

Chapter 2A

European Legislation

2A.1 Introduction

Background and scope

2A.1.1

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- (1) This section summarises the scope and content of the *UCITS Directive* as amended ("the Directive") as it applies in the *United Kingdom*. The Directive establishes a degree of harmonisation of *EEA States'* laws governing:
- (a) the activities of *management companies*;
 - (b) the *UCITS* they manage; and
 - (c) how *units* of the *UCITS* they manage are sold to the public.
- (2) The main topics governed by the Directive and summarised in this section concern:
- (a) the general scope of the Directive;
 - (b) the obligations of the *management company* and the *depository*;
 - (c) investment and borrowing powers and limits;
 - (d) information for investors,
 - (e) how the *management company* passport works; and
 - (f) *marketing* requirements.
- (3) The Directive also covers other topics which are not summarised in this section. These include:
- (a) the ability to establish master-feeder *UCITS*, with the *master UCITS* and *feeder UCITS* either in the same or different *EEA States*; and
 - (b) a procedure for the merger of *UCITS* where the *UCITS* involved are established in different *EEA States*, or market their *units* in an *EEA State* other than the one in which they are established.

General scope of the UCITS Directive

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- (1) The Directive applies to any open-ended collective investment undertaking that is established and authorised as a *UCITS* in an *EEA State*, regardless of whether it is promoted in any other *EEA State*. However, the Directive applies only to collective investment undertakings that are promoted to the general public within the *EEA*, so collective investment undertakings that are restricted in their promotion fall outside the Directive's scope.

- (2) Furthermore, the Directive does not cover *collective investment schemes* that are authorised in an *EEA State* with different investment and borrowing powers to those covered by the Directive. So, *schemes* that invest in (for example) real property or *commodities* are not within the Directive's scope.

Obligations on the management company and depositary

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- (1) The Directive assigns certain functions and requirements to a *management company* and a *depositary*. As a result, a *UK firm* which wishes to operate *UCITS schemes* or act as a *depositary* must first seek *authorisation* from the *FCA*. A *UK firm* operating a *UCITS scheme* (a *UK management company*) is referred to as the *authorised fund manager (AFM)*.
- (2) In addition, the Directive imposes certain conduct of business and financial resources requirements on the *UCITS management company*.
- (3) The Directive states that the *depositary* must be subject to 'public control' and provide 'sufficient financial and professional guarantees'. The *depositary* is responsible for the safe keeping of a *UCITS'* assets, and for ensuring that the *issue, sale, redemption* and *cancellation of units* and the calculation of the value of *units* are effected in accordance with the law and constituting document of the *UCITS*.
- (4) Two main principles govern the relationship between the *UCITS management company* and the *depositary* of a *UCITS*. First, no single company may act in both capacities. Second, they must act independently of each other and, apart from management of a *UCITS*, a *UCITS management company* cannot engage in any activities other than:
- (a) management of other collective investment undertakings;
 - (b) *managing investments*; and
 - (c) *advising on investments and safeguarding and administering investments*, but in either case only where it also has *permission to manage investments*.

Investment and borrowing powers and limits

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- (1) The Directive states the types of assets a *UCITS* can invest in. These include:
- (a) *transferable securities*;
 - (b) *approved money-market instruments*;
 - (c) *deposits*;
 - (d) *derivatives* and forwards; and
 - (e) *units* in other *collective investment schemes*.
- (2) The *UCITS eligible assets Directive*, which came into effect in July 2008, clarifies the definition of terms used in the Directive by setting out criteria for determining which types of *transferable securities*, *approved money-market instruments* and *derivatives* are eligible to be held by a *UCITS*.

