

# *UCITS IV*

## How to merge UCITS?

*Asset Management*  
*November 2010*

With UCITS IV coming into force from July next year, mergers of EU UCITS could soon become a reality. But how will it work in practice?

## Background

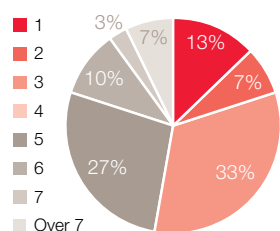
### Consolidation needs

Clearly, the market needs to consolidate. 23% of European UCITS have less than €10 million in assets under management and 60% have less than €50 million. In addition, 80% of the top 30 asset managers offer UCITS domiciled in at least three countries in the European Union (EU): 10% of which have UCITS offerings in seven or more EU countries.

Market fragmentation hinders economies of scale, and prevents optimal management of Total Expense Ratios (TER) which many, most notably the European Commission, consider too high.

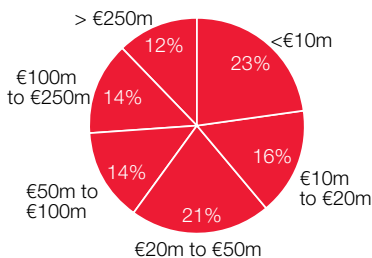
Against this background, the revised UCITS Directive (dubbed 'UCITS IV') offers opportunities for market consolidation and the rationalisation of UCITS structures through permitting mergers of UCITS on both a domestic and cross-border basis.

### Number of UCITS domiciles per Group



Source: Lipper – Top 30 cross-border group promoters – Figures end 2009

### Size of European UCITS



Source Lipper – Figures as at end 2009 based on a sample of 19,735 portfolios

## Scope of the UCITS IV merger provisions

### UCITS only!

Any type of UCITS – established under contract, as a limited company or as a unit trust – will be able to merge. It does not matter if the same legal form for UCITS does not exist in the country where a merger target resides. In addition, promoters can choose to merge entire umbrella structures or a selection of their investment compartments.

Non-UCITS, which are obviously outside the scope of UCITS IV, will not be able to merge across borders. Importantly, under this scheme, a UCITS cannot merge with a non-UCITS (or any part of it). Non-UCITS will still be subject to national rules, and existing legal and administrative challenges in the EU will remain.

### Types of merger

EU Member States can, of course, continue to approve any form of merger in relation to purely domestic non-UCITS mergers.

However, at the European level, three merger schemes will be recognised:

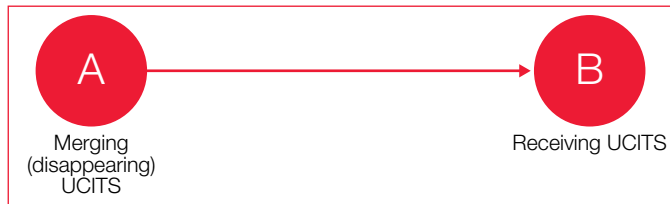
- Where a UCITS (or some of its investment compartments), transfers all its assets and liabilities to another existing UCITS without going into liquidation.
- Where at least two UCITS (or some of their investment compartments) transfer all their assets and liabilities to a new UCITS which they form without going into liquidation.

### 1 UCITS IV How to merge UCITS

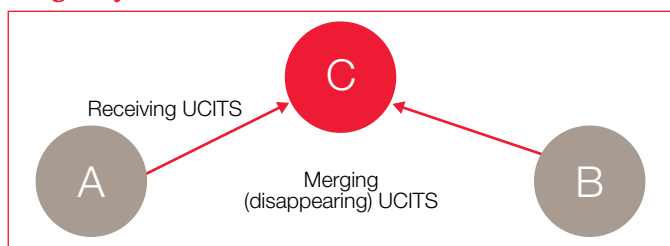
- Where one or more UCITS (or investment compartments thereof) – which continue to exist until the liabilities have been discharged – transfer their net assets to another compartment of the same UCITS, to a UCITS which they form, or to another existing UCITS (or investment compartment thereof).

