

UCITS III News

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Pan-European UCITS III Newsletter

The PricewaterhouseCoopers European UCITS III Group wishes you all a happy and successful New Year!

As announced in our latest UCITS III News, CESR's Expert Group on Investment Management has been busy working on the many questions surrounding the implementation of UCITS III throughout Europe. This work has resulted in (i) a Consultation Paper regarding the transitional provisions of UCITS III and (ii) in a Call For Evidence on the eligible assets of UCITS, both documents published in late October 2004. The outcome of CESR's consultation of the industry, which, for the transitional issues, will take the form of "guidelines" expected for end of this month, will be most welcome in the context of increasing uncertainties due to diverging local interpretations and what seems to be a general weakening of the "Home Country Control" principle.

The following chart summarizes some of CESR's proposals on the transitional treatment of UCITS vehicles and also raises several key questions unanswered by the draft guidelines.

	Recommendations	Open questions/Remarks
(1) UCITS III vehicle with "grandfathered" ManCo	Launch of passportable UCITS III funds until 30 April 2006 (risk management process however required)	Grandfathered ManCo with UCITS III funds resulting from a conversion?
(2) UCITS I sub-funds created after 13/02/2002 in a GF UCITS I fund	Launch of passportable UCITS I sub-funds until 31 December 2005	Deadline for conversion? Date triggering the potential compliance? How to deal with bottleneck?
(3) UCITS III sub-funds created after 13/02/2004 in a GF UCITS I fund	Not permissible	No big issue (even for Ireland)
(4) Requirement for a simplified prospectus for UCITS I funds created before 13/02/04?	SP to produce ASAP, and in any event no later than 30 September 2005	How to deal with bottleneck?
(5) Can a SICAV designate a foreign ManCo?	Not permissible according to CESR	CESR wants clarification from EU Commission on this topic, in an amendment to the Directive!
(6) Can a UCITS III ManCo distribute third-party funds?	Distribution of third-party funds is included in the scope of activity of a ManCo	Good news!

While it would appear that new UCITS III funds with a grandfathered management company ("ManCo") or UCITS I sub-funds created after February 2002 should be allowed to passport their units in the EU Member States, CESR proposes to bring forward the deadlines of the transition periods:

- UCITS I grandfathered ManCos would be allowed to launch new passportable UCITS III funds until 30 April 2006 (subject however to a written attestation related to the "appropriate risk management process" of the grandfathered ManCo being produced by the home country regulator),
- New UCITS I sub-funds could be launched until 31 December 2005,
- UCITS I funds should provide a simplified prospectus by 30 September 2005 at the latest.

While these deadlines clarify the rules applicable to new products, other scenarios are unfortunately not dealt with at the date of this newsletter.

What happens with ManCos which have not “launched” UCITS III products but nonetheless manage one or several funds having had to convert to the new rules? What is their deadline?

What happens to UCITS I funds which, in all good faith, have launched sub-funds after 2002 (but before 2004): do they have to comply with the December 2005 deadline?

Strangely enough, CESR does not even address the issue of self-managed investment companies, which are quite popular in both Luxembourg and Ireland: if a grandfathered SICAV has launched a sub-fund after 2002, when is the date by which it must be compliant as regards its “substance”: December 2005, April 2006 or February 2007?

Responses to the consultation by members of the industry are generally in favor of CESR’s proposals. Still, many market players or professional associations express concern over the potential bottlenecks when applying the proposed deadlines and suggest the following practical approach:

- Make use of fast-track procedures or at least simplify the procedures for converting/registering UCITS, as in Ireland and Luxembourg for instance,

- Consider that a UCITS complies with CESR deadlines if it has made an application to its home state regulator prior to these dates (even if the final authorization is not yet granted),
- Limit CESR deadlines to UCITS marketed on a cross-border basis only,
- Standardize as much as possible attestations to be provided to the Host Country regulators,
- Reinforce the Home Country Control principle.

Based on the answers provided by the industry, no major amendments to the draft guidelines are expected although the precise terms of their implementation may be clarified. Countries that have already implemented the UCITS III provisions in their local legislation may consequently have to (i) either modify their law(s) or draft law(s) (in Germany, Italy and Belgium for instance, where the February 2007 deadline is clearly mentioned) or (ii) adapt their positions on the basis of CESR’s recommendations (e.g. in Luxembourg, Italy, Ireland, Spain, UK, ...).

Lastly, CESR also launched a “Call for Evidence on the Mandate from the European Commission regarding the eligible assets of UCITS” in order to assist the Commission in the preparation of a possible modification of the UCITS

Directive. Based on the answers provided by the industry (they were due by end of November 2004), it clearly appears that interpretations of the concept of “eligible assets” may diverge from one country to another, depending on the flexibility of the regulators concerned.

As an example, assuming that “structured financial instruments” – a much debated-type of asset in CESR’s Call For Evidence and in the responses given by the industry – fall within the scope of eligible assets, their treatment may vary from one country to another. Indeed, some countries seem to consider that such instruments are admissible provided that the underlying assets are themselves eligible assets (“look-through principle”); others would limit the look-through approach to investment restrictions and issuer ratios, meaning that underlying assets could even be instruments in which a UCITS could not invest into directly.

In that context, while part of the uncertainties related to the transitional periods of UCITS III may be lifted in the coming weeks, new divergences might appear between the EU regulators with regard to the definition of eligible assets under UCITS III, especially since CESR’s advice is not expected before October 2005!

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