



HM Treasury

Post implementation review of the undertakings for collective investment in transferable securities regulations 2011



Post implementation review of the undertakings for collective investment in transferable securities regulations 2011

Presented to Parliament by
the Economic Secretary to the
Treasury
by Command of Her Majesty

June 2016

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Post Implementation Review of the Undertakings for Collective Investment in Transferable Securities Regulations 2011 (SI 2011/1613)

Introduction

1. The government is required¹ to undertake a review of its transposition of the Recast Undertakings for Collective Investments in Transferable Securities (UCITS IV) Directive 2009/65/EC.
2. The UK was required to transpose this Directive by July 2011. Transposition was carried out within the required timeframe, and in line with the approach considered within the government's original Impact Assessment.²
3. This Command Paper and the associated Post Implementation Review (PIR) (found at Annex 1) set out the government's views on the effectiveness of the regulatory regime. They cover:
 - the extent to which the regulation is achieving its objectives
 - the impacts that have resulted, and in particular, to what extent the effects anticipated in the regulation's original Impact Assessment (IA) actually occurred
 - whether there have been any unintended consequences

Scope of the Post Implementation Review (PIR)

4. The review clause of the 2011 regulations³ specifies that the Treasury must carry out a review of the relevant regulations (2 to 15) and set out and publish the conclusions in a report, before the end of the review period⁴. In carrying out the review the Treasury must, so far as is reasonable, have regard to how the UCITS Directive is implemented in other Member States. In particular, the report should:
 - set out the objectives intended to be achieved by the regulatory system established by the 2011 regulations
 - assess the extent to which those objectives are achieved
 - assess whether those objectives remain appropriate and, if so, the extent to which they could be achieved with a system that imposes less regulation

¹ By regulation 17 of the Undertakings for Collective Investment in Transferable Securities Regulations 2011 (SI/2011/1613)

² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81609/transpositionof_ucits_iv_annexe.PDF

³ http://www.legislation.gov.uk/uksi/2011/1613/pdfs/uksi_20111613_en.pdf (Please note that the version of the instrument on the legislation.gov.uk website may not be the latest version of the instrument, incorporating subsequent changes)

⁴ The review period is a period of five years beginning with the day on which the relevant regulations come into force, which means by 30 June 2016.

Methodology of analysis

5. These questions have been addressed through feedback from the main trade associations in the UK whose members have a direct interest in UCITS legislation. It is considered that these bodies represent a significant cross-section of the asset management industry, and that limiting the informal consultation to these bodies is sufficient and proportionate to obtain the information necessary to inform the PIR. A questionnaire was submitted to these bodies asking to what extent each of the Directive's objectives have been achieved through the UK's implementation, and what costs have been incurred by industry.
6. Information held by the Financial Conduct Authority, as the correct regulatory authority responsible for enforcing the UCITS legislation, has also informed our conclusions. Information on implementation of the directive in other Member States has been provided by the European Commission.

Background to the UCITS IV Directive

7. The original Directive relating to undertakings for collective investment in transferable securities (UCITS) came into effect in 1988. It aimed to offer greater business and investment opportunities for both industry and investors by integrating the EU market for investment funds. The UCITS Directive established a harmonised regulatory framework for investment funds that invest in certain classes of assets, providing high levels of investor protection and a basis for the cross-border sale of these funds.
8. In the intervening years there have been modifications to this legislation to improve the functioning of the UCITS framework (the most recent such amendment was UCITS V, which was implemented in the UK in March 2016).
9. In 2005 the European Commission identified a number of problems with the then current UCITS framework (UCITS III) that were causing significant inefficiencies in the EU investment fund market, resulting in higher costs and lower returns for investors. These problems included: (1) bottlenecks and failures with the product passport; (2) sub-standard investor disclosure; (3) proliferation of funds of a sub-optimal size, and; (4) obstacles to functional and geographical specialisation. After extensive consultation, a 2006 Commission White Paper identified that these inefficiencies were caused by serious failings in the legislative framework and that a number of targeted reforms were necessary for these to be corrected.

