Launching a UCITS Fund

GATEWAY TO EUROPE

IN LIGHT OF

REGULATORY CHANGES

HYDE PARK INVESTMENT

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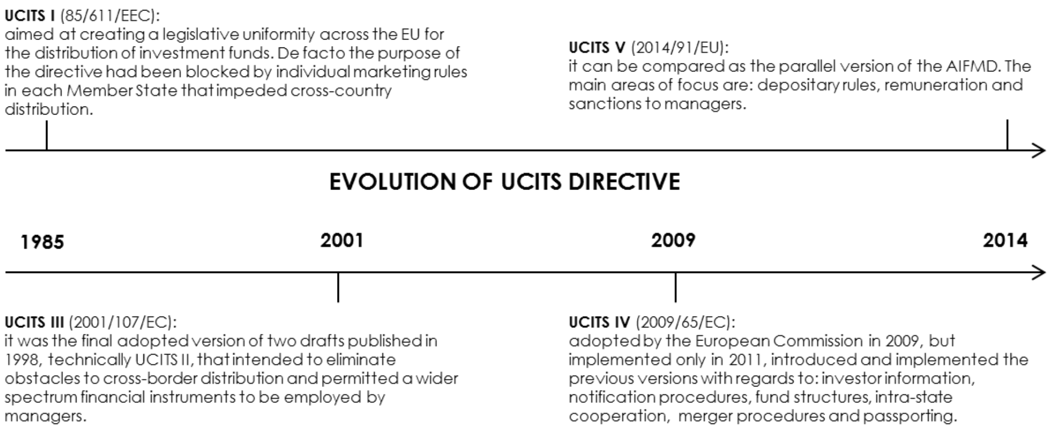
The Undertakings for Collective Investments in Transferable Securities (UCITS) Directive is a Pan-European regulatory framework initially designed to allow distribution of investment funds throughout Europe. The Directive introduced a set of tools that permitted fund managers, domiciled and authorised in one Member State, to establish and manage a fund in another Member State. It effectively removed administrative barriers by allowing cross-border distribution and eased the consolidation of the UCITS vehicles within the EU by allowing mergers via absorption, formation or amalgamation. The first UCITS Directive dates back to 1985, since then other versions of the Directive have been published (UCITS III, UCITS IV and UCITS V) to keep pace with the constantly evolving universe of traditional and alternative investing. In a panorama dominated by lethargic economic growth and socio-political instability, UCITS funds have increasingly been the response to the search for yield in a low interest rate environment and to the demand of protection by the investor side. In 2014, the demand for UCITS fund in Europe reached its peak with net sales of EUR 472 billion, which brought net UCITS assets in the region to EUR 7,979 billion.

UCITS key procedural phases:



Main UCITS requirements:

Financial Instruments	Allows for transferable securities listed in regulated markets, selected financial derivatives, indices, deposits and units of mutual funds.
Short Selling	Physical short selling is not allowed, shorting through derivatives is permitted though.
Leverage	Maximum gross exposure of 200%.
Concentration	- 10% maximum exposure in one single issuer. - Maximum aggregate exposure of 40% of net assets on exposure to single issuers greater than 5%. - Maximum 20% exposure on single index replicators. - Net assets can be invested in cash to a maximum of 20%. - OTC derivatives allowed to a maximum of 20% on single issuer. - Exposure to non listed instruments limited to 10%. - Limitations on control position on issuers equity.
Fund Liquidity	Daily, Weekly or Bi-weekly

It is pretty straightforward to set-up a UCITS fund, although there might be minor differences in the constitution of the fund according to the choice of jurisdiction and fund structure. The authorisation process can usually take from a period of 6 weeks to 3+ months from the submission of the required documentation to the local regulator of the chosen Member State.

The approval process starts by choosing the local legislator and then moves to the approval of the manager and finally to the approval of the fund.

