EXPLANATORY MEMORANDUM TO

THE UNDERTAKINGS FOR COLLECTIVE INVESTMENT IN TRANSFERABLE SECURITIES REGULATIONS 2011

2011 No. XXXX

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 Is to amend the Financial Services and Markets Act 2000, the Open Ended-Investment Companies Regulations 2010, and related secondary legislation on financial services to implement in part Directive 2009/65/EC of the European Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities ("UCITS") (the 2009 Directive).

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 The 2009 Directive is the fourth directive made by the European Parliament and the Council on the regulation of UCITS. It consolidates, and repeals, the earlier directives. It also makes new provision in the following areas:

- for the removal of administrative barriers to the cross-border marketing of UCITS, enabling units of a UCITS established in one Member State to be sold in another Member State as soon as the regulator of the fund has given notice to the regulator in the EU Member State where the units are to be sold;
- the introduction of "passport" rights enabling a management company to operate a fund in Member States without being established there;
- for improved investor disclosure;
- for a framework for mergers between UCITS funds,
- for "master-feeder" structures allowing a "feeder" UCITS to invest 85% of its assets into another UCITS fund (the "master" UCITS), and
- for improved supervisory co-operation (particularly where a UCITS and its management company are established in different Member States).

The first three UCITS Directives were implemented in the United Kingdom primarily through provisions in the Financial Services and Markets Act 2000 (and in particular Part 17 of that Act), and the Open-Ended Investment Companies Regulations 2001. This instrument amends that legislation, and other secondary legislation made under the Financial Services and Markets Act 2000 (the Financial Services and Markets Act

2000 (Disclosure of Confidential Information) Regulations 2001; the Financial Services and Markets Act 2000 (Collective Investment Schemes Constituted in Other EEA States) Regulations 2001, and the Financial Services and Markets Act 2000 (Compensation Scheme: Electing Participants) Regulations 2001 to give effect to the 2009 Directive. It makes other consequential amendments, and implements the provisions of the 2009 Directive in relation to mergers. The Directive is also being implemented in FSA rules.

5. Territorial Extent and Application

5.1 This instrument applies to the United Kingdom.

6. European Convention on Human Rights

6.1 The Financial Secretary to the Treasury, Mark Hoban, has made the following statement regarding Human Rights:

> "In my view the provisions of the Undertakings for Collective Investment in Transferable Securities Regulations 2011 are compatible with the Convention rights".

7. Policy background

- ***What is being done and why***

7.1 On 13 July 2009, the EU approved a reform of the UCITS Directive. This recast Directive is commonly referred to as UCITS IV and repeals all other UCITS Directives. UCITS IV must be implemented by 1 July 2011. This is an EU Directive and the UK has a treaty obligation to implement it into national law by the required deadline. If the UK chooses not to implement this Directive then it will be in infraction of EU law and infringement proceedings may be launched by the Commission. The Directive allows Member States little flexibility in how it should be implemented and, as such, HM Treasury has made no substantive policy choices in drawing up draft legislation for consultation

A 2005 Commission Green Paper identified a number of problems with the current UCITS framework which have caused 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 (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.

UCITS IV has been broadly welcomed by UK industry. UCITS IV aims to remove market inefficiencies, improving investor disclosure and develop a true single market in investment funds. It seeks to achieve the following results—

(1) Improving the single market in investment funds by removing administrative barriers to the cross-border marketing of UCITS, introducing a

management company (ManCo) passport and improving supervisory cooperation;
(2) Allowing for the consolidation of the UCITS fund market so that it can benefit from greater economies of scale, by facilitating mergers between UCITS funds and providing for asset pooling through 'master-feeder structures;
(3) Increasing investor protection by replacing the simplified prospectus (SP) with the Key Investor Information (KII).

Consolidation

7.2 The Treasury does not have plans to consolidate the Financial Services and Markets Act 2000 or the other secondary legislation made under it at this time. Commercial publishers produce consolidated versions of the Act, and of secondary legislation made under it, both in electronic and hard copy versions.

8. Consultation outcome

8.1 HM Treasury launched a joint consultation with the FSA on 23 December. We received 20 responses from a variety of industry participants and trade bodies. The responses largely focused on the FSA rules and did not raise any major issues with HM Treasury legislation.

9. Guidance

9.1 The FSA will provide guidance in the FSA handbook.

10. Impact

10.1 The impact on business, charities or voluntary bodies is minimal. We expect the Directive to have very little effect on any business other than the fund management industry. See impact assessment for further detail.

10.2 The impact on the public sector is minimal. See impact assessment for detail.

10.3 An Impact Assessment is attached to this memorandum and will be published alongside the Explanatory Memorandum on the OPSI website.

11. Regulating small business

11.1 The legislation applies to small business.

To minimise the impact of the requirements on firms employing up to 20 people, the approach taken is proportionate.

UCITS IV does not have any thresholds and so the requirements will apply equally to small firms engaged in fund management. There are however several areas, especially in relation to organisational requirements such as the compliance, risk management and internal audit functions, where the arrangements can be proportionate to the scale and complexity of the firm's business.

This should mean that the requirements on a small firm are not unduly burdensome although if it wishes to operate (e.g.) a fund with complex risk features it may face higher cost barriers than now. It is generally likely that smaller firms will have a small range of funds (there are a number of UK managers operating only one or two UCITS schemes) and that those funds will typically have relatively few unitholders, which may enable them to save on costs of (e.g.) provision of key investor information documents.

12. Monitoring & review

12.1 The Treasury is required to review the operation and effect of the Regulations within five years from the date on which they come into force, and publish a report.

13. Contact

James Steer at HM Treasury Tel: 020 7270 or email: James.Steer@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.