Summary of the Directive's objectives

10. UCITS IV sought to correct inefficiencies identified in the UCITS III framework through the following changes:
 - removing administrative barriers to the cross-border marketing of UCITS to allow UCITS to access the market without delay once the regulator of the fund has notified the regulator in the EEA Member State where the management company wants to sell its product
 - introducing a management company passport to allow a management company to operate a fund in a different Member State without the need to be established in the Member State of the fund; new harmonised requirements for the organisational, conduct

of business and risk management processes of UCITS management companies were introduced

- improving investor disclosure by replacing the simplified prospectus with a key investor information document (KIID). This is a simple document giving key facts to investors in a clear and understandable manner to allow them to make informed investment decisions
- introducing a framework for mergers between UCITS funds by establishing harmonised requirements for authorisation of a cross-border fund merger and requirements for making information available to investors
- providing for 'master-feeder' structures in which a UCITS fund (feeder) is allowed to invest at least 85% of its assets into another UCITS fund (master)
- improving supervisory co-operation, particularly in relation to supervising a UCITS management company and fund when they are established in different Member States

Implementation

11. As an EU Directive, the UK had a Treaty obligation to implement UCITS IV into national law by the required deadline. Although it is a minimum harmonisation Directive, it allowed Member States little flexibility in how it should be implemented and, as such, HM Treasury made no substantive policy choices in drawing up draft legislation for consultation.

12. Implementation of UCITS IV involved changes to primary and secondary legislation, and to the Financial Services Authority (FSA) Handbook of rules and guidance. HM Treasury made the required changes to legislation by way of a statutory instrument, the Undertakings for Collective Investment in Transferable Securities Regulations 2011 (SI 2011/1613) ("2011 regulations").

13. HM Treasury and the FSA put out a consultation paper in December 2010 seeking stakeholders' views on implementation of UCITS IV.⁵

14. In September 2011 the FSA (the pre-cursor to the FCA) published a policy paper on the transposition of the revised UCITS Directive⁶ which contains a detailed explanation of the choices made during the implementation process. The paper also outlines the responses the consultation document received.

Extent to which the objectives of UCITS IV have been achieved by the UK's implementation

15. UCITS funds now have more than €8 trillion of assets under management and account for more than 70% of the assets under management in Europe. Outside Europe, the UCITS framework has been successful in creating a global investment standard and structure based on European norms; UCITS have brought substantial flows of capital into European markets. More than 70% of funds sold in Hong Kong, for example, are branded as UCITS and formed under this legislative framework.

⁵ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81604/transpositionof_ucits_iv_ch1-10.pdf

⁶ http://www.fsa.gov.uk/pubs/policy/ps11_10.pdf

16. Details of the extent to which specific objectives of UCITS IV have been met can be found in the annexed PIR, as can an assessment of how the actual costs of implementation of the Directive compared to those anticipated in the then government's original Impact Assessment.

17. The original objectives UCITS IV set out to achieve are still appropriate. The elimination of barriers to cross-border functioning of UCITS funds, and efforts to facilitate the merger of funds of sub-optimal size or create master feeder structures, can lower costs for industry and consumers. The introduction of the Key Investor Information document remains in consumers' interest as it facilitates effective understanding and consumer choice. Evidence in the annexed PIR suggests that the proposed benefits of UCITS IV remain valid but that future improvements to the UCITS framework can potentially enhance these benefits.

18. Evidence supplied to this review suggests that the then government's approach to implementation took a copy-out approach and therefore did not impose undue additional regulation in the UK over-and-above that required in the Directive, or lead to any unintended consequences.

Suggestions for improvements to the UCITS framework

19. While industry opinion of the UCITS framework is broadly positive, the responses provided for this review have highlighted several areas in which the UCITS framework is not fulfilling its objectives to the degree the then government had hoped. Several barriers to fund mergers and master feeder structures in particular mean that the economies of scale anticipated in the UCITS market have not been achieved. A more detailed explanation of the barriers and future improvements can be found in the annexed PIR. Several of the issues raised by industry in their responses to this review have already been highlighted by the government in its response to the European Commission's 2015 Call for Evidence on the EU regulatory framework for financial services.⁷

20. In addition to issues directly relating to UCITS IV, the Call for Evidence response also contains broader suggestions for changes to the European regulatory framework that would lessen the burden on industry. For example, differences between the UCITS framework and similar directives, such as the Alternative Investment Fund Managers Directive (AIFMD), can result in practical complexities with regard to fund management operations. Broadly speaking, Article 6 of AIFMD and UCITS are similar, except Article 6(3) does not permit UCITS management companies to perform non-core service of transmitting and receiving orders of financial instruments. AIFMD Article 6(4), however, does permit this practice. This inconsistency is a burden to firms that undertake both UCITS and Alternative Investment Fund management. This could be corrected by aligning the permitted activities under UCITS to those under AIFMD. Extending the UCITS permissions would decrease the burden on firms that undertake both UCITS and AIF management.

21. However it is important to note that these issues do not stem from the approach taken by the UK in implementing the Directive, but rather from the Directive provisions themselves, which the UK and other Member States are required to transpose.