- (3) Within this range of investment assets there are some detailed spread and concentration rules in the Directive. The main requirements can be summarised as follows:
- (a) no more than 5% may be invested in *transferable securities* or *approved money-market instruments* with one *issuer* - this can be raised to 10% but only in respect of a maximum of 40% of the *UCITS* value;
 - (b) no more than 20% may be invested in *deposits* with one body;
 - (c) 100% may be invested in other collective investment undertakings provided:
 - (i) no more than 30% is invested in total in units in collective investment undertakings which are not *UCITS* and then only in collective investment undertakings that offer equivalent protection to investors;
 - (ii) the collective investment undertaking being invested into is not permitted to invest more than 10% in other collective investment undertakings; and
 - (iii) no more than 10% is invested in any one *UCITS* (which may be raised to 20% at the discretion of the Member State and has been raised to 20% for *UK UCITS*), except where a *feeder UCITS* is investing in a *master UCITS* (see ■ COLL 5.8 (Investment powers and borrowing limits for feeder UCITS));
 - (d) no more than 20% may be invested in *transferable securities* and *approved money-market instruments* issued by one group;
 - (e) no more than 20% may be invested in any combination of *transferable securities*, *approved money-market instruments*, *deposits*, or *OTC derivatives* from a single body; and
 - (f) no more than 5% may be invested in *OTC derivative* exposure to one counterparty, or 10% where the counterparty is an *approved bank*.
- (4) Where a *UCITS* has the investment objective of replicating the composition of a qualifying index, it may have an exposure of up to 20% in any *issuer* or exceptionally up to 35% (but only for one *issuer*). A qualifying index is one which has a sufficiently diversified composition, is a representative benchmark for that market, and is published in an appropriate manner.
- (5) The *management company* must employ a specific risk management process to monitor the risk of all investment positions. Where *derivatives* are to be used within a *UCITS*, the *management company* must notify details of this risk management process and any significant change to it to its *competent authority*. The exposure to all *derivative* transactions must not exceed the current net asset value of the *UCITS*. The underlying assets representing any *derivative* position must be taken into account in applying the spread of limits above. This does not apply in the case of any *derivative* which is on a qualifying index.
- (6) A *UCITS* may borrow up to 10% in value of its assets, provided the borrowing is on a temporary basis.

Information to investors

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- (1) The Directive sets out which *documents* must be made available or offered to investors. The three main documentary requirements are:
 - (a) the *prospectus*;
 - (b) the *key investor information document*; and
 - (c) the annual and half-yearly reports and accounts.
- (2) The full *prospectus* requirements are included in Annex A of the Directive and provide detailed information on the main parties involved in operating the *UCITS*, the investment objectives and policy of the *UCITS*, and general day-to-day operating matters such as dealing times and income allocation.
- (3) In addition to the *prospectus*, the *management company* must publish a *key investor information document* for each *UCITS*. This is intended to be a standardised *document* used for selling *UCITS* throughout the *EEA*. It must be provided to any prospective investor free of charge so that they can take investment decisions on an informed basis. The required contents for the *key investor information document* are set out in the *KII Regulation*, which is directly applicable in each Member State.
- (4) Reports and accounts must be prepared on a half-yearly and annual basis and the latest report must be supplied to investors free of charge. They must also be available at the place specified in the *prospectus*. The required contents for the report and accounts are set out in Schedule B of the Directive.

The management company passport

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- (1) Chapter III of the Directive provides the framework for a *UCITS management company* to provide services in another *EEA State* by way of a *branch* or *cross border services*.
- (2) *UK firms* which are *UCITS management companies* can operate *UCITS* established in other *EEA states* (see ■ SUP 13 (Exercise of passport rights by UK firms) and ■ COLL 12 (Management company and product passports under the UCITS Directive) for more information).
- (3) A non-UK *management company* may operate a *UK UCITS* by way of *branch* or *cross border services* in accordance with the provision of Schedule 3 to the *Act* and if so it is defined in the *FCA Handbook* as an *EEA UCITS management company*.

Marketing requirements

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- (1) Chapter XI of the Directive provides the framework for a *UCITS* to be marketed in another *EEA State*. A *UCITS* is required to comply with the *marketing* and advertising rules in the relevant *Host State* (Article 91) and is also required to maintain facilities in the *Host State* (Article 92).
- (2) Certain *documents* must be provided to the *Host State regulator* in the relevant *EEA State* at the same time as notification of the proposal to market there. Before a *UCITS* can begin *marketing* in a

Host State, it must submit a notification letter to the *Home State regulator*, together with the *instrument constituting the scheme*, the *prospectus*, *key investor information document* and the most recent annual and half-yearly reports. The *Home State regulator* has ten working days in which to process the notification and transmit it to the *Host State regulator*. The *UCITS* may begin accessing the market immediately following transmission of the notification (Article 93).

- (3) The relevant information and *documents* distributed in the *Host State* are required to be the same as those that the *UCITS* provides in its *Home State*. In addition, the *key investor information document* must be published in an official language of the *Host State* or another language if approved by the relevant *Host State regulator* (Article 94). The other *documents* may either be translated in the same way, or published in a language customary in the sphere of international finance (English is accepted to be such a language).
- (4) A *UK UCITS* may access the market in another *EEA State* using the procedure set out in Schedule 3 to the *Act*.
- (5) A *UCITS* from another *EEA State* may access the market in the *United Kingdom* in accordance with the procedure set out in section 264 of the *Act*.