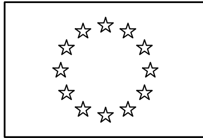

EUROPEAN COMMISSION
Internal Market and Services DG

FINANCIAL SERVICES POLICY AND FINANCIAL MARKETS
Asset Management

Exposure Draft

Initial orientations for discussion on possible adjustments to the UCITS Directive

3. Mergers

Important note: ***This document is a working document of DG MARKT services which is published for discussion purposes only. It presents DG MARKT services preliminary reflections on possible future adjustments to the UCITS Directive. It does not necessarily reflect the views of the European Commission. The Commission retains full autonomy and discretion as regards the content of any subsequent legislative proposal.***

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1. Assessing the impacts of creating a EU framework for fund mergers

1.1. Background

The European fund landscape is characterised by an ever increasing number of small funds. (54% of European funds manage less than €50 million of assets.) This results from the European fund industry's pro-active response to innovation and to changes in investor preferences. Some rationalisation efforts are taking place at national level. However, cross-border mergers, when at all possible, are long and cumbersome operations. Average size of a European fund is less than a fifth of that of its American counterpart[1]. Economies of scale are thus hardly exploitable. Inefficiencies are through unnecessarily high charges passed on to investors[2].

The White Paper's IA analysis concludes that in the absence of a facilitating framework for fund mergers (a particularly for cross-border ones) this trend will be exacerbated. It therefore recommends to change the Directive in order to create the conditions for the rationalisation of the fund landscape while, at the same time, ensuring high levels of investor protection.

There is a certain consensus on the main principles of such a framework. The analysis presented in the IOSCO's report on CIS mergers[3] and the recommendations of the expert group on market efficiency's report are largely convergent. The following table summarises the conclusions of both reports. Further in the text, the main related choices made in parallel to the analysis of the possible solution are explained.

	IOSCO review	Expert Group
Regulatory approval	▪ Before presented to unit-holders ▪ Verification of requirements	▪ Before presented to unit-holders ▪ Disappearing fund regulator decides
Unit-holder approval	Generally in line with national company law	▪ Following national legislation ▪ Threshold max. 75% of votes cast
Information disclosure	▪ Sufficient for informed decision ▪ Accurate and well balanced ▪ On merger rationale, continuing fund, tax implications, costs	▪ Submitted to regulator before ▪ In the language of investor's MS ▪ On investment policy, charges, valuation, voting process
Costs	▪ Clearly disclosed ▪ Borne by the manager	——
Redemption	Dissenting unit-holders: possibility to redeem free of charge	Dissenting unit-holders: possibility to redeem free of charge
Third-party monitoring	Disappearing fund audited; depositary reviews proposal	Valuation audited; depositary responsible for assets transfer

Despite the existing broad consensus about the main principles that a fund merger framework should follow, in a cross-border context, the main open question remains how to deal with the

[1] It has been estimated that annual savings of up to 17 b.p. could be attained if European equity fund sizes would converge to that of the average US fund. ("Potential cost savings in a fully integrated European investment fund market", CRA, August 2006.)

[2] According to a comparative study of Lipper the average Total Expenses Ratio of a Luxembourg fund of assets under US $ 5 million is more than double that that of a fund over $ 250 million. ("Economies of scale and consolidation in collective funds" Lipper, March 2005.)

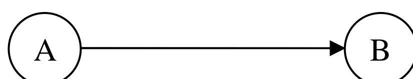
[3] "An examination of the regulatory issues arising from CIS mergers", IOSCO, November 2004

regulatory approval pre-requirement[4]. The below options have been designed in order to smooth the approval process and to overcome potential split supervisory concerns.

1.2. Option description

A more detailed description of the different options is provided in annex.

A fund in country A merges into a fund in country B (merger by absorption)[5].



Option 1: The regulator responsible for the disappearing fund (A) decides on the merger.

Authority A verifies compliance of the merger proposal with all information and other conditions imposed by the Directive. It has a maximum of 15 working days from the submission of a complete file to assess the merger proposal and issue its decision. A new merger regime would ideally also include provisions ensuring that the interests of B investors are also taken into account (e.g. fund B could be requested to assess the impact of the merger on its investors, to take appropriate measures to avoid negative impacts and/or to inform accordingly its unit-holders[6]).