⁷ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/496887/PU1903_HMT_response_to_EU_consultation.pdf

Next steps for the regulation & conclusion

22. The UCITS IV Directive remains in place, but it has since been amended by UCITS V. UCITS V introduces a number of targeted reforms to the UCITS Directive with the objective of updating the legislative framework to ensure the safeguarding of UCITS fund operations across the EU, lower risk surrounding the management of UCITS funds, and to build consumer protection and trust in the market. In particular UCITS V introduces provisions for:

- UCITS depositaries (the firms responsible for the safekeeping of client assets), to ensure minimum standards of safeguarding across the EU
- remuneration rules for fund managers to ensure risk taking is aligned with investor appetite
- sanctions for contraventions of the Directive

23. UCITS V was implemented in the UK through a statutory instrument (the Undertakings for Collective Investment in Transferable Securities Regulations 2016 (SI/2016/225) and through FCA rules.

24. UCITS V is expected to be followed with a UCITS VI Directive. The government will continue to engage with industry and consumer groups to ensure that future UCITS legislation remain proportional and fit for purpose.

25. Given that the improvements identified for the UCITS framework are changes to the underlying EU Directive, rather than changes to the method of UK implementation, the government will consider how best to feed the findings of this review into future EU-wide reviews or consultations regarding the UCITS framework.

Title: Review of the UK's transposition of the Recast Undertakings for Collective Investments in Transferable Securities (UCITS IV) Directive 2009/65/EC PIR No: Original IA/RPC No: RPC11-HMT-0560(2) Lead department or agency: Treasury	Post Implementation Review
	Date:
	Type of regulation: EU
	Type of review: Statutory
	Date measure came into force: 30/6/2011
	Recommendation: Keep
Contact for enquiries: Charles Powell	RPC Opinion:

1. What were the policy objectives of the measure?

UCITS IV sought to improve the existing UCITS framework through:

- removal of administrative barriers to the cross-border marketing of UCITS;
- introduction of a management company passport;
- improved investor disclosure;
- a framework for mergers between UCITS funds;
- provision for 'master-feeder' structures; and
- improved supervisory co-operation.

2. What evidence has informed the PIR?

A series of questions were submitted to the main UK trade associations whose members have a direct interest in the UK's implementation of the UCITS IV Directive. It is considered that these associations represent a significant cross-section of the asset management industry, and that limiting the informal consultation to these bodies is sufficient and proportionate to obtain the information necessary to inform the review. Information held by the Financial Conduct Authority (FCA), as the authority responsible for enforcing the UCITS Directive, has also informed our conclusions. Information on implementation of the Directive in other Member States has been provided by the European Commission.

3. To what extent have the policy objectives been achieved?

The UK implemented the UCITS IV Directive into national law in time for the July 2011 transposition date. Feedback from the industry associations consulted has indicated that the UK's transposition avoided gold plating. Feedback on the Directive itself, while positive overall, has indicated that not all of the supposed benefits have materialised and that further targeted improvements to the legislation could lead to the initial objectives being more successfully achieved. The Government will consider how best to feed the findings of this review into future EU-wide reviews or consultations regarding the UCITS framework.

Sign-off For Post Implementation Review:

I have read the PIR and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

H. H. Bald

Signed:

Date: 29 June 2016

4. What were the original assumptions?

A July 2005 Commission Green Paper identified the following shortcomings in the existing UCITS legislative framework which caused significant inefficiencies in the EU investment fund market¹:

- obstacles to functional and geographical specialisation – a management company passport would allow a UCITS to appoint a management company in another Member State, or to allow a management company to establish a UCITS in another Member State.
- provisions for a management company passport were introduced in 2002, yet had not functioned in practice. As a result, fund managers had in effect to establish management companies in the domiciles of each of their funds. This created a lack of organisational flexibility and increases administrative costs.
- sub-standard investor disclosure – the Simplified Prospectus was intended to ensure retail investors could easily identify and understand key information about the fund precontractually. However, the document was in practice often too long and complex and failed to enable effective comparisons between UCITS funds, ultimately leading to an increased potential for mis-sales.
- proliferation of funds of a sub-optimal size – at the time, the European fund market was characterised by a high number of funds of small size, with 65% of all funds managing less than €50 million in assets, and the average size of a UCITS was a fifth of that of a US counterpart. Economies of scale were thereby not being exploited, increasing costs for investors. The efficiency of (cross-border) business was furthermore hampered by the difficulty of merging funds (cross-border), or pooling the assets of funds.
- bottlenecks and failures with the product passport – notification procedures for cross-border marketing (where the management company directly notifies each host Member State authority) were noted to have been cumbersome, time-consuming and expensive, at odds with the intention for a simple notification process and, crucially, raising costs. Significant differences across Member States in their requirements have hindered competition and the development of a single market in investment funds.