## Core requirements of UCITS IV

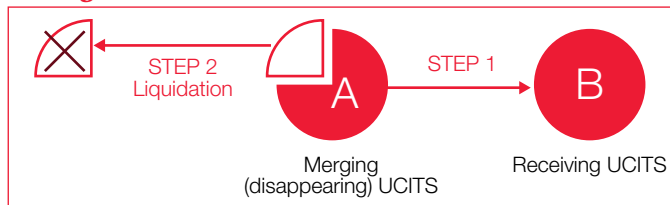
### Merger by way of absorption



### Merger by formation of new fund



### Amalgamation scheme



### Competent regulators

The home regulator of the 'merging' UCITS (i.e. the one driving the merger) will authorise that merger. The role of the home regulator of the 'receiving' UCITS (the UCITS which is being absorbed partially or in full) is to safeguard the interests of investors in that UCITS, working closely with the home regulator of the merging UCITS.

### Third party control

The depositary(ies) of both the merging and the receiving UCITS have to confirm, separately in a written statement, that the draft terms of the merger (describing in particular the type of the merger, the merger date and the transfer of assets) comply with UCITS IV provisions as well as the UCITS legal documentation.

Either a depositary or an independent external auditor (in this situation, the external auditor of both the merging and the receiving UCITS are considered independent) will also need to validate the methodology used to calculate the exchange ratio, the actual exchange ratio and any cash payment per unit.

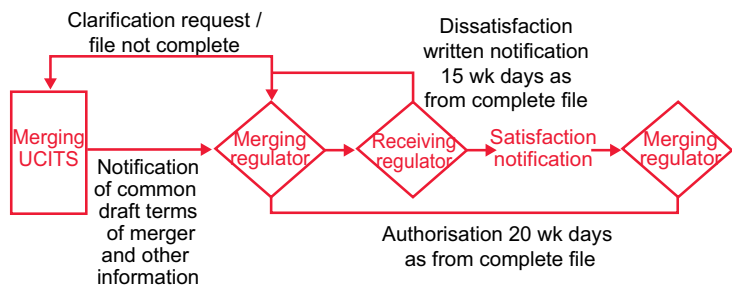
### Merger approval process

A regulator-to-regulator approach is key to the approval process.

The merging UCITS must file a standard, prescribed set of documents with its home regulator (the 'Merging Regulator'). This includes the draft terms of the merger, an up-to-date prospectus and Key Investor Information Document (KIID), both depositaries' statements and any translated information intended for either the receiving or merging UCITS investors.

The Merging Regulator has to check the dossier for completeness, requesting any additional information within 10 working days of initially receiving it.

Once complete, the Merging Regulator immediately has to send the file to the receiving UCITS regulator (the 'Receiving Regulator'). Authorisation then follows within 20 working days.



### Investors' rights

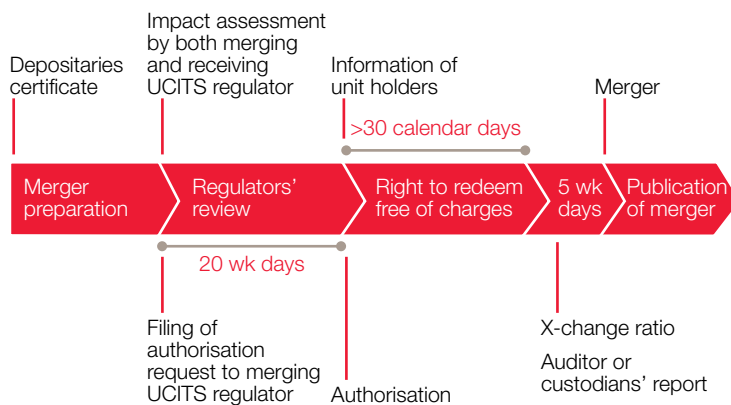
Investors obviously need to be properly informed. They need to receive information on the background of, and rationale for, the merger, possible impacts on investors, description of investors' rights, the merger process, the date of the merger and KIID of the receiving UCITS.

