

**MEMO# 13248**

March 13, 2001

## **COUNCIL OF THE EUROPEAN UNION AGREES TO TEXT OF UCITS II PROPOSAL**

[13248] March 13, 2001 TO: INTERNATIONAL COMMITTEE No. 19-01 RE: COUNCIL OF THE EUROPEAN UNION AGREES TO TEXT OF UCITS II PROPOSAL At the March 12, 2001 meeting, the Council of the European Union (ECOFIN) approved the text of a proposal to amend the UCITS Directive to create a passport for management companies to operate throughout the European Union (UCITS II Proposal). ECOFIN's press release confirming the text that was agreed to by the national ambassadors (COREPER) is attached.<sup>1</sup> The official text of the UCITS II Proposal, which will be publicly available in the next few months, will be forwarded to the Parliament for a second reading. We briefly describe below what we understand to be ECOFIN's text of the UCITS II Proposal and the issues that may be debated in the Parliament. The description of these issues is based on information received from the Institute's consultant and discussions last week in London and Brussels with Institute member firms, European industry representatives, and EU officials. Capital Requirements ECOFIN's proposal would require a management company to have (1) initial capital of EUR 125,000 and (2) ongoing capital of .02% of the amount of the value of the portfolios of the management company that exceeds EUR 250,000,000. Although the total of initial capital and ongoing capital based on assets under management would be capped at EUR 10,000,000, the capital could not, in any case, be less than 13 weeks of expenditures as provided for in the Capital Adequacy Directive. The Capital Adequacy Directive currently requires firms to hold own funds equivalent to one quarter of their preceding year's fixed overhead.<sup>2</sup> The proposal also would permit member states to allow a management company to substitute 50% of the ongoing capital if it benefits from a guarantee given by a credit institution or an insurance undertaking. Separately, investment company UCITS funds that have not designated a management company would be required to have initial capital of EUR 300,000. <sup>1</sup> See Memorandum to International Committee No. 18-01 (Mar. 2, 2001) <sup>2</sup> See Annex IV of the Capital Adequacy Directive (93/6/EEC). <sup>2</sup>With respect to the calculation of the 13 weeks of "fixed overhead," there is a debate within the European industry whether the Directive should specify in greater detail the types of expenses that should be included in the calculation. We understand that practices within the member states of the EU differ with respect to the definition of "fixed overhead." In certain EU member states, a management company that has delegated its management, administrative, or distribution functions to other entities is required to include the fees paid to the other entities in its calculation of fixed overhead. The European industry may seek a common standard on this matter. We also have been advised that, although the text of the proposal does not preclude a management company from obtaining a guarantee from a bank or insurance company in lieu of 50% of the ongoing capital, the provision was drafted to allow a parent of the management company that is a bank or insurance company to provide the guarantee. If the provision is read to limit guarantees to those provided by a bank or

insurance company parent, the Directive would be discriminating against independent asset management companies that are not part of a bank or insurance company. We understand that the European industry is considering seeking clarification on this issue.

Delegation The text agreed to by ECOFIN amends the delegation language of the text to state that “[i]n no case shall the management company's and the depositary's liability be affected by the fact that the management company delegated any functions to third parties nor shall the management company delegate its functions to an extent that it becomes a letter box entity.” For investment company UCITS funds that have not designated a management company authorized pursuant to the UCITS Directive, the investment company itself would be required to comply with the conditions for delegation.<sup>3</sup> The text was amended to address concerns raised by the Irish representatives that previous versions of the text might prohibit practices in which Irish management firms are engaging currently. Upon adoption of the UCITS II Proposal, the regulators in each member state would be required to interpret the conditions for delegation, and it remains to be seen whether the language provides sufficient flexibility for regulators to accommodate current delegation practices. We also understand that some in the European industry are considering requesting clarification in the Parliament that the member state conduct rules for management companies would apply equally to entities that are delegated functions.<sup>4</sup> 3 Investment companies would have to comply with the delegation provisions either directly or through the management company that was designated by the investment company. 4 Under the UCITS II Proposal, each member state would be required to adopt rules of conduct for management companies authorized in that member state. Member states must adopt rules that implement the principles set forth in the Directive. The principles must ensure that a management company: (1) acts honestly and fairly in conducting its business activities in the best interests of the UCITS it manages and the integrity of the market; (2) acts with due skill, care, and diligence in the best interests of the UCITS it manages and the integrity of the market; (3) has and employs effectively the resources and procedures that are necessary for the proper performance of its business activities; (4) tries to avoid conflicts of interests and, when they cannot be avoided, ensures that the UCITS it manages are fairly treated; and (5) complies with all 30Other Matters The UCITS II Proposal also includes a provision for the simplified prospectus, which provides for maximum harmonization and prohibits member states from requiring supplementary documents or items in addition to those required in the Directive. The simplified prospectus is designed to standardize disclosure made to shareholders at the time of sale. Although host member states may continue to regulate marketing of funds in their jurisdiction, the host member states would be prohibited from requiring additional disclosure documents to be provided to investors. Finally, the UCITS II Proposal is part of a package that contains the UCITS I Proposal.<sup>5</sup> The European industry also may seek clarification in UCITS I regarding how exposure to derivatives would be calculated. \* \* \* It is unclear to what extent the Parliament will consider the issues discussed above when the Parliament debates both the UCITS I and UCITS II Proposals this fall. Because the proposals are part of a package and agreement by ECOFIN was reached with difficulty, the Parliament may be hesitant to disturb the political balance that was achieved by ECOFIN. Please let us know if you have any concerns about the proposal. If you have any comments or questions regarding the proposal, please contact me at (202) 326-5810 or at [jchoi@ici.org](mailto:jchoi@ici.org). Jennifer S. Choi Assistant Counsel Attachment Attachment (in .pdf format) regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of its investors and the integrity of the market. 5 See Memorandum to International Members No. 3-01 (Jan. 16, 2001) (ECOFIN's agreed text for UCITS I Proposal).

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