5. How did the UK implement UCITS IV?

On 13 July 2009, political agreement was reached on Directive 2009/65/EC (UCITS IV). This was a revised and recast version which consolidated and repealed Directive 1985/611/EC and its amending directives (known as UCITS III), so it is commonly referred to as “UCITS IV”. On 1 July 2010 the Commission completed its legislative programme for UCITS funds by adopting the following “level 2” implementing acts:

- Commission Directive 2010/43/EU implementing Directive 2009/65/EC as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company;
- Commission Directive 2010/44/EU implementing Directive 2009/65/EC as regards certain provisions concerning fund mergers, master-feeder structures and notification procedure;
- Commission Regulation (EU) 583/2010 implementing Directive 2009/65/EC as regards key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than by paper or by means of a website;
- Commission Regulation (EU) 584/2010 implementing Directive 2009/65/EC as regards the form and content of the standard notification letter and UCITS attestation, the use of electronic communication between competent authorities for the purpose of notification, and procedures for on-the-spot verifications and investigations between competent authorities.

¹ http://ec.europa.eu/internal_market/securities/docs/ucits/whitepaper/whitepaper_en.pdf

EU law required that the Directive be transposed into UK law by July 2011; the “level 2” Regulations applied directly, but any laws or regulations that would inhibit their effective application needed to be amended by the same deadline.

Although it is a minimum harmonisation Directive, it allowed Member States little flexibility in how it should be implemented and, as such, HM Treasury made no substantive policy choices in drawing up draft legislation for consultation.

Implementation of UCITS IV involved changes to primary and secondary legislation, and to the Financial Services Authority Handbook of rules and guidance.

HM Treasury made the required changes to legislation by way of a statutory instrument, the Undertakings for Collective Investment in Transferable Securities Regulations 2011 (SI/2011/1613) (“2011 Regulations”).

Regulation 2 of the 2011 Regulations amended the Financial Services and Markets Act 2000 (FSMA) as it applies to collective investment schemes which are UCITS.

- Paragraph (3) inserted a new section into FSMA limiting the liability which may arise in relation to key investor information (section 90ZA).
- Paragraph (8) revised the conditions which must be satisfied before the Financial Services Authority (“FSA”) was able to exercise its powers of intervention in relation to a EEA management company or UCITS, by substituting section 195A.
- Paragraph (10) inserted section 199A, imposing an obligation on the FSA to take action to safeguard investors in the United Kingdom where the authorisation of an EEA management company is withdrawn.
- Paragraph (13) clarified the definition of “relevant person” for the purposes of section 213 of the Financial Services and Markets Act 2000.
- Paragraph (14) inserted new definitions into section 237.
- Paragraphs (15) and (16) amended sections 243 and 244 respectively, to revise the conditions which must be satisfied before a UCITS may be authorised and required the FSA to determine applications for authorisation of unit trust schemes which are UCITS within two months.
- Paragraphs (19), (21), (23) and (26) made provision for master and feeder UCITS. Paragraph (19) set out the procedure applying to any proposal by a UCITS to cease being a feeder UCITS (new section 252A). Paragraph (21) provided for the consequences where a master UCITS which has one or more feeder UCITS is wound up (new section 258A). Paragraph (23) inserted new sections 261A and 261B, which set out the circumstances in which the FSA is required to provide information to home state regulators of EEA UCITS, or the operators of authorised unit trust schemes which are feeder UCITS. Paragraph (26) inserted new section 283A, requiring approval of significant investments by a UCITS in another UCITS (the master UCITS), and new section 283B, requiring management companies to provide periodic reports to the FSA about any investment in derivative instruments made by UCITS under their management.
- Paragraph (28) inserted new section 351A, which enables depositaries and auditors of master and feeder UCITS to enter into information sharing agreements as required by the UCITS directive, and ensures that they are exempt from liability in relation to disclosures made under those agreements.
- Paragraph (30) repealed section 409(1)(e) of the Act, removing the Treasury’s power to provide for the Authority to give notice under section 264(2) on grounds relating to the law of Gibraltar.
- Paragraph (33) amended Schedule 3 to set out the circumstances in which the FSA may reject an application by an EEA management company to manage a UK UCITS, the procedure applying to such applications, and what information must be given to the home state regulator of the management company (paragraphs 15A, 15B and 15C). Paragraphs 19 and 20 were amended (and paragraph 20ZA inserted) to set out the conditions which must be satisfied by a UK management company wishing to provide services in another Member

State, and the obligations the FSA must meet in such a case. New paragraphs 26 to 28 imposed obligations on the FSA to provide information to the home state regulator of the EEA UCITS managed by a UK management company in certain circumstances, and to consult with that regulator before withdrawing authorisation from the management company. New paragraph 20B set out the conditions to be satisfied before a UK UCITS is able to market its units in another Member State.

