a mandatory disclosure available to investors before they decide to invest, the Directive contains several safeguards relating to the delivery of the information and the form of this delivery, so as to ensure the information is easily accessible to investors. Delivery requirements are founded on the obligation of the management or investment company to provide investors with KII in good time before the investment (Article 80(1)). Moreover, management and investment companies are obliged to provide KII to product manufacturers and intermediaries selling on advising investors on potential investments in UCITS or in products offering exposure to UCITS upon their request (Article 80(2)). Article 81 specifies that the delivery could be effected in a durable medium or by means of a website.

Moreover, co-legislators agreed a requirement that an up-to-date version of the KII should always be published on the website of the investment company or a management company, and the competent authorities have been encouraged to consider publishing the KII of all funds present in their market on their website so as to allow investors to easily compare between funds.

Where the KII is to be delivered in a durable medium other than paper or by a website which does not constitute a durable medium additional safety measures compared to the paper form may be necessary to maintain the integrity of the information, prevent alterations that undermine its comprehensibility and effectiveness, avoid manipulation or modifications by unauthorised persons or any other interventions which may have a negative effect on the content, availability, and durability of the information. The nature of these requirements is likely to also depend on the nature of the harmonisation of the form or presentation of the KII itself. Therefore the Commission has been given the possibility to adopt implementing measures in this field though it is not required to do so.

While providing its advice CESR is invited to take duly into account the definition of the durable medium provided for in the Commission Directive 2006/73/EC with a view to achieving the necessary level of consistency. This MiFID level 2 definition specifies that it "means any instrument which enables a client to store information addressed personally to that client in a way accessible for future reference for a period of time adequate for the purposes of the information and which allows the unchanged reproduction of the information stored".

Detailed questions

I. Scope of the Commission's implementing powers (Article 81(2))

"2. The Commission may adopt implementing measures which define the specific conditions which need to be met when providing key investor information in a durable medium other than on paper or by means of a website which does not constitute a durable medium.

...."

II. Question

CESR is invited to advise the Commission on the specific conditions which need to be met when providing KII in a durable medium other than on paper or by means of a website which does not constitute a durable medium.

2.2.3. Specific conditions when providing the prospectus in a durable medium (Article 75(4))

Although this delegation does not belong to the KII package, the importance of the prospectus as an element of investor disclosure, including for non-retail investors, is unquestionable. Also from the practical standpoint it seems advisable to include this delegation in the Part II of the mandate as the delegation contained in the Article 75(4) mirrors that from the Article 81(2).

CESR is nevertheless invited to indicate any differences in conditions which it considers should be met when providing the prospectus in a durable medium other than paper or by means of a website which does not constitute a durable medium, in comparison to these conditions which are to be satisfied when providing KII in a paper form.

Detailed questions

I. Scope of the Commission's implementing powers (Article 75(4))

“4. The Commission may adopt implementing measures which define the specific conditions which need to be met when providing the prospectus in a durable medium other than paper or by means of a website which does not constitute a durable medium.”

II. Question

CESR is invited to advise the Commission on the specific conditions which need to be met when providing the prospectus in a durable medium other than on paper or by means of a website which does not constitute a durable medium.

3. REQUEST FOR TECHNICAL ADVICE ON REMAINING ISSUES: FUND MERGERS, MASTER-FEEDER STRUCTURE AND NOTIFICATION PROCEDURE (PART III OF THE MANDATE)

3.1. Merger of UCITS (Article 43(5))

Article 43(1) obliges merging and receiving UCITS to provide appropriate and accurate information on the proposed merger to their respective investors (subsequently referred to as the 'information letter'). This provision aims at enabling investors to make an informed judgement on the impact of the merger on their investment. This will help investors to make use of the voting right referred to in Article 44, if any,¹ and to decide whether they want to stay invested irrespective of the merger or to re-purchase, redeem or convert their units free of charge pursuant to Article 45(1).

Article 43(3) specifies which kind of information the information letter must contain in order to satisfy the requirements under Article 43.

Both the competent authorities of the merging and of the receiving UCITS have to consider the impact of the proposed merger on their respective investors in order to assess whether the information letter the merging, or respectively, the receiving UCITS intends to provide to its investors (referred to as the 'draft information letter') is appropriate (Article 39(3)). Should this not be the case, the competent authorities may require that the draft information letter be modified. The competent authorities of the merging UCITS may not authorise the merger, except where both the competent authorities of the merging and of the receiving UCITS are satisfied with the draft information letter or where they do not receive an indication of dissatisfaction from the competent authorities of the receiving UCITS (Article 39(4)).

Article 43(4) contains a language regime in case the merging or the receiving UCITS have been notified to market their units in another Member State. Article 43(4) follows the pattern of the language regime for key investor information pursuant to Article 94(1)(b) in order to ensure that each investor may obtain the information letter either in the official or one of the official languages of the host Member State or in another language approved by the competent authorities of the host Member State. This also means that the language into which the information letter needs to be translated is at the choice of the competent authorities of the host Member State.² To reduce costs no sworn translation is required; the UCITS may produce it under its own responsibility. In doing so, the UCITS must however ensure that the translation faithfully reflects the content of the original information letter.

¹ Community law however does not oblige UCITS to convene a general meeting of unitholders in order to approve the merger. Such voting rights are therefore subject to national law.

² This stems from the fact that, as opposed to Article 94(1)(b), neither Article 94(1)(a) nor Article 43(4) grant the UCITS the power to choose this language itself.

Article 43(5) grants the Commission the right to adopt implementing measures specifying the detailed content, format and way to provide the information referred to in paragraphs 1 and 3 of Article 43.

The Commission invites CESR to bear in mind when drafting its advice that (i) the information letter shall enable the unit-holders to make an informed judgement of the impact of the merger on their investment, (ii) that industry needs legal certainty on how to comply with the obligations under Article 43, (iii) there is a need to avoid practical problems arising from different interpretations by various competent authorities, (iv) competent authorities might need to know more precisely how to assess whether the draft information letter is appropriate and (v) an EU wide standard document for information letters would reduce costs.