CHOICE OF DOMICILE &SERVICE PROVIDERS

The first step to take with regards to the launch of a UCITS fund is the designation of domicile. Once the domicile is chosen, the fund manager will have to comply with the local regulator to establish the fund. In theory, it is possible to choose any state in the European Union, but in practice the preferred routes are Luxembourg or Ireland. Both states offer high-end infrastructures to serve the fund and offer exemption on income and capital gains taxation on the fund level; their offering is quite similar with some differences in relation to:

1. Legal System: continental European versus Anglo Saxon.
2. Taxe d'abonnement: Luxembourg imposes a tax of 5 basis points NAV per annum on equity funds and 1bp for money market and institutional funds per annum. Ireland has no corresponding tax, but a flat fee depending on the number of sub-funds.
3. Role of Custodian/Depositary: rules are similar in both countries with reference to safekeeping of assets and settlement. In Ireland, rules pertaining independent monitoring and reporting to shareholders are relatively stricter. In Luxembourg, similar obligations apply to funds established as FCPs (non-corporate structure) whilst on SICAV structures (corporate structures) they don't.
4. Independent Directors: in Luxembourg there is no obligation to appoint a resident as a Director, although there must be at least a resident performing the function of officer. In Ireland instead at least two Irish residents should be appointed Directors.

Once the fund promoter has been chosen and approved, the local regulator will then move their attention to questions relating to the fund: service providers and fund documentation. First, the fund will have to identify and appoint those service providers that need to be authorised by the local authority: Directors, Promoter, Investment Manager, Administrator, and Custodian/Depositary.

Other service providers that have to be appointed by the fund but do not require approval from local authority are: Legal advisors, Auditors, Tax Advisor, Distributor and Company Secretary.

LEGAL DOCUMENTATION

One of the final steps to set-up a UCITS find is the creation of the necessary legal documentation. The Prospectus is one of the main documents to be submitted to the local regulator for review and authorisation. The Prospectus contains and specifies to the investors at the outset of the relationship the main features and most relevant information regarding the fund: investment objectives, risk factors, valuation, parties involved and key personnel. The Key Investor Information document (KIID) is a simplified version of the Prospectus, which replaced the simplified prospectus introduced by UCITS III. Another major change introduced by UCITS III is the Risk Management Process Statement (RMP); it provides the investor with a precise outlook on the risk management framework relative to the use of derivatives, liquidity, leverage, counterparty risk and position exposure. It provides a framework which assures that all necessary controls and procedures are in place to support the risk management function. The Business Plan or Substance of Application (Luxembourg vs Ireland), defines the governance structure of the fund, by identifying the directors and key personnel, their roles and responsibilities. The last documentation to be submitted to the local regulator will be the Constitutional Documentation (depending on the legal structure on the fund), Legal and Operating Agreements and the Application Form/Letter to apply to the local regulator for the set-up of the fund.

FUND STRUCTURE

The choice of fund structure is one of the key decisions to be taken at the outset of the launch of an UCITS. Which route to take is very much dependant on the managers' expectations of new future launches and their comfort with the different features available within each structure.

The first route is the single strategy fund structure, wherein all investors will have to participate in a single UCITS strategy. Some degrees of freedom are still available though, for example in relation to different share classes.

The second route is represented by the umbrella fund structure. Depending on the laws and regulation of the Member State chosen as domicile, the UCITS structure can offer different strategies to investors thanks to different sub-funds. A principle of segregation applies to the sub-funds, therefore each can act as a single and distinct entity. This would be the case when a manager chooses to launch a UCITS fund through a platform, wherein the different managers within the platform would be represented by sub-funds.

The third route available to the manager is the master/feeder fund structure, introduced by the UCITS IV Directive. This structure improves cross-marketing capabilities for the UCITS fund, reduces inefficiency and lowers expense ratios. The main requirements of the master fund are the following: it should have at least a feeder fund, not hold any shares in any feeder fund, must not be a feeder itself and not charge subscription and redemption fees to the feeders. The feeder fund must receive the approval of the Member State's regulator before being able to invest in the master fund. Furthermore, master and feeder funds can have different domicile and service providers with the exception that a sharing agreement will be in place among the different service providers, in turn approved by local authorities.