Regulation 3 amended the Open-ended Investment Companies Regulations 2001 to ensure that the amendments made to the Financial Services and Markets Act 2000 in relation to authorised unit trusts also applied in relation to open-ended investment companies.

Regulation 4 amended the Financial Services and Markets Act 2000 (Compensation Scheme: Electing Participants) Regulations 2001 to ensure that the definitions in those Regulations reflect the provisions of the UCITS directive, and to clarify the authorised activities in relation to which an EEA management company exercising rights in this country is subject to the compensation scheme.

Regulation 5 amended the Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Regulations 2001 to ensure that those Regulations apply to information received by the Authority in the course of the exercise of its functions as competent authority under the UCITS directive.

Regulation 6 amended the Financial Services and Markets Act 2000 (Collective Investment Schemes Constituted in Other EEA States) Regulations 2001 to make transitional provision for the use of simplified prospectuses until 30th June 2012.

Regulations 7 to 14 implemented the UCITS directive provisions in relation to mergers of UCITS. Regulation 15 made provision in relation to divisions.

HM Treasury and the FSA (the pre-cursor to the FCA) published a consultation paper, in December 2010, seeking stakeholders' views on implementation of UCITS IV.²

In September 2011, the FSA published a policy paper³ on the transposition of the revised UCITS Directive which contains a detailed explanation of the choices made during the implementation process. The paper also outlined the responses the consultation document received.

6. What were the anticipated benefits?

UCITS IV was expected to deliver major competition, efficiency and consumer protection benefits. Both investors and industry generally welcomed the reforms at the time of their introduction. Based on previous European Commission impact assessments, industry reaction and the Government's understanding of the proposals, it was estimated that the long term benefits for the industry would be significant and could outweigh the potential costs of implementing the Directive. The Directive also introduced important improvements to investor protection through improved disclosure and supervisory cooperation, which were expected to enhance the effectiveness and reputation of the UCITS framework.

- **Management Company Passport** – before UCITS IV, management groups needed to establish a fully functional authorised management company in each country where they domiciled a fund. These needed to satisfy costly local substance requirements, which pushed up costs and prevented scale and specialisation gains. UCITS IV introduced a management company passport to allow a UCITS to appoint a management company in another Member State, or a management company to establish a UCITS in another Member State. This was expected to significantly reduce unnecessary costs.
- **Simplified Notification Procedure** – before marketing a fund in another Member State, the UCITS Directive required the fund manager to file extensive documentation with the relevant national regulator and wait for up to two months while the latter verified compliance with local marketing rules. The deadline of two months was not always respected. Cases were reported where it took eight to nine months to complete the notification process. This imposed

² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81604/transpositionof_ucits_iv_ch1-10.pdf

³ http://www.fsa.gov.uk/pubs/policy/ps11_10.pdf

unnecessary costs for market participants and severely hampered the roll-out of new products across the single market. UCITS IV introduced a new streamlined approach which made it easier for UCITS funds to access other Member States by removing host regulators' right to vet funds before they start marketing. This was expected to reduce administrative costs, enhance the single market and improve investor choice.

- **Mergers** – the UCITS market was considered to be populated by funds of sub-optimal size. Consequently, important economies of scale remained unexploited, with the end investor bearing unnecessarily high costs. In the absence of a facilitating EU framework, fund mergers were complex, time consuming and expensive – where at all possible. Cross-border fund mergers were faced with particular hurdles – arising from differences between national legal and supervisory arrangements. UCITS IV provided an improved mechanism for UCITS funds to merge, both within a country and cross-border. This was expected to encourage the consolidation of the UCITS fund market, resulting in economies of scale.
- **Master-Feeders** – Asset pooling through master-feeder structures allows simultaneous management of assets gathered by different funds – while maintaining a local fund presence in different target markets. The skills and costs of successful management teams can be spread over a wider pool of assets. Pooling was becoming increasingly used in some Member States, and master-feeder structures were becoming common for other types of fund in many jurisdictions, so their introduction within the UCITS Directive framework was expected to enable fund managers to organise and manage their funds more efficiently and cost-effectively.
- **Key Investor Information** – the Simplified Prospectus of previous UCITS Directives was intended to ensure retail investors could easily identify and understand key information about the fund pre-contractually. However, in practice, the document was often too long and complex, and lacked sufficient harmonisation to enable effective comparisons between UCITS funds, ultimately leading to an increased potential for mis-selling. UCITS IV replaced the simplified prospectus with the more investor-friendly Key Investor Information (KII) document. This was expected to increase investor protection by providing improved pre-sale disclosure and enabling investors to make better-informed investment decisions.
- **Improved supervisory co-operation** – Measures introduced were intended to improve and intensify co-operation between UCITS regulators, particularly in relation to supervising a UCITS management company and fund when they are established in different Member States.