Detailed questions

I. Scope of the Commission's implementing powers (Article 43(5))

"The Commission may adopt implementing measures specifying the detailed content, format and way to provide the information referred to in paragraphs 1 and 3. ..."

II. Questions

- with regard to the content of the information letter:

1. With regard to the five kinds of information listed in Articles 43(3)(a) to (e) which the merging and the receiving UCITS have to provide to their investors, CESR is invited to advise the Commission:

a) which information should be considered useful and indispensable with regard to the background and the rationale of the proposed merger?

b) what could be other considerations than those already expressly mentioned in Article 43(3)(b)³ that would be useful and indispensable with regard to the possible impact of the proposed merger?

c) which 'density' of information (amount of detail) CESR would consider useful and indispensable with regard to the considerations that should be part of the information letter in order to describe the possible impact of the merger on unit-holders?

d) what could be other specific rights than those already expressly mentioned in Article 43(3)(c)?⁴.

³ Article 43(3)(b) lists the following considerations, but also makes clear that this list does not need to be exhaustive: any material differences in respect of (i) investment policy and (ii) investment strategy, (iii) costs, (iv) expected outcome, (v) periodic reporting, (vi) a possible dilution in performance and (vii), where relevant, a prominent warning to investors that their tax treatment may be changed following the merger.

e) which relevant procedural aspects should be contained in the information letter?

2. With regard to Article 43(3)(e) which refers to the key investor information of the other⁵ UCITS involved in the proposed mergers, CESR is invited to clarify whether the KII of the other UCITS should be an integral part of the information letter or a standalone document attached to the information letter containing the information referred to in Article 43(3)(a) to (d).

3. Bearing in mind that the competent authorities cannot oblige the merging and the receiving UCITS to provide other information to their unit-holders than those listed in Article 43(3), but that the merging and the receiving UCITS are free to add, on a voluntary basis, further information, CESR is invited to advise on the form in which the information letter and the additional information should be provided.

4. CESR is encouraged to provide the Commission with a draft EU standard information letter.

- with regard to the format of the information letter:

CESR is encouraged to specify the format of the information letter.

- with regard to the way to provide the information letter:

1. The new UCITS Directive does not in general harmonise the way documents and information need to be provided to investors and to competent authorities. Only some specific provisions (notably Article 81(1) for key investor information) harmonise this. The delegation clause in Article 43(5) gives the Commission the power (without obliging it) to harmonise the way the information letter needs to be provided. CESR is invited to consider the priority that should be given to this measure bearing in mind its usefulness in ensuring that investors actually become aware of the proposed merger and can easily read the information letter.

2. Article 43 does not expressly require any specific form for the information letter; it only requires such information to be provided to investors. However, by contrast to Article 81(1) the use of another durable medium than paper is not expressly permitted. CESR is requested to reflect whether the merging or receiving UCITS are obliged to use a specific form for providing the information letter and on any practical questions that need to be dealt with at level 2 in this regard.

⁴ Pursuant to Article 43(3)(c) the information letter must contain information on all specific rights unit-holders have in relation to the proposed merger. The wording 'including, but not limited to' in Article 43(3)(c) however makes clear that the list of specific rights is not necessarily exhaustive.

⁵ Please note that the current wording at the end of Article 43(3)(e) ('of the receiving UCITS') most likely will be corrected by legal revisers. Given that the receiving UCITS also has to inform its investors and that more than two UCITS may merge, the wording needs to be wider.

3.2. Master-feeder structures

3.2.1. *Article 60(6) regarding the content of the agreement/internal conduct of business rules between feeder and master UCITS*

Pursuant to Article 58(1) a feeder UCITS has to invest at least 85% of its assets in one single master UCITS. As a consequence the fate of a feeder UCITS is much more closely related to that of its master UCITS than the relationship between two 'ordinary' UCITS, including funds of funds. This warrants a specific protection of the genuine interests of the feeder UCITS and its investors, since:

- any changes in the investment strategy and policy of the master UCITS have a significant impact on the feeder UCITS and on its investors;
- the feeder UCITS is subject to the general information and reporting obligations, but in satisfying these, depends on documents (e.g. key investor information, (half) annual report) and information from the master UCITS;
- the feeder UCITS must be in a position to effectively monitor the activities of the master UCITS, but can only do so when it receives all necessary information and documents from the master UCITS or, where applicable, its management company, depositary and auditor, in due course.

UCITS IV contains a number of provisions which take account of the dependency of the feeder UCITS on the master UCITS (see for instance Article 60, 66(3) and 67). Article 60(1) is one of the most important of these provisions. It obliges the feeder and the master UCITS to enter into a legally binding and enforceable agreement.⁶ This agreement shall place the feeder UCITS in a position to obtain in due course all documents and information from the master UCITS which are necessary to enable the feeder UCITS to comply with its duties. This agreement goes however beyond the mere exchange of documents and information.⁷ Bearing in mind that the rationale of this agreement is threefold: (i) to enable the feeder UCITS to fully comply with its obligations, (ii) to protect the best interests of the other investors of the master UCITS and (iii) to ensure financial stability and integrity, the agreement must also stipulate in a comprehensive way all other rights and duties of the feeder UCITS and the master UCITS towards each other (e.g. regarding management fees or anti-dilution measures to be taken or to claim damages in case of non-compliance). In doing so, the agreement has to flank other UCITS provisions (such as Article 60(2) to (5), 66(3) and 67).⁸ If the feeder and the master UCITS are established in different Member States, the agreement

⁶ See recital 53.

⁷ See recital 53 which reads '... and notably place it in a position to obtain from the master UCITS all information and documents necessary to perform its obligations'.

⁸ For instance by putting the feeder UCITS in a position to enforce a right in case national law does not yet grant the feeder UCITS such an enforceable right.

also has to take account of the fact that these Member State may have transposed the UCITS IV provisions and any level 2 measures in different ways.⁹

If the feeder and the master UCITS are both managed by the same management company, the agreement can, but does not have to be replaced by internal conduct of business rules. These are rules adopted by their joint management company. The rationale behind the agreement and the internal conduct of business rules is identical. Like the agreement the internal conduct of business rules have to comply with the requirements laid down in paragraph 1.