Pros

- Most time-effective
- No need for regulator B to re-examine the merger file
- Less burdensome for the industry (only one file to be prepared)
- It is in line with the single market's mutual recognition logic

Cons

- Possible reluctance on the side of regulator B to let the decision on the hands of another regulator
- Potential (B's) investors protection concerns if no measures are taken to mitigate possible negative impact of the merger on them

Option 2: Both regulators decide on the merger. They take a common decision.

Both authority A and authority B verify compliance of the merger proposal with all information and other conditions imposed by the Directive. They have a maximum of 20 working days from the submission of a complete file to assess the merger proposal and issue a decision. Authorities

[4] There is also the question of the tax implications of fund mergers. However, as indicated in the White Paper for investment funds, this will be dealt with a non-legislative measure (Commission Communication). Therefore, the following analysis does not take into account taxation related issues.

[5] For the sake of simplicity, the case of mergers by creation of a new fund or, in general, mergers where the disappearing funds are located in different domiciles is only commented in annex. However, the conclusions of the below analysis of impacts could be extended to those mergers.

[6] Independently of the possibility for B investors to redeem free of charge or, if national rules foresee it, to vote on the merger proposal.

A and B need to work closely. Two possibilities then: they agree on bilateral co-operation modalities or these are developed by CESR (at level 2 or 3).

Pros

- In principle less burdensome and time-consuming for the industry than having to launch two individual procedures with two completely independent regulators
- Enhanced co-operation among regulators (which could benefit work in other areas)

Cons

- Before effective working arrangements between regulators are in place, the procedure can be quite time consuming (for the industry and the regulators)

Option 3: Both regulators decide on the merger. They take their decision individually.

Both authority A and authority B verify compliance of the merger proposal with all information and other conditions imposed by the Directive. They have a maximum of 15 working days from the submission of a complete file to assess the merger proposal and issue their decisions.

Pros

- Maximum freedom for each regulator to manage the procedure

Cons

- Most time consuming (interface with two independent regulators, decision deadlines would run from different moments…)
- Risk of divergent decisions

1.3. Efficiency impacts[7]

Option 1: The regulator responsible for the disappearing fund decides on the merger.

A. Compliance costs

Compliance costs are set to rise. This does not mean that the process described in option 1 is more cumbersome than current procedures. That rise is simply the result of a volume effect. The number of cross-border mergers will increase considerably. A study by Invesco[8] in 2005 identified 4,033 potential European merger candidates for the top 50 fund providers. This compares to the 28 cross-border mergers reported by FERI that same year.

Such a surge in cross-border mergers[9] could put some strain on certain countries' regulators, namely those with a big proportion of exporting or imported funds. Internal adjustments or

[7] This section should be seen as a preliminary analysis of the potential implications of the different options. A more detailed impact assessment will be carried out at a later stage.
[8] "Building of an integrated European fund management: cross border merger of funds, a quick win?", Invesco, January 2005.
[9] Domestic mergers are also set to rise in those countries in which there is not yet a fund merger regime.

increased resources may be needed, particularly if short approval deadlines are enforced [10]. On the other hand, a clear framework and the split of responsibilities foreseen in option 1 would reduce the (case by case) checks currently conducted by the regulators involved in a cross-border merger and, thus, free resources.

On the side of the industry, having to prepare a single merger file and to deal with a single regulator would undoubtedly reduce administrative costs. There would in principle no be a need to involve lawyer teams in the different domiciles of the merging funds.

B. Economic benefits

The procedure introduced by option 1 would be less time-consuming than the current practice for both industry and regulator(s). This would free resources for other productive uses. The rationalisation that would be favoured could also have a positive effect on risks. It could entail a reduction of the operational risks associated with the managing of a large range of funds and/or facilitate portfolio risk management. It would also reduce the (distributors and investors') confusion created by the existence of a broad choice of similar funds.