7. To what extent were these benefits realised?

1. Removal of administrative barriers to the cross-border marketing of UCITS:

The Government and the FCA consider that there were relatively few if any barriers to cross-border marketing of non-UK UCITS in the UK prior to UCITS IV, but that the implementation of UCITS IV may have introduced some efficiency gains for firms wishing to passport their funds out of the UK.

The simplified notification procedure introduced by UCITS IV gives regulators in a home Member State a maximum of 10 working days to review a notification file and transmit it to the host Member State regulator. Industry responses have indicated that, in practice, this process can take longer – up to 6 weeks in certain Member States.

Industry responses raised a number of issues that have the potential to hamper the cross-border marketing of UCITS. The examples below refer to the UCITS framework as a whole rather than specific objectives of UCITS IV.

Registration fees for UCITS funds vary dramatically between Member States, which can impose a barrier to cross-border activity. Industry representatives have indicated that some Member

States have no registration fee, while others have high fees. In the UK, the registration fee imposed on UCITS passporting into the jurisdiction is thought to be reasonable and proportionate to the costs incurred by the FCA for the service. According to the FCA fees manual,⁴ the fee payable on application for an order declaring a UCITS scheme to be an investment company with variable capital (ICVC) or an authorised unit trust scheme (AUT) is £1,200. In the case of umbrella funds, the registration fee is simply doubled, rather than separate fees applying to the component sub-funds. The FCA's risk based approach is also understood to impose less burden than some Member States which charge for additional processes such as the reviewing of marketing materials.

Several Member States have required that UCITS have a physical presence in the Member State (typically referred to as the facilities agent or paying agent) in order to fulfil the Directive's requirement to "take the measures necessary to ensure that facilities are available in that Member State for making payments to unit-holders, repurchasing or redeeming units and making available the information which UCITS are required to provide." Industry responses have suggested that this requirement has proven costly.

In the UK, this requirement has been met through COLL 9.4 of the FCA Handbook ("Facilities in the United Kingdom"), which specifies that the operator of a recognised scheme must maintain facilities in the UK to satisfy the requirements of the Directive, but does not place restrictions on what form these facilities must take.

One industry respondent indicated that the persistence of local marketing rules also adds an additional compliance burden to the process.

It is worth noting that the European Commission is expected to launch a 'Consultation on the main barriers to the cross-border distribution of investment funds' in summer 2016. This will include an examination of barriers to the passporting of UCITS funds. This evidence is expected to inform any further improvements to the UCITS framework through UCITS VI and other future amendments.

2. Introduction of a management company passport:

The FCA has indicated that relatively few UK firms have taken advantage of the UCITS management company passport. However, a level playing field benefit may have materialised as a result as UCITS IV introduced harmonised prudential and conduct of business rules in other all Member States that were broadly in line with those already in place in the UK.

Industry associations that responded to our request for information agreed that the UK's implementation delivered this objective and met the Directive's requirements.

3. Improved investor disclosure:

One of the main objectives of introducing the Key Investor Information Documents (KIIDs) was to improve comparability between products. For this reason, the Treasury and the FSA sought to reflect the text of the Directive as closely as possible in UK law and regulation in order to ensure consistent implementation.

Industry responses were supportive of the KIID and felt that it fulfilled its objectives. They agreed that it has improved the comparability of products and agreed that it was an improvement over the Simplified Prospectus required under previous UCITS Directives.

Industry provided some suggestions to improve the investor disclosure requirements. For example, institutional investors are likely to prefer more detailed information provided by prospectuses, so the requirement to provide a KIID for all UCITS, rather than only those going to

⁴ <https://www.handbook.fca.org.uk/handbook/FEES/3/Annex2.html>

consumers, can entail the replication of unnecessary data. It was also suggested that a future UCITS Directive could consider the possibility of providing the Key Investor Information in a digital form.

There was little discretion for the UK to make changes to the KIID as detailed information requirements were set out in a directly-applicable EU Regulation. The FCA has tried to provide some additional clarity in its rules about certain situations where the need to provide a KIID may or may not apply. The FCA also does not require all KIIDs to be submitted for pre-approval, which lessens the burden on industry. The UCITS KIID will be replaced by the Packaged Retail Investment and Insurance-based Investment Products (PRIIPs) Key Information Document (KID) from December 2019. The PRIIPs KID is modelled on the UCITS KIID but aims to improve consumer protection by increasing transparency on transaction costs.