The competent authorities of the feeder UCITS home Member State may only grant approval of the feeder's investment into the master UCITS, if, among others, the agreement/internal conduct of business rules between the feeder and the master UCITS complies with the requirements laid down in Article 60.

The Commission invites CESR to bear in mind when drafting its advice the (i) above-mentioned rationale of the agreement, (ii) that industry needs legal certainty on how to comply with the obligations under Article 60(1), (iii) there is a need to avoid practical problems arising from different interpretations by various competent authorities, (iv) competent authorities might need to know more precisely how to assess whether an agreement complies with requirements pursuant to Article 60(1) and (v) an EU-wide standard document would reduce costs.

Detailed questions

I. Scope of the Commission's implementing powers (Article 60(6))

"The Commission may adopt implementing measures specifying:

- (a) *the content of the agreement or of the internal conduct of business rules referred to in paragraph 1;*

..."

II. Questions

- with regard to the content of the agreement

1. CESR is invited to advise the Commission on which elements need to be covered by the agreement between feeder and master UCITS and to clarify how certain issues need to be stipulated in order to satisfy the requirements under Article 60(1). While preparing its advice CESR should take account of certain specific circumstances (e.g. whether feeder and master UCITS are established in the same or in different Member States).

⁹ Example: A feeder UCITS from Member States A invests into a master UCITS from Member State B. Member States A and B have transposed Article 60(2) on appropriate measures to prevent market timing in slightly different ways both of which are compatible with Article 60(2). The feeder and the master UCITS have to stipulate in their agreement by which measures they intend to prevent market timing. These measures need to be compatible with the laws of Member State A and B.

2. CESR is encouraged to provide the Commission with a draft model agreement.

3. Article 60(1) does not lay down whether and how master and feeder UCITS may choose the applicable law regarding their agreement.¹⁰ Given that the competent authorities of the feeder UCITS has to check the agreement, CESR is invited to advise on any restrictions regarding the choice of the applicable law.

- with regard to the content of the internal conduct of business rules

1. If the feeder and the master UCITS are managed by the same management company, they can replace the agreement by internal conduct of business rules.

a) given the specific circumstances of both master and feeder UCITS being managed by the same management company, CESR is invited to recommend any useful or indispensable modifications of the content of the internal conduct of business rules compared of an agreement,

b) CESR is encouraged to provide the Commission with a draft of internal conduct of business rules.

3.2.2. Article 60(6) regarding the appropriate measures to avoid market timing

Since the feeder UCITS has to invest at least 85% of its assets into the master UCITS, the performance of the feeder UCITS depends (at least to a very high degree) on that of the master UCITS. This may create risks of 'market timing' or other arbitrage opportunities in the sense that if the master UCITS publishes its unit price (or NAV) at a certain time before the feeder UCITS, investors may make use of this information for subscribing or buying¹¹ units of the feeder UCITS for the same day. Those investors would thus be in a competitive advantage compared to other investors in the feeder UCITS who have not taken note of the NAV publication of the master UCITS or who are not that easily in a position to determine to what extent the unit price of the feeder UCITS is determined by that of the master UCITS.¹²

¹⁰ If no restrictions were to be added, the master and the feeder UCITS could choose the law of the home Member State of one of them or the law of any other country.

¹¹ The term 'buying' means that the investor makes use of other distribution channels (e.g. a stock exchange) than by subscribing units at the UCITS.

¹² Example: A feeder UCITS which is listed at a stock exchange or for which a secondary trading at a stock exchange takes place invests 85% of its assets in the master UCITS and holds 10% liquidity and 5% derivatives. The master UCITS has published its unit price at 2 p.m. CET. The unit price rose by 5% compared to the day before. The feeder UCITS will publish its unit price at 3 p.m. CET. A sophisticated investor seeks exposure to the master UCITS. Since the unit price of the master UCITS has risen by 5%, the sophisticated investor may perhaps not directly invest in the master UCITS, but try to invest before 3 p.m. of that day in the feeder UCITS by finding a seller who is not aware of the prior unit price publication of the master UCITS (and thus of the rise of 5%). The sophisticated investor might thus be in a competitive advantage compared to (i) this seller, (ii) to all other investors which have subscribed units in the feeder UCITS before 2 p.m. (assuming that the cut-off time for

To avoid any forms of 'market timing' or other arbitrage opportunities Article 60(2) obliges the master UCITS and the feeder UCITS to take appropriate measures to coordinate the timing of their net asset value calculation and publication.

Detailed questions

I. Scope of the Commission's implementing powers (Article 60 (6))

'The Commission may adopt implementing measures specifying:

(b) *which measures referred to in paragraph 2 are deemed appropriate and;*
...'

II. Questions

1. CESR is invited to advise on measures needed to avoid "market timing" or other arbitrage opportunities.
2. While preparing its advice CESR is invited to consider a need to take into account different circumstances for master and feeder UCITS listed at a stock exchange or for whom a platform for secondary trading exists on the one side and for master and feeder UCITS whose units can only be subscribed as well as specific circumstances of certain Member States or certain markets.

3.2.3. Article 60(6) regarding the procedures for approvals in case of liquidation, merger or division of the master UCITS

As already mentioned above, the fate of the feeder is very closely linked to that of the master UCITS. That is why Article 60(4) and (5) provides specific rules in case of a liquidation, merger or division of the master UCITS.

If the master UCITS is liquidated, the feeder UCITS can no longer stay invested. As a consequence, the feeder UCITS must either find a new master UCITS, convert into an 'ordinary' UCITS or otherwise be liquidated. For both the investment into another master UCITS or the conversion into an 'ordinary' UCITS an approval by the competent authorities of the feeder UCITS is required.

A merger or division of the master UCITS does not per se put into question the master-feeder structures, since the feeder UCITS may stay invested in the master UCITS¹³ or another UCITS¹⁴ resulting from the merger or division. The feeder UCITS may however come to the conclusion that the merger or division of the master UCITS is not in the best

subscriptions is before 2 p.m.) and (iii) to retail investors who will not be able to determine which effect the 5% rise of the master will have for the feeder UCITS given that the latter also holds derivatives and ancillary liquidity.