In straight connection with the chosen fund structure, fund managers will then have to decide whether to establish the fund independently, to use a third party service provider or to rely on a platform provider. It basically comes down to the managers' confidence on developing the fund's destiny upon an independent solution (independent route and third-party route) or using an established platform provider which has greater experience and knowledge in the UCITS space. The independent routes offer the fund manager higher degrees of freedom in relation to the most important decisions to be taken with regards to service providers, management of the fund and distribution. The stand-alone route will require the manager to establish a European entity that would be the manager of the fund; it is essential to recruit high calibre personnel in relation to compliance, risk management and IT infrastructure. Third-party providers offer a less expensive solution and have the advantage of allowing the manager to focus solely on investment decisions. On the opposite side, the platform route is more standardised and lacks that freedom that the manager would typically enjoy with a stand-alone solution. Many factors come into play regarding this choice, but it mainly depends on the trade-off between independence and risk-aversion by leveraging a platform's expertise. The solutions offered by platform providers differ widely from each other on both an organizational and economic point of view. The advantage of third-party platforms is the "plug-and-play" feature of the solution, with clear disadvantages on choice of service providers, little or no independence and limited control over the product and its distribution. When it comes to this decision, it should also be taken into account the reputational and operational risks that might arise from choosing the platform route: a manager might not like to be associated with other managers on the same platform or, in a worst case scenario, to go down together with the platform in case of any trouble or issue exclusively specific to the platform provider.

The independent route is usually taken by those experienced managers, who most of the time come from a hedge-fund background, have adequate financial resources and can typically leverage on the expertise acquired in the off-shore space to successfully transfer it into the UCITS space.

ALTERNATIVE UCITS

The alternative UCITS universe comprised circa 1200 funds at the end of 2014, amounting to circa EUR 300[1] billion of assets under management. Those numbers speak for themselves as to the rapid ascent and popularity of the format within alternative investing, which drastically widened the potential customer base by opening the doors to retail investors.

The UCITS III Directive, whose primary purpose was to allow for a more comprehensive investment scope, finally opened the doors of the regulatory framework to the implementation of alternative strategies. The less restrictive rules on the use of derivatives made it possible for many hedge fund strategies to be directly transposed into the UCITS format. This produced innumerable positive outcomes for both managers and investors; a phenomenon also witnessed by the rapid growth and popularity of adoption of the format by alternative managers. Furthermore, one of the main drivers underlying the surge in popularity of Alternative UCITS is the capability to address those issues that contributed to the financial crisis in 2008. The UCITS format provides a clear and defined answer to investor's concerns over TLC, Transparency, Liquidity and Control (through regulation, and defined risk limits). Apart from considerations on the transparency and liquidity features of the format, the UCITS brand itself has developed over the years a psychologically reassuring trait in the eyes of investors that has helped to contribute to the high reputation of the format. On the fund managers' side, the incumbent requirements dictated by the AIFMD and the related confusion generated by its implementation on a state-by-state basis has further boosted the adherence to the UCITS format for many non-EU alternative fund managers eager to market in

[1] Source: LuxHegde Database

Europe, due to its simplicity and straightforward application. It can also be said that the UCITS format is not just only about Europe; it is also a widely recognized and accepted format in geographic areas like the Middle East and South America. With regards to fees, the 2/20 module is widely accepted, management fees generally range from 0.75% to 2% of NAV while performance fees span from 10% to 20% of profits. Research from Prequin[2] shows that average fees (management/performance) for alternative UCITS funds are 1.42%/16.81%, slightly lower than those of off-shore vehicles (1.55%/19.23%). Because of eligibility of assets and liquidity restrictions the UCITS format does not constitute the best-fit option for all off-shore strategies; the format will mainly suit liquid equity, managed futures and global macro strategies.

[2] The Prequin Global hedge Fund Report, pg. 44

As of today, the UCITS format has become one of the most popular formats for both traditional and liquid alternative funds; with the exception of North America because of its US equivalent, the '40 Act format, UCITS popularity has spread from Europe to the Middle East, Latam and Asia. UCITS funds enjoy passportability across all EU territories: once a fund is authorised in one Member State, the fund can be marketed in any other state just by registration without the need for further authorisation. The requirements dictated to adhere to the format have elevated UCITS to a sort of internationally recognized standard, synonymous with well implemented regulatory oversight, thorough risk management and investor protection.