4. A framework for mergers between UCITS funds:

Industry associations indicated that while UK implementation successfully created a framework for mergers between UCITS funds, they do not feel it delivered the benefits intended by the European Commission.

Currently, notice of a merger must be given in writing to all unit holders of the receiving UCITS, even where the merging fund is extremely small. This can lead to the cost of merging a small, inefficient fund into a well performing vehicle becoming prohibitive. This point was made in HM Treasury's response to the European Commission's 2015 Call for Evidence on the EU regulatory framework for financial services.⁵

There are other factors that may have contributed to the lower than anticipated level of fund mergers since UCITS IV's implementation. Examples of barriers referenced by industry are listed below.

Industry responses indicated that tax remains a significant barrier to cross-border fund mergers. They have suggested that major changes to the Mergers Directive (90/434/EEC as updated by 2005/19/EC) would be required in order to facilitate the economies of scale that UCITS IV was intended to deliver.

Industry responses also suggested that Article 46 of the Directive (regarding costs and entry into effect) might make the cost of merging funds prohibitive. Article 46 requires that, except in the case of self-managed UCITS, management companies pay any legal, advisory or administrative costs associated with the preparation and completion of mergers. Responses also suggested that Member States' interpretation of Article 46 has hampered the merging of funds in some jurisdictions. Respondents suggested that some Member State competent authorities have gone further than required in implementing UCITS IV, by adding the wording 'and any other costs' in transposition. They suggest that this implies that management companies must also pay for any rebalancing of portfolios that might take place prior to the merger, thus imposing an additional cost burden.

Article 46 was implemented in the UK through the FCA handbook (COLL 7.7.20). This refers to 'any other costs', which was thought to be the intention of the Directive, and was intended as a clarification of purpose rather than an attempt to enlarge the scope of costs covered. More recently, in its response to the Commission's Call for Evidence⁶, the FCA has called for Article 46 of the Directive to be reviewed to determine whether a more flexible approach to merger cost charging might encourage uptake of the merger option by fund managers.

⁵ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/496887/PU1903_HMT_response_to_EU_consultation.pdf

⁶ <https://www.fca.org.uk/static/fca/documents/eu-regulatory-framework-call-for-evidence-response.pdf>

The recommendations from industry suggested above do not relate directly to the UK's transposition of UCITS IV, and could not be delivered through action solely on the part of the UK. Improvements to the underlying Directive would need to be addressed at a European level.

5. Provision for “master-feeder” structures:

Industry associations have indicated that while the implementation of the Directive has allowed the provision for master-feeder structures, they do not feel the Directive will deliver the benefits intended by the Commission.

Under UCITS Article 58, a UCITS (employing the investment powers under Article 55) is prevented from being the master UCITS in a master-feeder structure. This ultimately hinders the uptake of master-feeder structures. Restricting the uptake of master-feeder structures is problematic because the fund of funds model is a popular vehicle. The provisions of the Directive relating to master-feeder structures were transposed by way of amendments to FSMA (e.g. Chapter 5A of Part 17) and FCA's COLL rules.

HM Treasury's response to the European Commission's 2015 Call for Evidence on the EU regulatory framework for financial services suggests that the Commission should review Article 58 to allow UCITS fund of funds to operate as master funds in the master-feeder structure.

The recommendations from industry suggested above do not relate directly to the UK's transposition of UCITS IV, and could not be delivered through action solely on the part of the UK. Improvements to the underlying Directive would need to be addressed at a European level.

6. Improved supervisory co-operation:

Industry associations that responded to our request for information agreed that the UK's implementation delivered its objective and met the Directive's requirements.

Although the provisions in UCITS IV relating to supervisory co-operation provide greater assurance that difficulties between Member States can be addressed through formal procedures, the FCA has indicated that it has not been necessary so far to make use of them.

8. What were the anticipated costs?

According to the UCITS IV Impact Assessment⁷, it was forecast that implementing the Directive would cost industry a headline figure of £50 million in transitional costs, with ongoing annual costs of £10 million, totalling £90 million (over a 5-year period). There were also anticipated costs to the UK's regulatory authorities.

The impact assessment anticipated UCITS IV to introduce costs in the following areas:

Key Investor Information – Each UCITS fund/sub-fund was expected incur the one-off cost of replacing the Simplified Prospectus with a key investor information document (KIID) and then the incremental cost of producing and distributing it instead of the Simplified Prospectus.

Management Company Passport – All UCITS management companies, whether or not they choose to use the management company passport, have to comply with UCITS IV requirements for systems and controls and conduct of business measures. Although the majority of these measures already applied to UK management companies, it was necessary to review existing procedures to ensure continued compliance.