¹³ In a merger this is the case, if the master UCITS is the receiving UCITS.

¹⁴ In a merger this is the case, if the master UCITS is the merging UCITS.

interest of its own end-investors. In that case the feeder UCITS may either find another master UCITS or convert into an 'ordinary' UCITS. As in the case of liquidation, this requires the approval of the feeder UCITS competent authorities.¹⁵ To allow the feeder UCITS to make use of these options, subparagraph 3 of Article 60(5) provides that the master UCITS shall answer the feeder UCITS' redemption requests¹⁶ before the merger or division becomes effective. Should the feeder UCITS not make use of any of the three options granted under point (a) to (c) of subparagraph 1 of Article 60(5), the feeder UCITS will be liquidated.

Article 60(6)(c) provides that the Commission may adopt implementing measures specifying the procedures for these approvals. The need for a set of harmonised rules for these procedures in particular stems from the fact that there is only a short time frame¹⁷ for the feeder UCITS to choose one of the available options and to apply for approval and for the competent authorities to grant approval, given that the master UCITS can be liquidated three months after it informed its investors of the binding decision to liquidate. In case of a merger or division the time frame can even be shorter. The time frames cannot be prolonged, because this would disproportionately delay the liquidation, merger or division of the master UCITS.

There may be a need for different procedures for liquidations on the one hand and mergers and divisions on the other hand, since the time pressure in a liquidation of the master UCITS is less burdensome than in a merger or division. If the feeder UCITS wants to avoid any impacts of the merger or division, it can only do so by redeeming before these measures take effect.¹⁸ By contrast, a liquidation of the master UCITS could be organised in such a way as to pay back the feeder UCITS *in specie*. This would allow the feeder UCITS to decide among the three options foreseen in Article 60(4) even following the liquidation.

Procedures need to be particularly fine-tuned, given that they must also cope with situations where the competent authorities refuse approval and where the feeder UCITS may have to look for an alternative solution (and eventually seek approval) before the merger or division of the master UCITS takes effect.¹⁹

Detailed questions

¹⁵ In addition also the third option, to stay invested, requires the approval of the competent authorities.

¹⁶ Subparagraph 3 of Article 60(5) gives the feeder UCITS the right to request redemption, but does not explicitly oblige the feeder UCITS to actually request redemption.

¹⁷ Please note that short time frames were required in order not to overly delay the liquidation, merger or division of the master UCITS.

¹⁸ Only under these circumstances can the feeder UCITS benefit from the right to redeem free of charge pursuant to Article 45(1).

¹⁹ As said before, the situation in a liquidation of the master UCITS might be different.

I. Scope of the Commission's implementing powers (Article 60(6))

"The Commission may adopt implementing measures specifying:

c) the procedures for the required approvals pursuant to paragraphs 4 and 5 in case of a liquidation, merger or division of a master UCITS.

...".

II. Questions

- regarding a liquidation of the master UCITS

CESR is invited to advise the Commission on the elements of the procedure for approvals referred to in Article 60(4)(a) and (b) (approval of the investment of at least 85 % of the assets of the feeder UCITS in units of another master UCITS or approval of the amendment of fund rules or instruments of incorporation in order to enable the feeder UCITS to convert into a UCITS which is not a feeder UCITS). While preparing its advice CESR is encouraged to reflect particularly on the following elements:

- a) time frames in which the feeder UCITS may use one of the options mentioned in points (a) or (b) of subparagraph 1,
- b) conditions which should be applied in such circumstances,
- c) time periods for granting²⁰ approval,
- d) additional time period for cases in which the competent authorities refused the feeder UCITS' application for approval under Article 60(4)(a) and (b),
- e) need for specific rules on the exchange of information between competent authorities with regard to the liquidation of the master UCITS if the feeder and the master UCITS are established in different Member States.

- regarding a merger or division of the master UCITS

CESR is invited to advise the Commission on the elements of the procedure for approvals referred to in Article 60(5)(a) to (c). While preparing its advice CESR is encouraged to reflect particularly on the following issues:

²⁰ Please note that Article 59(2) provides for a 15 working days period for granting approval for the investment of a feeder UCITS into a master UCITS. There is however no time period for the conversion of a feeder UCITS into an 'ordinary' UCITS.

²¹ Please note that Article 59(2) provides for a 15 working days period for granting approval for the investment of a feeder UCITS into a master UCITS. There is however neither a time period for the conversion of a feeder UCITS into an 'ordinary' UCITS nor for the assessment of the competent authorities that the master UCITS irrespective of the merger continues to comply with the requirements of Chapter VIII. If the (new) master UCITS is another UCITS resulting from the merger, a completely assessment on whether this new master UCITS complies with the requirements will be necessary which will even take more time.

- a) time frames in which the feeder UCITS may use one of the options mentioned in points (a) to (c),
- b) conditions which should be applied in such circumstances,
- c) possible ways to ensure protection of the feeder UCITS' investors and provide certainty for the master UCITS by requiring that the approval procedure for the alternative measures under Article 60(5)(b) and (c) be completed sufficiently in advance of the time period pursuant to the last sentence of Article 45(1) in order to allow the feeder UCITS to request free of charge redemption of its units before the merger takes effect,
- d) time periods for requesting and granting²¹ approval,
- e) additional time period for cases in which the competent authorities refused the feeder UCITS' application for approval under Article 60(5)(a) to (c),
- f) elements which competent authorities have to check and conditions under which they have to grant approval if the feeder UCITS applies for approval in order to stay invested in the master UCITS or to become a feeder UCITS of another UCITS resulting from the merger or division,
- g) need for specific rules regarding the exchange of information between competent authorities if the feeder and the master UCITS are established in different Member States.

3.2.4. *Article 61(3) regarding the agreement between depositaries*

The feeder and the master UCITS can, and if they are established in different Member States, must have different depositaries. The feeder UCITS must have timely access to all relevant information and documents regarding the feeder's investment into the master UCITS. Article 61(1) therefore obliges the feeder UCITS (or its management company) to communicate to its depositary any information about the master UCITS required for the completion of the depositary's duties. The feeder UCITS will however not always possess all relevant information or be in a position to obtain them in due course from the master UCITS or the depositary of the master UCITS. For this purpose, Article 61(1) obliges the depositaries of the feeder and of the master UCITS to enter into an agreement which governs the exchange of information and documents to ensure the fulfilment of their duties.²² Since there is no contractual relationship between both depositaries, this agreement forms the legal basis for any information requests on the part of the feeder UCITS' depositary.

