WILMER, CUTLER & PICKERING

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THE UK FINANCIAL SERVICES AUTHORITY AND TREASURY'S JOINT CONSULTATION ON THE IMPLEMENTATION OF THE UCITS MANAGEMENT DIRECTIVE

Following on from the implementation of the "Product Directive" which extended the investment powers of UCITS schemes, the FSA and HM Treasury have issued a joint consultation paper on the implementation of the so-called "Management Directive" (Directive 2001/107/EC) which allows UCITS management companies a "passport" to provide cross-border investment services, imposes new financial resource and conduct of business rules, and sets up a simplified prospectus for pan-EEA marketing. The consultation is a joint one because changes to secondary legislation, as well as FSA rules, will be required. The effect of the proposed transitional provisions means that the new rules will not apply to firms until 13 February 2004, and the new financial resources requirements will not kick in until February 2007.

The "Simplified Prospectus"

The Management Directive will require schemes to issue simplified prospectuses in a prescribed form. However, the FSA will be consulting on its rules for these as part of its review of product information at the point of sale, on which a consultation paper is due in January 2003.

The Passport

The effect of the original UCITS Directive (the "Original Directive") meant that managers of EEA-based UCITS schemes could market those schemes in other Member States, but could not offer other cross-border investment services (Article 6 of the Original Directive provides that *"no management company may engage in activities other than the management of unit trusts and of investment companies"*). The proposed introduction of a "passport" for scheme managers would allow them to engage in:

- the management of other collective investment schemes not covered by the Directive;
- discretionary portfolio management, including pension schemes;
- investment advice (provided discretionary management activities are FSA authorised); and
- the safekeeping and administration of collective investment scheme units (provided discretionary management activities are FSA authorised).

This obviously represents a significant extension to the scope of activities that UCITS managers can undertake, and the proposal is to effect this extension via two statutory instruments which include changes to Schedule 3 of the Financial Services and Markets Act (which sets out the cross-border rights given to EEA firms under the single market directives) to make UCITS management companies "EEA firms," and the FSMA (EEA Passport Rights) Regulations 2001, as well as amendments to other pieces of secondary legislation.

The "Management Company" and ICVCs

The Management Directive requires that the management company of the UCITS scheme is identified. This is not a problem for unit trust managers, who are already identified under pre-existing legislation, and the FSA now propose to apply the definition in the Management Directive to the Authorised Corporate Directors ("ACDs") of ICVCs (Investment Companies with Variable Capital). This will mean that a small number of ACDs who currently hold a passport under the Investment Services Directive will no longer be able to do so, as Article 2(2)(h) of that Directive states that a manager of a UCITS scheme cannot qualify for an ISD passport.

Financial Resources

In contrast with the absence of prescription of the Original Directive, the Management Directive applies financial resources requirements which the FSA proposes implementing via the Interim Prudential Sourcebook for Investment Businesses rather than waiting for the issue of the integrated Prudential Sourcebook. The proposed requirements apply to firms depending on whether they operate as UCITS firms only, or as UCITS firms which also provide ISD-type activities such as discretionary portfolio management, the provision of investment advice or safekeeping and administration who will, in addition, be subject to the Capital Adequacy Directive.

The Management Directive will require all UCITS firms to have initial capital of €125,000, plus additional capital of 0.02% of the value of portfolios under management which exceed €250 million to a cumulative maximum of €10 million. In addition, there is continuing requirement that the firm's financial resources must never be less than 25% of its annual overheads which the FSA proposes to calculate on the basis of annual audited expenditure. The Consultation Paper sets out the ways in which these capital requirements must be made up, which represent a shift to "higher quality" capital from current financial resources obligations on such firms, and the FSA is consulting on its intention to require firms to continue to make deductions for illiquid assets in the name of consumer protection.

Consultation closes on 1 April 2003.

For further information contact:

London - 4 Carlton Gardens, Pall Mall
London SW1Y 5AA

Simon Firth +44 (20) 7872-1036
Simon.Firth@wilmer.com

James Greig +44 (20) 7872-1040
James.Greig@wilmer.com

David Capps +44 (20) 7872-1080
David.Capps@wilmer.com

Alix Prentice +44 (20) 7872-1064
Alix.Prentice@wilmer.com

James E. Anderson	+1 (202) 663-6180	Simon Firth	+44 (20) 7872-1036	Eric Mogilnicki	+1 (202) 663-6410
Philip D. Anker	+1 (202) 663-6613	James Greig	+44 (20) 7872-1040	Bruce Newman	+1 (212) 230-8835
Gregory A. Baer	+1 (202) 663-6859	Franca Harris Gutierrez	+1 (202) 663-6557	David Ogden	+1 (202) 663-6440
Robert G. Bagnall	+1 (202) 663-6974	Stephen R. Heifetz	+1 (202) 663-6558	Alix Prentice	+44 (20) 7872-1064
Brandon Becker	+1 (202) 663-6979	Kirk Jensen	+1 (202) 663-6182	Matthew P. Previn	+1 (212) 230-8878
Russell J. Bruemmer	+1 (202) 663-6804	Satish M. Kini	+1 (202) 663-6482	Victoria E. Schonfeld	+1 (212) 230-8874
J. Beckwith Burr	+1 (202) 663-6695	Michael D. Leffel	+1 (202) 663-6784	Marianne K. Smythe	+1 (202) 663-6711
David M. Capps	+44 (20) 7872-1080	Christopher R. Lipsett	+1 (212) 230-8880	Daniel H. Squire	+1 (202) 663-6060
Matthew A. Chambers	+1 (202) 663-6591	David A. Luigs	+1 (202) 663-6451	Natacha D. Steimer	+1 (202) 663-6534
David S. Cohen	+1 (202) 663-6925	Martin E. Lybecker	+1 (202) 663-6240	Todd Stern	+1 (202) 663-6940
Ricardo R. Delfin	+1 (202) 663-6912	James H. Mann	+1 (212) 230-8843	Manley Williams	+1 (202) 663-6595
Christian Duvernoy	+32 (2) 285-4906	David Medine	+1 (202) 663-6220	Soo J. Yim	+1 (202) 663-6958