Savings are expected to stem from two sources: the cost savings achieved by the closure of absorbed funds and the scale economies that the bigger size of the absorbing ones will enjoy. The Invesco model above-mentioned estimated savings of some € 1.6 bn (or 20 b.p.)[11] These are annual savings that should in the medium-term largely offset the one-off costs of the merger approval procedure.

Pressure to pass those savings on to investors will depend on competition forces. Improvements on fund disclosure (please see proposal on the simplified prospectus) should give investors the possibility to compare among funds. Also, the rapid rhythm of new fund launches should impose a certain fee-discipline on similar existing funds. Being the mergers across the borders, higher competition pressure will be introduced in domestic markets. Cost reductions and/or better performances for the investors should have a positive effect on the whole economy in the longer term[12].

C. Investor protection impacts

For all three options, investor protection is considered to be ensured by a series of basic requirements (please see section 1.6). The regulator assesses compliance of the merger proposal with the conditions imposed by the Directive; the investor needs to receive the information on the merger necessary to take an informed decision; the valuation of the assets and the exchange ratio is audited by an independent auditor; the depositary reviews the merger proposal and is responsible for the transfer of assets; investors have the right to redeem without any charge and,

[10] In some countries though the number of (domestic) fund mergers is already high. (For instance, the French regulator is already dealing with more than 500 mergers/year. Decision on the merger generally takes the regulator 8 working days.) In those cases, capacities may already be in place.
[11] These savings correspond to the sample of the top 50 fund providers. Considering the whole universe of European funds, Invesco estimated savings of up to €8.6bn.
[12] Other economic effects such as potential redundancies due to the rationalisation of the work typically promoted by mergers have been considered as negligible. The rapid increase in the number of new funds would seem to compensate any need to reduce (front or back-office teams).

in some cases, to vote on the merger proposal; costs are not to be directly or indirectly borne by investors. Thus, this section will not focus, on the content of the information given to investors, their rights or on the role of depositary and auditor but on how the different regulatory approval processes described in options 1, 2 and 3 may impact investor protection.

The main potential criticism to this option is the fact that, since authority B is not involved, the interest of B investors may not be taken into account. Negative consequences for B investors could arise from two sources, the administrative (and other) costs directly linked to the merger and the risks of 'performance dilution' stemming from a restructuring of the merged portfolio. The first is avoided by the principle that costs are not to be borne by the investors. The second is a risk that needs to be addressed. Measures already exist to mitigate this risk[13]. In order to minimise any potential detriment for B investors, the manager of fund B could be required to put the adequate mitigating measures in place. B management company could also be given additional information or other responsibilities in order to ensure that that risk is kept to a minimum.

Option 2: Both regulators decide on the merger. They take a common decision.

A. Compliance costs

Compliance costs would be higher than in option 1. On the side of the industry, two merger files will need to be prepared taking into account the requirements of each regulator. Greater efforts and/or (resources) investments are to be expected on the side of the regulators (which will need to put in place the right co-operation infrastructure). Both authorities will have to consider the merger file, which will imply a duplication of the work[14].

B. Economic benefits

The process risks being longer than option 1 (particularly, before the adequate working arrangements are put in place). It will also necessitate resources that could be better employed elsewhere. In the longer term though, similar economic effects as those described for option 1 should materialise. However, their scale may be smaller since a more burdensome procedure would probably encourage a lower number of cross-border mergers.

C. Investor protection impacts

Participation of both regulators to the decision should minimise any risk for the investors (both A and B). However, this is questionable, particularly in the case where the continuing fund (B) is largely sold all over Europe. The fact that the regulator B is involved in the decision does not automatically ensure that the interests of all B investors are taken into account. Also most MS do not impose 'performance dilution' mitigating measures. Thus, involvement of this second authority may not add much from an investor protection point of view.

[13] Very often similar to the anti-dilution measures used in the event of a big subscription into the fund.
[14] Considering that the merger needs in any case to be done in the best interest of all concerned investors, this double check should not add anything from the point of view of investor protection.

Option 3: Both regulators decide on the merger. They take their decision individually.