When authorising the feeder UCITS, the competent authorities have to check whether the information-sharing agreement actually enables the depositaries to comply with their duties (Article 59(3)). Through implementing measures the Commission may specify the content of any such information-sharing agreements.

²² There is of course no such obligation if the feeder and the master UCITS have the same depositary.

The Commission invites CESR to bear in mind when drafting its advice the (i) above-mentioned rationale of the agreement, (ii) that industry needs legal certainty on how to comply with the obligations under Article 61(1), (iii) there is a need to avoid practical problems arising from different interpretations by various competent authorities, (iv) competent authorities might need to know more precisely how to assess whether an agreement complies with requirements pursuant to Article 61(1) and (v) an EU wide standard document would reduce costs.

Detailed questions

I. Scope of the Commission's implementing powers (Article 61(3))

"The Commission may adopt implementing measures specifying:

- (a) *the particulars that need to be included in the agreement referred to in paragraph 1.*
... "

II. Questions

1. CESR is invited to advise the Commission:

a) on the useful and indispensable elements to be covered by the agreement between the depositaries of the feeder and the master UCITS and, if appropriate, the way they should be stipulated in order to satisfy the requirements under Article 61(1),

b) on a need to take account of specific circumstances (e.g. whether the depositaries of the feeder and the master UCITS are established in the same or in different Member States).

2. CESR is encouraged to provide the Commission with a draft model agreement.

3. Article 61(1) does not lay down whether and how the depositaries of the master and the feeder UCITS may choose the applicable law for the agreement. Given that the competent authorities of the feeder UCITS have to check the agreement, CESR is invited to reflect on any restrictions regarding the choice of the applicable law.

3.2.5. Article 61(3) regarding the irregularities the depositary of the master UCITS has to report

Article 61(2) obliges the master UCITS' depositary to immediately inform the competent authorities of the master UCITS, the feeder UCITS and the feeder UCITS' management company and depositary of any irregularities it detects with regard to the master UCITS which are deemed to have a negative impact on the feeder UCITS. The information available to the competent authorities of the master UCITS shall ensure that they may take appropriate measures to stop irregularities and protect the best interests of all investors in the master UCITS. Given the strong link between the feeder UCITS and the master UCITS, this information should enable both the feeder UCITS and its depositary to decide on own measures to protect the best interests of investors (e.g. by obliging the

master UCITS to comply with the law, fund rules and the agreement, by claiming damages or by divesting). The master UCITS' depositary is however only obliged to report on those irregularities of the master UCITS which are deemed to have a negative impact on the feeder UCITS. Only then may there be a need for the feeder UCITS or its depositary to act. The Commission may, through level 2 measures, specify which types of irregularities are deemed to have a negative impact on the feeder UCITS. For the sake of legal certainty, the wording of Article 61(2) 'are deemed to have' makes clear that an information duty only exists for those (types of) irregularities specified by Commission implementing measures.

Detailed questions

I. Scope of the Commission's implementing powers (Article 61(3))

"3. The Commission may adopt implementing measures further specifying the following:

(b) the types of irregularities referred to in paragraph 2 which are deemed to have a negative impact on the feeder UCITS.

...)." "

II. Questions

1. When carrying out its tasks, the depositary of the master UCITS may not only detect irregularities in the master UCITS' business that are directly related to the aforementioned tasks of the depositary (e.g. detect that the valuation is not in line with the law or fund rules), but by chance the depositary may become aware of other irregularities in the course of carrying out its tasks.²³

CESR is invited to advise the Commission on whether also those irregularities that the depositary detected in the course of carrying out its tasks should be relevant in this context.

2. CESR is invited to provide the Commission with a list of irregularities the depositary of a UCITS may detect and to categorize these irregularities.

3.2.6. Article 62(4) regarding the agreement between auditors

The feeder UCITS and the master UCITS may either have the same auditor or different auditors. As the portfolio of the feeder UCITS (mainly) consists of units of the master UCITS, the role of the feeder UCITS' auditor would be slightly different from the role of auditors of "ordinary" UCITS. If the master UCITS and the feeder UCITS have different auditors, the feeder UCITS' auditor may only meet its obligations, if it has timely access to all relevant information and documents and may discuss them with the master UCITS' auditor, if need be. The auditor of the feeder UCITS has to take into account the audit

²³ See also Article 106(1).

report of the master UCITS when auditing the feeder UCITS. This means that it must obtain a copy of the (draft) audit report of the master UCITS in due course to meet its own deadlines. To ensure such timely access, the auditors of the feeder UCITS and of the master UCITS have to enter into an agreement which governs the exchange of information to ensure the fulfilment of their duties.²⁴ Since there is no contractual relationship between both auditors, this agreement forms the legal basis for any information requests on the part of the feeder UCITS' auditor.

When authorising the feeder UCITS, the competent authorities have to check whether the information-sharing agreement actually enables the auditors to accomplish their duties. The Commission may adopt implementing measures to specify the content of such information-sharing agreement.

The Commission invites CESR to bear in mind when drafting its advice the (i) above-mentioned rationale of the agreement, (ii) that industry needs legal certainty on how to comply with the obligations under Article 62(1), (iii) there is a need to avoid practical problems arising from different interpretations by various competent authorities, (iv) competent authorities might need to know more precisely how to assess whether the agreement complies with the requirements pursuant to Article 62(1) and (v) an EU wide standard document would reduce costs.