The implications for the investors in the receiving UCITS will differ from those for the investors in the merging UCITS. So, logically, both sets of investors do not need to receive the same information.

The Merging Regulator has to assess the appropriateness and accuracy of the information provided to the merging and receiving investors in close cooperation with the Receiving Regulator, and approve its issuance.

Under UCITS IV, investors should have at least 30 calendar days to request the repurchase (or, where possible, conversion) of their units free of charge (except for related divestment costs). Consequently, investors have to receive the approved information at least 30 days before the cut-off date for repurchases. The cut-off date is set five working days before the date for calculating the exchange ratio.

In the case where the merger decision would be subject to the vote of the investors, such decision will not be subject to a majority of more than 75% of the present and represented investors.



## Main business implications for the UCITS industry

### Focus on the preparatory work/tasks

Before deciding on a merger, a promoter should undertake an in-depth review to analyse the major implications and identify the key factors to be taken into account, including distribution, tax and regulatory issues. It is worth noting that tax is often the most important consideration as a merger, generally, has significant tax implications for investors.

The promoter needs to analyse the different merger schemes to choose the most appropriate.

A clear plan for managing the merger will ensure it goes smoothly, without regulatory or operational difficulties on transfer.

Particular attention needs to be paid to the completeness and accuracy of the merger file.

The KIID of the receiving UCITS must be updated (including empty shelves if necessary) and communicated to investors prior to deciding on the merger.

The promoter will have to make sure that the investment policies of the merging and receiving UCITS are aligned, as well as each of the portfolios, to avoid possible investment breaches.

### Focus on the transfer

The rules described above will be applicable for cross-border and domestic mergers, including the contribution of one investment compartment to another.

Given that EU rules will apply to domestic mergers of UCITS, national practices may become less flexible (as the depositary and the auditor will have to intervene, investors in both investment compartments will be able to request the redemption of their units, etc).

A merger implies potential migration issues that must be considered prior to the merger.

In the case of a merger between two UCITS being incorporated under the form of a company, the existing agreements may remain in force (i.e., no renegotiation will be required).

The performance track record may be kept, subject to certain conditions, at least from a marketing perspective.

### Focus on the investors

The rules relating to the merger decision and the way in which information is provided to investors will still be subject to national laws (no harmonisation): the promoter will have to comply with specific local requirements and manage possibly divergent rules.

In the case where the merger decision is subject to a vote by investors, such a decision will not be subject to a majority of more than 75% of the present and represented shareholders. The merger decision will then bind the investors being not in favour of the merger and having not requested the repurchase of their units during the 30 days period of time.

### Focus on the tax issues

Mergers may have tax consequences for the investors in their home country when no tax relief or deferral is available. So, before moving ahead with a merger, it is advisable to undertake a detailed analysis of the nature of the investors and tax implications in their country of residence.

It will also be key to consider the impact of the EU Savings Directive (including tax and reporting duties) as the Directive normally triggers a reportable/taxable event where it is applicable.

Exit taxation and/or registration/stamp duties in underlying investments' countries should also be closely analysed.

In some circumstances, a merger may qualify as a transfer of going concern and, therefore, be out of the scope of the VAT requirements. This should be confirmed at a national level, as conditions can vary between EU Member States.

However, reorganisations can create additional and often irrecoverable VAT costs. Considering the VAT implications as part of the reorganisation plan should enable the promoter to take advantage of any opportunities while mitigating VAT costs.

### Focus on the distribution footprint

The preparatory work based on distribution footprint will be key.

Relevant notifications (within the EU) and prior registrations (outside the EU) must be approved before merging.

Potential registration issues outside the EU must be considered prior to merger.

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