Luxembourg and Ireland dominate the choice of domicile, but UCITS funds can be domiciled in all states of the European Union, by way of example in France, Germany, Malta, Jersey and UK. The cross-border features of the format allowed 10,430 funds to seek for 83,505 cross-border registrations just in 2014, an average of 8 registrations per fund[3]. The main destination for registration of Luxembourg domiciled funds are Germany (4,704), Switzerland (4,098), Austria (4,067), France (3,470) and UK (3,258) while Ireland domiciled funds for instance preferred: UK (1,880), Germany (1,708), Switzerland (1,371), France (1,343) and the Netherlands (1,275). It has been studied that on a single, true cross-border, fund basis 34% have applied for registration to 3 to 4 markets, 29% applied to 5 to 9 markets, 20% applied to 10 to 14 markets, 10% applied to 15 to 19 markets and the remaining 7% applied to 20+ markets.

With regards to the top European domiciles, the growth in the last five years has been quite spectacular, as of 2014, in Luxembourg the AuM of UCITS products amounted to EUR 2,643 bn (+66% since 2009), EUR 1,274 bn in Ireland (+113% since 2009)and EUR 995 bn in UK (+96% since 2009). The only domicile that experienced a decrease in AuM is France, which moved from EUR 1,253 bn in 2009 to EUR 1,146 bn in 2014 (-9% in 5 years).

Registration in a Member State does not necessarily translate into sales, but is a solid proxy of the scale and scope of distribution capabilities of a UCITS fund.

[3] Source: Lipper LIM and PwC Analysis; only true cross-border funds were taken into account, i.e. fund distributed in more than three countries including domicile.

HYDE PARK INVESTMENT – Marketing & Distribution

Hyde Park Investment brings together an international team of professionals with many years of financial services experience, in a variety of markets, from a range of blue chip investment banks. Having developed a detailed knowledge of the core buyers of traditional and alternative funds throughout Europe continuously over the last ten years, the team at Hyde Park Investment is ideally positioned to reduce the time-consuming effort of raising capital and marketing using in-house resources.

HAKO GRAF VON FINCKENSTEIN

Hako has twenty-five plus years experience in investment banking and the hedge fund industry. In 1988 Hako started his career with Deutsche Bank, for whom he worked in Frankfurt, Singapore and New York. Prior to co-founding Hyde Park Investment, Hako was an Executive Director at UBS in London (coming from SG Warburg) with managerial responsibility for the distribution of Pan–European Equities to German institutional investors. Hako received a Masters in Business Management from Ludwig-Maximilian University in Munich in 1987 and is fluent in English, German and French. Approved by the Financial Conduct Authority and Malta Financial Services Authority.

CARNE GROUP – UCITS Structuring & Oversight

Carne can advise on investment strategy and compatibility with UCITS regulations, provide training on UCITS, guidance on appropriate domicile, choice of service providers and warning against potential legal pitfalls. Carne can help fund managers to establish funds in both mainstream domiciles and more specialist jurisdictions. In Luxembourg, Carne can offer an effective launch pad for FCPs, SIFs and SICAVs, while in Ireland the local team works with leading managers on QIFs and UCITS amongst other structures.

AYMERIC LECHARTIER

Aymeric began his career in the financial services industry in 1994. He sits on the boards of Cayman, Irish Luxembourg and Maltese funds. He has a thorough knowledge of the regulatory and distribution environment for European funds, including UCITS and EU professional funds, and is particularly knowledgeable about key European markets for investment products. His specialist areas include corporate governance and product structuring. He has also assisted a number of managers launching various types of funds including UCITS traditional funds, alternative UCITS, hedge funds and private equity funds. These covered multiple jurisdictions including the Cayman Islands, Ireland and Luxembourg. Aymeric worked for nine years with Merrill Lynch in three countries, finishing his career there as Chief Operating Officer of the Zurich private wealth management office and manager in charge of the Monaco private wealth office. After leaving Merrill Lynch, Aymeric led the restructuring of a family-owned business as CEO. Aymeric holds a Business Degree from European Business School London and has also taken the Financial Industry Exam Series 7, Series 3, Series 8 and SFA.

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