Detailed questions

I. Scope of the Commission's implementing powers (Article 62(4))

*"The Commission may adopt implementing measures specifying the content of the agreement referred to in paragraph 1 subparagraph 1.
..."*

II. Questions

1. CESR is invited to advise the Commission on the useful and indispensable elements to be covered by the agreement between the auditors of the feeder and the master UCITS²⁵ and, if appropriate, the way they should be stipulated in order to satisfy the requirements under Article 62(1). While preparing its advice CESR is encouraged to reflect particularly on the necessary arrangements which would allow the auditor of the feeder UCITS to take into account the audit report of the master UCITS and on other specific circumstances (e.g. whether the auditors of the feeder and the master UCITS are established in the same or in different Member States).

²⁴ There is of course no such obligation if the feeder and the master UCITS have the same auditor.

²⁵ The DG MARKT initial orientations contain the following, non-exhaustive examples for issues which could be included in the information-sharing agreement:

- (a) time limits and requirement for submitting annual documents periodical statements, certified inventories, reports on a merger, division, contribution in kind or a liquidations affecting the master UCITS
- (b) information about the master UCITS' exposure and
- (c) information on irregularities of the master UCITS

See: http://ec.europa.eu/internal_market/investment/docs/legal_texts/orientations/poolingexposure_en.pdf

2. CESR is encouraged to provide the Commission with a draft model agreement.

3. Article 62(1) does not lay down whether and how the auditors of the master and the feeder UCITS may choose the applicable law for the agreement. Given that the competent authorities of the feeder UCITS has to check the agreement, CESR is invited to advise on any restrictions regarding the choice of the applicable law.

3.2.7. *Article 64(4) regarding the format and the way to provide information on a conversion into a feeder UCITS or on a change of the master UCITS*

Subject to approval by the competent authorities an 'ordinary' UCITS may convert into a feeder UCITS and an existing feeder UCITS may change the master UCITS. Both the conversion and the change of master constitute a significant change in the investment strategy and policy of the (feeder) UCITS. This is why Article 64(1) obliges the feeder UCITS to inform all its investors of such a change. The feeder UCITS has to provide this information (the so-called 'information letter') after the competent authorities approved the conversion/change of master UCITS and at least 30 days before the feeder UCITS starts to invest into the (other) master UCITS. The rationale of the information letter is to enable investors to make an informed decision on whether to stay invested or to request redemption without any charges than those to cover disinvestment costs pursuant to Article 64(1)(d). The Commission may adopt implementing measures specifying the format and the way to provide this information letter (Article 64(4)(a)).

Detailed questions

I. Scope of the Commission's implementing powers (Article 64(4))

" The Commission may adopt implementing measures specifying:

*(a) the format and the way to provide the information referred to in paragraph 1;
... "*

II. Questions

- with regard to the format of the information letter:

CESR is invited to specify the format of the information letter.

- with regard to the way to provide the information letter:

1. The new UCITS Directive does not, in general, harmonise the way documents and information need to be provided to investors and to competent authorities. Only some specific provisions (notably Article 81(1) for key investor information) harmonise this. The delegation clause in Article 64(4) gives the Commission the power (without obliging it) to harmonise the way the information letter needs to be provided. CESR is invited to consider the priority that should be given to this measure bearing in mind its usefulness in ensuring that investors actually become aware of the conversion or change of the

master UCITS.

2. Article 64(1) does not expressly require any specific form for the information letter; it only requires such information to be provided to investors. However, by contrast to Article 81(1) the use of a durable medium other than paper is not expressly permitted. CESR is invited to reflect whether the feeder UCITS should be obliged to use a specific form for providing the information letter and on any practical questions which need to be dealt with at level 2 in this respect.

3.2.8. Article 64(4) regarding a contribution in kind

When an existing UCITS converts into a feeder UCITS, it may be detrimental to the interests of investors to first sell the assets and then invest cash in the master UCITS. Likewise a feeder UCITS which wants or has to change the master UCITS (e.g. because of a liquidation) may want to save transaction costs by (i) (partially) requesting redemption *in specie* from the old master and (ii) by a contribution in kind into a new master UCITS. In these cases Article 64(4)(b) implicitly allows feeder UCITS to invest into the master UCITS through a contribution in kind, i.e. by a transfer of all or parts of the feeder UCITS' assets to the master UCITS in exchange for units, should the master UCITS agree with it.²⁶ The particulars of the contribution in kind need to be stipulated in the agreement between the feeder and the master UCITS.

To protect both the interests of the feeder UCITS and those of other investors of the master UCITS the Commission may adopt implementing measures specifying the procedure for valuing and auditing such a contribution in kind and the role of the depositary in this process.

Detailed questions

I. Scope of the Commission's implementing powers (Article 64(4))

" The Commission may adopt implementing measures specifying:

(b) if the feeder UCITS transfers all or parts of its assets to the master UCITS in exchange for units, the procedure for valuing and auditing such a contribution in kind and the role of the depositary of the feeder UCITS in this process.

... "

II. Questions

CESR is invited to advise the Commission on the elements of the procedure for valuing and auditing a contribution in kind while reflecting, in particular, on the following

²⁶ Article 64(4)(b) does not presuppose that Member States in general allow investors in UCITS to invest through contributions in kind. It however implicitly obliges Member States to enable UCITS which convert into a feeder UCITS or feeder UCITS which change the master UCITS to transfer all or parts of their assets to the (other) master UCITS in exchange for units in the latter.

elements:

- a) similarities between a merger and a contribution in kind which may justify modelling the procedures for a contribution in kind on Article 42,
- b) role for the depositaries of the feeder and the master UCITS in a contribution of kind,
- c) the date for valuing the assets and liabilities of the feeder and the master UCITS and for calculating the exchange ratio,
- d) the effective date for the contribution in kind.

3.3. Notification procedure

The recast of the UCITS directive provides for the overhaul of the notification procedure for a UCITS which intends to market its units cross border in the EU. The objective of the reform is to simplify and accelerate the notification as well as to remove unnecessary administrative burdens. The new notification procedure is based on swift, electronic communication of standardised documentation between supervisors. It removes an ex-ante check of marketing arrangements by authorities of the UCITS host Member State and facilitates immediate access to the host market for UCITS. This requires that host Member State is provided with or has access to all relevant information on marketing arrangements made by UCITS to be prepared for ongoing control of compliance with those rules which fall within its supervisory competences.