Fund Mergers – UCITS are prohibited from passing the cost of a merger on to investors. The full cost of the merger must be borne by the management companies involved.

⁷ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81609/transpositionof_ucits_iv_annexe.PDF

9. What were the actual costs?

Costs to Industry:

Members of the trade associations that responded to our request for information did not provide this information to their representative bodies. The trade associations themselves do not have records of the costs incurred by industry and were therefore unable to confirm whether or not the costs estimated in the original Impact Assessment were accurate. They agreed with our assessment that the introduction of the KIID is likely to have been the most costly aspect of the implementation of UCITS IV, but they noted that the overall costs were likely to vary on a firm by firm basis and that individual firms were unlikely to share this information for reasons of competition.

One individual or firm, which responded to a survey initiated by one of the trade associations contacted felt that the total costs incurred by industry were higher than the figure estimated by the then government. This feedback was submitted on an anonymous basis, so it has not been possible to clarify the nature and extent of costs incurred with the individual or firm. The trade association who passed along this feedback noted that as this was a response from a single respondent, it should not be assumed to be representative of the industry as a whole.

Costs to regulators:

Since UCITS IV was a recast and an expansion of the previous version of the Directive, rather than a completely new regulatory framework, the costs of implementation incurred by the FSA could be met from within its normal yearly budget. The one-off costs to the FCA in 2011/12 were slightly higher than anticipated, owing to the level of engagement with firms necessary to ensure the KIID was introduced successfully, but the ongoing costs since then have been lower than foreseen in the cost-benefit analysis published in 2010, largely due to the relatively low take-up by firms of optional measures such as use of the management company passport or cross-border mergers.

10. Were there any unintended consequences?

Respondents to the Government's request for evidence did not identify any unintended consequences. While industry associations felt that some of the objectives have not yet been met to the extent that the European Commission originally anticipated, they were unaware of any other negative consequences.

11. Has the evidence identified any opportunities for reducing the burden on business?

Respondents to the Government's request for evidence have identified several areas in which the UCITS framework could be improved to make it easier for businesses to merge funds or set up master-feeder structures to lower costs. However, these changes would need to be made to the underlying EU Directive rather than to the UK's transposition. The UK's method of implementation aimed to avoid gold plating, which would have imposed additional regulatory burdens on firms at a national level. The UK's approach has been successful in this regard, as feedback from industry has attested that the UK's copy-out approach to transposition has not imposed additional regulatory burden beyond that of implementing the Directive's requirements.

12. For EU measures, how does the UK's implementation compare with that in other EU member states in terms of costs to business?

The European Commission has indicated that it is not aware of any gold-plating claims in relation to specific measures in UCITS IV. However, several Member States were late in implementing UCITS IV. This caused problems for some of the cross-border aspects of the Directive.

In October 2011 The European Securities and Markets Authority (ESMA) published an opinion on the "Practical arrangements for the late transposition of the UCITS IV Directive". This was intended to address the situation at an operational level in order to minimise, as far as possible, the impact on industry and investors deriving from lack of transposition.

Further examples of variations between Member States in the implementation of the UCITS framework as a whole, which can impose burdens on firms wishing to carry out business on a cross-border basis, can be found in section 7 above (e.g. variations in registration fees, marketing requirements and requirements regarding paying agents and facilitating agents).

13. What next steps are proposed for the regulation (e.g. remain/renewal, amendment, removal or replacement)?

The UCITS IV Directive remains in place, but it has since been amended by UCITS V. UCITS V introduces a number of targeted reforms to the UCITS Directive with the objective of updating the legislative framework to ensure the safeguarding of UCITS fund operations across the EU, to lower risk surrounding the management of UCITS funds, and to build consumer protection and trust in the market. In particular UCITS V introduces provisions for:

- UCITS depositaries (the firms responsible for the safekeeping of client assets), to ensure minimum standards of safeguarding across the EU;
- remuneration rules for fund managers to ensure risk taking is aligned with investor appetite; and
- sanctions for contraventions of the Directive.

UCITS V was implemented in the UK through a statutory instrument (the Undertakings for Collective Investment in Transferable Securities Regulations 2016 (SI/2016/225) and through FCA rules.

UCITS V is expected to be followed with a UCITS VI Directive at some stage, the scope of which is yet to be confirmed. The Government will continue to engage with industry and consumer groups to ensure that the UCITS framework remains proportional to the risks of the sector and fit for purpose, while ensuring adequate levels of consumer protection.

Given that the improvements identified for the UCITS framework are changes to the underlying EU Directive, rather than changes to the method of UK implementation, the Government will consider how best to feed the findings of this review into future EU-wide reviews or consultations regarding the UCITS framework.

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