A. Compliance costs

Out of all the options, this should lead to the highest compliance costs per merger. Not only two different merger files would need to be prepared by the industry, but also they will have to be discussed with two independently-working regulators. Negotiations with one of those could even require changing the file prepared for the other one or re-starting discussions with it. Local teams of lawyers would need to be involved.

B. Economic benefits

The process risk to be the longest of all three (particularly if the merger file is not submitted in parallel to both authorities). It would also be the most resources intensive (at both industry and regulator side). The uncertainty about the result would most probably be the highest. Since it would still imply dealing with two independent regulators, the number of cross-border mergers may not differ much from the current one (at least in the short to medium-term[15]). The economic potential of this option is therefore much lower than in any of the previous cases.

C. Investor protection impacts

As in option 2, the involvement of both regulators should minimise any risk for (all) the investors (although the same counter-arguments would apply). On the other hand, the decision being taken individually, some investor protection problems could arise. Main risk derives from the co-operation mechanism between authorities, particularly if this would not work smoothly. Failure to timely exchange the relevant information concerning the merger may lead to cracks in the protection of investors. (However, the possibility of negative consequences for investors appears rather small[16]).

1.4. Preferred option

In view of the above analysis, option 1 is the preferred option. It avoids the duplication of work and efforts involved in options 2 and 3. Industry players' burden is the lowest and the managing of the process is facilitated by the fact that there is a direct relation with a single regulator. Potential savings are also the highest. Investor protection is preserved despite the fact that the B regulator is not involved (in any case, the protection of investors should not rely only on the regulatory approval but also on a series of complementary requirements as explained above).

The possible reticence of the absorbing fund's regulator to leave the decision entirely in the hands of the merging fund regulator may, however, require some work at level 2. This could focus for example on the contents of the information to be given to (both funds') investors.

[15] Level 2 implementing measures may smooth the process and foster, to a certain extent, cross-border merging activity.
[16] In the absence of effective co-operation, regulators will most probably impose more strict requirements on the fund industry.

1.5. Impact table

Impacts on → Option ↓	Compliance costs	Economic benefits	Investor protection	Preferred option
Authority A decides	neutral	+++	Neutral	X
Both authorities decide (together)	-	++	+	—
Both authorities decide (individually)	--	+	+	—

1.6. Rationale behind other key choices made in respect of possible adjustments to UCITS Directive

Information to investors: Comprehensive information to investors is one of the pillars of the envisaged framework. (A potential list of contents is considered in the below section). Content and language requirements may impose an important burden on the industry. However, this is indispensable to ensure a proper protection of investors. Besides, these requirements entail only one-off costs that should be compensated in the medium-term by the annual savings generated by the merger.

Third party monitoring: Imposing responsibilities to (independent) parties such as the auditor and the depositary would add an extra layer of investor protection. Since this does not require many additional resources, and is in line with the current practice in some MS, the impact in terms of costs should be limited.

Costs: The decision to merger being a commercial one on the side of the fund promoter(s), it would seem appropriate to require that the costs are assumed by it. This would help to keep those costs to a minimum and to promote mergers that make really sense from an economical point of view.

Unit-holders' vote: Approval of investors of the merger proposal would follow national rules and should, thus, not impose an additional burden on the industry. The only considered interference with national legislation in the section below is the establishment of a maximum for the percentage of votes in favour required to approve the merger proposal. The objective would be to avoid that over-demanding percentages will act as a barrier to mergers (eliminating in this way all potential for savings).

2. Shape of possible adjustments to the UCITS Directive[17]

Possible adjustments to the UCITS Directive could consist of adding a new definition of "mergers" to the existing list of definitions and introducing of a new section on mergers of UCITS. Some possible orientations on how this could look like are set out below.

"Merger" definition

"Merger" shall mean an operation whereby:

(a) one or more UCITS or investment compartments thereof, the "merging UCITS", on being dissolved without going into liquidation, transfer all of their assets and liabilities to another existing UCITS or an investment compartment thereof, the "receiving UCITS", in exchange for the issue to their unit-holders of units or shares of the receiving UCITS and, if applicable, a cash payment not exceeding 10% of the net asset value of those units or shares; or

(b) two or more UCITS or investment compartments thereof, the "merging UCITS", on being dissolved without going into liquidation, transfer all of their assets and liabilities to a UCITS they form, the "receiving UCITS", in exchange for the issue to their unit-holders of units or shares of the receiving UCITS and, if applicable, a cash payment not exceeding 10% of the net asset value of those units or shares; or

(c) one or more UCITS or investment compartments thereof, the "merging UCITS"[18], on being dissolved without going into liquidation, transfer their net assets to another existing UCITS or an investment compartment thereof, the receiving UCITS, whereby the outstanding liabilities of the "merging UCITS" will be discharged at a subsequent time.