Level 1 provisions set up general rules and principles for the new UCITS passport and delegate to level 2 measures regulation of technical and procedural aspects. Implementing legislation should in particular:

- introduce a standardised form of notification letter and attestation that the notified fund is a UCITS within the meaning of the Directive;
- establish procedures for electronic transmission of notification files, exchange of information between regulators, updating notified documents and facilitating access to information;
- define the scope of information on national rules governing arrangements made for marketing and other activities related to marketing of units of UCITS in the host Member State that are subject to supervision of that state.

CESR is invited to advise on detailed solutions that would ensure smooth processing of notification files and access to information necessary for UCITS host authorities to discharge their supervisory duties. Such solutions should also eliminate any sources of potential delays in the access of the UCITS to the market of UCITS host Member State as guaranteed by level 1 provisions. CESR is also invited to identify potential procedural or technical failures that might occur and set out procedures to deal with such situations.

As a principle CESR is requested to find balanced solutions that will ensure that supervisors can discharge their duties but also that will not compromise the objectives of the reform of the notification procedure. CESR is also invited to take into account

initiatives in other areas that foster development of cross-border networks and common electronic systems for the exchange of information between national administrations. In the context of the current consultation it is necessary to recall the important and excellent work that CESR has done to simplify notification procedure within the limits of directive 85/611/EEC. Voluntary harmonisation of supervisory practices, agreed in the framework of CESR's guidelines to simplify the notification procedure of UCITS published in June 2006 (Ref: CESR/06-120b), played an important role in the shaping of amendments to the provisions on cross-border marketing of UCITS. Part of these guidelines, subject to necessary adjustments, as well as experience with their implementation by Member States can serve as inspiration for advice on level 2 measures for the reformed notification procedure.

3.3.1. Scope of the information on national law to be published by UCITS host Member State

Article 91(3) imposes on Member States obligations to make accessible at distance and by electronic means complete information on the laws, regulations and administrative provisions which do not fall within the field governed by the Directive and which are specifically relevant to the arrangements made for the marketing of UCITS established in another Member State. The purpose of this provision is to enable fund promoters to find information on nation-specific rules, that are not harmonised at EU-level, in particular rules governing marketing communication or rules falling within the scope of Article 92 i.e. laws governing facilities required for making payments to unit-holders, re-purchasing or redeeming units and making available the information which UCITS are obliged to provide. A clear picture of nation-specific rules offered to fund promoters will make it easier to prepare for accessing the host market and limit situations where the promoters are exposed to unintentional breaches of relevant rules. Since the new notification procedure does not foresee an ex-ante check of compliance of marketing arrangement by authorities of a host Member States, promoters cannot "test" with those authorities whether their marketing arrangements are compliant with national rules. They might be directly exposed to penalties for non-compliance with national rules. Therefore it is necessary to make those rules transparent and easily available to fund promoters to enable them to prepare for marketing of UCITS in an appropriate way.

CESR Members have already addressed this issue in the Guidelines to simplify the notification procedure of June 2006. Based on the Guideline 13 CESR Members committed themselves to publish certain information on national marketing rules and other specific national regulations on their websites in a standardised form. Review of the application of these guidelines might serve as a background for the consultation on the content of implementing measures to Article 91(3).

Since it is difficult to make an exhaustive list of all non-harmonised rules applicable for UCITS, co-legislators has decided to limit the scope of national rules subject to the obligation of publication to rules specific to marketing arrangements applicable in host Member States. CESR is invited to advise on the scope of rules that should be subject to publication, based on the knowledge of national rules and supervisory practice of its Members.

Detailed questions:

I. Scope of the Commission's implementing powers (Article 95(1)(a))

"The Commission may adopt implementing measures specifying

(a) the scope of the information as referred to in Article 91(3).

..."

Article 91(3)

"Member States shall ensure that complete information on the laws, regulation and administrative provisions which do not fall within the field governed by this Directive and which are specifically relevant to the arrangements made for the marketing of units of UCITS established in another Member State within their territories, is easily accessible at distance and by electronic means (...)"

II. Question

CESR is invited to advise on the scope of information that should constitute standardised overview of non-harmonised national provisions governing arrangements made for marketing of UCITS that fall within the supervisory powers of the UCITS host Member State.

3.3.2. Facilities and procedures providing for the access of a host Member States to statutory documents of a UCITS and other information as referred to in Article 93(1) to (3)

Under Article 93(7) UCITS home Member State must ensure that the authorities of the UCITS host Member State have access by electronic means to the updated version of fund rules or instruments of incorporation of UCITS, to the prospectus of UCITS, UCITS key investor information and its latest annual and semi annual reports translated in accordance with the relevant provisions of the Directive. The Directive requires also UCITS to inform authorities of any changes to the documents referred to in Article 93(2) and where the most recent versions of these documents can be obtained by electronic means.

The Directive leaves it to the discretion of Member States to decide how they will organise access to the documents. However, the Directive grants the Commission the option to adopt implementing measures establishing harmonised procedures facilitating access for documents referred to in Article 93(2). The Commission believes that it is opportune to harmonise the way the host authorities can access the most recent versions of the statutory documents of the UCITS. Divergent transposition of obligations set out in Article 93(7) by Member States might result in the situation where it would be difficult to UCITS host member states to identify how they can access UCITS statutory document in a given Member State. The Commission is also convinced that the procedure for notification of any changes to the documents by UCITS to the authorities of the host Member State should be unified to avoid divergent procedures across the EU. A simple common and practical approach should be of benefit to both supervisors and fund managers.

In particular CESR is requested to advise on whether a system of storage of the documents centralised at national or EU level is preferable or documents should be stored and made available directly by UCITS. CESR is invited to advise on the technical and procedural aspects of the preferable system.

Detailed questions

I. Scope of the Commission's implementing powers (Article 95(1)(b))

"The Commission may adopt implementing measures specifying

(b) the facilitation of access for the competent authorities of the UCITS host Member State to the information and/or documents referred to in Article 93(1),(2) and (3) as required by Article 93(7).

...."

