UCITS III - the Management Directive

The original Undertakings for Collective Investments in Transferable Securities Directive (UCITS I) came into effect in 1989. Since then it has been updated and improved by two amending Directives - UCITS II and III. This feature identifies the key objectives of UCITS III, the most recent amending Directive, and its implications for the European financial services industry.

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UCITS III, the Management Directive (2001/107/EC), is the second Directive to update the original UCITS of 1989 *(see box-out adjacent)*. It was implemented in the UK on 13 February 2004 and gives providers of collective investment schemes the same freedoms as brokers, dealers and fund managers under the Investment Services Directive (ISD - 93/22/EEC). UCITS III has four key objectives:

1. Allow providers of UCITS qualifying collective investment schemes (managers) to provide their services on a cross-border basis.
2. Allow UCITS managers to undertake a wider range of activities.
3. Introduce new financial resource requirements.
4. Introduce new minimum prospectus and reporting requirements for all UCITS qualifying collective investment schemes.

The EU passport

Under the original UCITS Directive, while the manager of a UCITS scheme could offer its products in other EU Member States, it could not establish itself in another Member State. For instance, a German based product provider could offer a German scheme in the UK but it could not come to the UK to set up a UK scheme.

UCITS III has now introduced a simple procedure for a UCITS manager to establish a presence in another Member State whereby, if authorised by the regulatory authorities in one EU Member State, a UCITS manager has authorisation that is 'valid for all Member States'.

As with the ISD, the UCITS manager notifies the Home State regulator of its intention to establish itself in another EU Member State. In turn, the Home State regulator notifies the Host State and, subject to notice periods, the UCITS manager can commence activities in the Host State without the need for any further consent.

In addition, under UCITS III, UCITS managers are now allowed to manage other (non UCITS) schemes as well as undertake related business, such as portfolio management and investment advice (Article 6).

New financial resource requirements

A UCITS manager must meet the new financial resource requirements laid down in UCITS III to take advantage of the right to 'passport'.

Under UCITS III, the minimum regulatory capital a UCITS manager will be required to have is €125,000, if the funds under management are less than €250 million. If the funds under management are over €250 million, the minimum regulatory capital requirement increases by an amount equal to 0.2% of funds under management to a maximum of €10 million.

UCITS III also requires that a UCITS manager's capital should not be less than a quarter of its annual fixed

UCITS background

The original Undertakings for Collective Investments in Transferable Securities Directive (UCITS I) came into effect in 1989 (85/611/EEC). It allowed collective investment schemes established in one EU Member State (which met the minimum standards set out in the Directive) to be made available, sold 'across border', or 'passported', into any other Member State.

In its drive towards the creation of a single European market in financial services, the European Commission introduced measures to allow collective investment schemes to enjoy the same freedoms that are available to other financial services under the Investment Services Directives.

The new arrangements have been introduced through two Directives designed to correct the deficiencies of the original UCITS Directive which only allowed a limited range of collective investment schemes to qualify for cross-border sale. It also restricted managers of UCITS-qualifying schemes from operating in other Member States and prevented them from carrying out other activities (although they might have equivalent rights under the ISD).

The first of these amending Directives, UCITS II, the Product Directive (2001/108/EC), was implemented in the UK in November 2002. It allowed more flexibility in the range of schemes that could qualify as a UCITS and so be sold cross-border; permitted the creation of new mixed schemes; relaxed the rules on the spread of investments; and allowed the use of derivatives as part of the scheme's investment strategy.

UCITS III - impact on UK regulation

Introducing UCITS III changes into the UK has not been difficult and there are no major changes in the structure of UK regulation. For regulatory purposes, UCITS managers will be treated like any other incoming ISD firm.

Identification of who qualifies as a UCITS manager has caused some issues for the FSA. In the case of unit trusts, under the original UCITS, the manager has always been treated as the manager of the scheme. With open-ended investment companies (OEICs or, for UK legal and regulatory purposes, Investment Companies with Variable Capital, ICVCs), the FSA has decided the authorised corporate director (ACD) of the company will be treated as the manager.

It is difficult for the Commission to cater for the many different legal systems throughout the EU and, even with the changes brought in by UCITS III, there are still limitations on UCITS-qualifying collective investment schemes. For instance, the requirement for a manager is that while self-managed collective investment schemes can qualify as UCITS schemes, they do not qualify for an EU passport.

In the UK, the FSA has not yet finally decided how to deal with the simplified prospectus requirements and is currently consulting on it (*see section below on 'Minimum reporting requirements'*).

This is part of a wider FSA initiative designed to improve information available to investors at the point of sale following a number of cases of product mis-selling, such as split capital investment trusts and pensions.

The current position is that the consultation on the simplified prospectus has reached a fairly advanced stage but in its latest statement on the subject (issued on 23 March), the FSA announced that implementation would be delayed while Member States agreed on a 'harmonised approach to its implementation'. A further feedback statement is expected shortly.

In the meantime, to comply with its EU obligations, the simplified prospectus requirement will apply to schemes 'passported' into the UK but not to UK schemes.

The requirement for annual and half-yearly statements has been in place since 13 February 2004.

overheads so that if it is higher, the higher amount is substituted as its minimum regulatory capital requirement. UCITS III does not set any requirement as to what constitutes annual fixed overheads.

In the UK, the Financial Services Authority (FSA) initially proposed that annual fixed overheads would simply be determined by taking a quarter of a manager's audited expenditure. There was industry concern, however, that this might include exceptional one off payments and in its rules as implemented a UCITS manager is allowed to disregard exceptional items in determining its annual fixed overheads.

Minimum reporting requirements

In the original UCITS Directive, there were no common reporting requirements on the form and content of reports to investors in collective investment schemes. To address this, UCITS II (the Product Directive) included some specific requirements, but UCITS III goes further by introducing minimum reporting requirements for a collective investment scheme. These requirements include a full prospectus, a simplified prospectus, annual and half-yearly reports.

While a prospectus, or some form of offer document, will be familiar to investors in most EU countries, it is often a lengthy and technical document written by lawyers. The simplified prospectus must be 'structured and written in such a way that it can be easily understood by the average investor' (Article 28). As this is a new requirement, UCITS III provides some high-level guidance on the form and content of the simplified prospectus. This includes the details of the scheme's investment policies, risk profile and the sort of investor for whom the scheme has been designed.

UCITS III also introduces a requirement for investors to be provided with updated information about the progress of their investment including yearly and half-yearly reports. The information the UCITS manager is required to give includes the current financial position of the scheme, charges and a three-year comparative history. The detailed content of the simplified prospectus is a Home State responsibility *(see box-out above)*.

In line with UCITS III, Member States are permitted transitional provisions until 13 February 2007, however, if a fund manager wishes to take advantage of the new rules it must adopt them in their entirety.

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