Explanatory comment

The "merger" definition which it considered to be introduced would cover three types of merger techniques:

(a) merger by way of absorption
(b) merger by formation of a new fund
(c) scheme of amalgamation/arrangement

The merger techniques defined under (a) and (b) are most commonly used in civil law countries. The envisaged definitions are based upon the definitions contained in the Cross Border Merger Directive 2005/56/EC (the "CMBD")[19] to be implemented by 15/12/2007. These forms of merger are commonly referred to as "true legal mergers" since they allow the transfer of all assets and liabilities to the receiving entity.

[17] Provisions on supervisory cooperation are set out in a separate section.
[18] For consistency and to facilitate the drafting of the full Section, the term "merging UCITS" has been used in the three definitions even though the merger technique referred to under c) is not a "true merger".
[19] Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies.

In some Member States, under certain circumstances a limited cash payment to unit-holders can be made on top of the allotment of units/shares in the receiving fund in exchange of their units/shares in transferring funds (e.g. France where shareholders who would not be entitled to a round number or a fraction of shares taking into account the fractioning of shares of the receiving fund, are entitled either to obtain payment of the difference in cash or to invest additional cash necessary to obtain a round number or a fraction of shares). The envisaged definitions contained in (a) and (b) provide for this possibility; a merger with cash payments to unit-holders of the transferring/merging entities not exceeding 10% of the net asset value of these units or shares would still be considered a "merger" for the purposes of this Directive.

The merger technique defined under (c) is commonly used in common law Member States (e.g. UK, Ireland). It does not constitute a "true legal merger" since it does not enable a transfer of all assets and liabilities to the receiving fund. It involves indeed that one or more funds, on being dissolved without going into liquidation, transfer their net assets to another existing fund whereby the outstanding liabilities (*e.g.* mainly tax liabilities) remain with the transferring/merging fund and are discharged later. There is therefore a delayed winding-up of the transferring/merging funds, which can only take place when all liabilities have been discharged.

However, it has been considered important to have this merger technique included in the possible merger definition so as to ensure that the current merger techniques used in common law countries be also recognised on a cross-border basis.

*

Possible items to be covered in the new section on "mergers of UCITS" could be the right to merger, prior regulatory approval, draft terms of merger, involvement of third parties (depositary, auditor), investor protection issues, costs of merger, and effectiveness of merger. Some initial orientations in this respect are set out below.

Principle
(Right to merge)

1. Member States shall, subject to the conditions set out in this Section, allow for mergers between:

- UCITS, or investment compartments thereof, situated within their territories
- UCITS, or investment compartments thereof, situated within their territories and UCITS, or investment compartments thereof, situated within the territories of another Member State,

irrespective of their legal form as defined in Article 1(3).

2. Save as otherwise provided in this Section on mergers, each UCITS taking part in a merger shall comply with the provisions and formalities of the national law to which it is subject, in particular under corporate, contractual or trust law.

Explanatory comment

The basic principle would be that UCITS are entitled to merge both on a domestic basis and on a cross-border basis. The rules would apply to all UCITS, irrespective of their legal form (common funds, unit trusts, investment companies). They would also apply to investment compartments of UCITS, which would be entitled to merge with other UCITS and/or investment compartments of the same or other UCITS.

The envisaged merger regime would cover both domestic and cross-border mergers. It seems preferable not to limit the envisaged merger regime to mergers involving UCITS domiciled in different jurisdictions. Given the increasingly cross-border investor base of many UCITS, a merger between two widely pass-ported funds domiciled in the same Member State may indeed have implications for a large population of investors outside that country. In view of this, it is considered necessary to impose the investor safeguards on domestic mergers as well.