II. Questions

1. CESR is invited to advise on the definition of common standards and the content of relevant procedures that will facilitate access for UCITS host Member States to documents referred to in Article 93(2) in accordance with the provisions of Article 93(7). In particular CESR is invited to assess the need for the general database at the national or EU level containing obligatory disclosures of UCITS notified for cross-border marketing.
2. CESR is invited to advise on the shape of common standards and procedures for notification by UCITS of changes to documents referred to in Article 93(2) to competent authorities of a host Member States.

3.3.3. Standard model of the notification letter (Article 93(1) and the attestation (Article 93(3))

The need for the standardised documents has been already expressed by CESR Members in the CESR's guidelines to simplify the notification procedure of UCITS of June 2006. These guidelines included a model attestation to market units of UCITS in an EEA Member State (Annex I) and a model notification letter to market units of UCITS in an EEA Member State (Annex II). The idea of standardised documents has been taken into account during the preparation of the overhaul of the notification procedure. As a result, the recast of the UCITS directive provides for the option to introduce by implementing measures, a standardised form of the notification letter as referred to in Article 93(1) and the standard attestation as referred to in Article 93(3). The Commission is convinced that the introduction of standardised documents is appropriate in cross-border exchanges of information and will contribute to the simplification of the notification procedure. Practical experience with implementation of the model notification letter and the attestation as provided for in the CESR's guidelines as well as review of the content of the model documents might serve as an important input into current consultation on level 2 measures.

Under Article 93(1) the notification letter shall include information on arrangements made for marketing of units of UCITS in the host Member State. This should cover also information on share classes that UCITS intends to market in the host Member State and information on whether units will be marketed directly by a management company of the UCITS under Article 16(1). Moreover, according to Article 95(2)(a), the standard notification letter should identify translations of obligatory documents that are enclosed in the notification file. It must be noted that the notification letter should cover information that is necessary for supervisory authorities of the host Member State to prepare for the on-going supervision of compliance of marketing arrangements with applicable national rules. CESR is requested to find solutions that do not impose unnecessary burdens for fund promoters or make the process too complex.

According to article 93(3) authorities of the UCITS home Member State shall enclose to the notification file an attestation that UCITS fulfils the conditions imposed by this Directive. In the view of the Commission, the purpose of this attestation is to certify that a fund notified to the authorities of the host Member State is a UCITS within the meaning of the recast UCITS Directive and complies with the rules subject to supervision by the UCITS home authorities. The scope of attestation does not require the UCITS home authorities to verify compliance of marketing arrangements made by UCITS with applicable national rules of the host Member State.

It should be noted that the new notification procedure foresees only electronic communication of documents. It assumes that no paper copy will follow electronic communication. CESR is therefore requested to advise on solutions which are easily adaptable for the purpose of electronic communication.

Detailed questions

I. Scope of the Commission's implementing powers (Article 95(2)(a) and (b))

" The Commission may also adopt implementing measures specifying:

(a) the form and contents of a standard model of the notification letter to be used by a UCITS for the purpose of notification, as referred to in Article 93(1), including an indication as to which documents the translations refer;

(b) The form and contents of a standard model of attestation to be used by competent authorities of Member States, as referred to in Article 93(3).

....."

II. Questions

1. CESR is invited to define the exhaustive list of particulars and elements which need to be included in the notification letter. CESR is also invited to advise on a format that would be easily adaptable for the purpose of electronic communication. The format of the letter should identify enclosed obligatory documents or translation thereof in a clear way.

2. CESR is invited to design a model attestation that will confirm that the UCITS fulfils the conditions imposed by the Directive. Information and elements of the model

attestation should be exhaustive for the purpose of the attestation as referred to in Article 93(3). The model attestation should be easily adaptable for the purpose of electronic communication

3.3.4. *Procedures for the electronic transmission of the notification file and the exchange of information between competent authorities for the purpose of the notification procedure.*

In order to improve functioning of the internal market for UCITS, the new notification procedure has reduced the powers of UCITS host Member State to control on an ex-ante basis the marketing arrangements made by the UCITS. The new system is based on a relationship of trust between supervisors that the notification file is complete and is transmitted in a proper way by electronic means. Authorities of a UCITS home Member State have 10 working days to transmit the complete documentation to authorities of the UCITS host Member State. Article 93(5) requires Member States to accept electronic filing and transmission of the notification file. Smooth electronic communication of the notification file is crucial to achieve expected benefits of the reformed notification procedure.

Therefore, CESR is invited to advise on detailed technical and procedural issues related to the electronic transmission of the notification file. The advice should design a step-by-step procedure where obligations and responsibilities of entities involved are clearly defined. The proposed solutions should in particular identify without any room for doubt the moment at which the authorities of the UCITS home Member State transmits a complete documentation to the authorities of the UCITS host Member State (which allows the UCITS to start marketing its units in the host Member State). CESR is also requested to identify potential failures in the process of transmission of the notification file and solutions whereby supervisors can remedy these failures.

Detailed questions

I. Scope of the Commission's implementing powers (Article 95(2)(c))

" The Commission may also adopt implementing measures specifying:

(c) the procedure for the exchange of information and the use of electronic communication between competent authorities for the purpose of notification under the provisions of Article 93.

... "

II. Questions

CESR is requested to advise on:

a) procedures that should be put in place to facilitate electronic communication of notification files between host and home authorities, including in particular the procedure for confirmation of transmission of the file by home authorities,

b) procedures that should be put in place to exchange information between competent authorities for the purpose of the notification procedure,

b) technical arrangements that should be put in place to facilitate electronic communication of notification files and exchange of other information related to the notification procedure between host and home authorities,

d) procedures that should be put in place to deal with situations where host authorities establish that notification file is incomplete or technical problems occur.

Annex: indicative timetable for the delivering of level 2 provisions

The end October 2009 deadline is based on the following timetable:

Deadline	Action
30 October 2009	CESR technical advice
January 2010	Publication of a first working document by Commission services on possible Level 2 legislation
February 2010	Formal Commission proposal for level 2 legislation sent to ESC and published on the Internet
May 2010	Vote in the European Securities Committee on level 2 proposals
June 2010	Formal adoption of Level 2 measure by the Commission
July 2011	End of transposition period for UCITS IV Directive (Level 1) and level 2 measures.