Except if otherwise provided in the new section on mergers of funds which would be introduced, each UCITS (or investment compartment thereof) taking part in a merger would remain subject to the provisions and formalities of the national law to which it is subject, in particular under corporate, contractual and trust law. The question whether or not unit-holders have a right to vote on the proposed merger and the publicity requirements would remain subject to national law. It should however be stressed that none of the provisions and formalities of national law, to which reference is made in the UCITS Directive, should introduce restrictions on the freedom of establishment or on the free movement of capital save where these can be justified in accordance with the case-law of the European Court of Justice and in particular by requirements of the general interest and are both necessary for, and proportionate to, the attainment of such overriding requirements[20].

*

Authorization of merger

1. Mergers shall be subject to the prior authorization by the competent authorities of the merging UCITS.

2. The merging UCITS shall provide the following information to its/their competent authorities:

(a) the common draft terms of the proposed merger;
(b) the approval of the common draft terms of merger by the depositary of the merging UCITS;
(c) the draft independent auditor report; and
(d) the proposed information to be provided to unit-holders of the merging UCITS.

3. The competent authorities of the merging UCITS shall grant authorization of the proposed merger if it complies with all the conditions set out in this Section. In addition, the competent

[20] Cf discussion on this subject under Article 44 in the notification section.

authorities of the merging UCITS shall only grant authorization if the receiving UCITS has been notified, [*in accordance with Article 46*], to market its units in all Member States where the merging UCITS is/are either authorized or has been notified to market its units [*in accordance with Article 46*].

4. The merging UCITS shall be informed, within at the latest 15 working days of the submission of a complete file, whether or not authorization of the merger has been granted. Reasons shall be given whenever an authorization is refused.

5. The competent authorities of the merging UCITS shall inform the competent authorities of the receiving UCITS if the common draft terms of merger indicate that the receiving UCITS considers that the proposed merger might have a negative impact on its unit-holders and that adequate investor disclosure to its unit-holders is required in accordance with [*relevant article on information of unit-holders*].

Explanatory comment

The envisaged orientation would be to provide for the prior regulatory approval by the competent authorities of the merging UCITS before the merger can be presented to unit-holders (including for a vote where this is required under national law). This is in line with the 2006 recommendations made by the Commission Expert Group on market efficiency[21] and current practice in several Member States where only the regulator of the fund that will disappear with the merger is to approve the merger, so as to ensure that the interest of investors who effectively change funds are duly protected. It is also in line with the conclusions drawn in the report of the Technical Committee of IOSCO of November 2004 examining the regulatory issues arising from CIS mergers[22]. One of the common themes or core principles emerging from the responses received to their questionnaire filled out by SC5 members[23] was indeed that in general, regulatory approval is required when a collective investment scheme (CIS) proposes to merge with another CIS either within the local jurisdiction or on a cross-border basis (assuming cross-border mergers are permitted by the home regulator) and that such regulatory approval is required in advance of presenting the merger proposal to unit-holders for their consideration.

The competent authorities would only be able to refuse their approval in the case of non-compliance with the provisions on fund mergers set forth in the Directive, as implemented into national law. For reasons of investor protection, they would only be entitled to grant authorization if the receiving UCITS can distribute its UCITS in all Member States where the merging UCITS is/are entitled to distribute its/their UCITS. The competent authorities would have to take a reasoned decision within a period of 15 working days of submission of a complete file by the merging UCITS.

If the merger involves more than one merging UCITS and such UCITS are domiciled in different Member States, it is envisaged that each relevant home Member State regulator(s) would need to

[21] Available on: http://europa.eu.int/comm/internal_market/securities/ucits/index_en.htm
[22] "An examination of the regulatory issues arising from CIS mergers", a report of the Technical Committee of IOSCO, November 2004 - http://www.iosco.org/library/pubdocs/pdf/IOSCOPD179.pdf
[23] Members of the Technical Committee Standing Committee on Investment Management.

approve the merger. However, such regulator(s) would have to cooperate in accordance with the provisions contained in Article 50.

The envisaged orientation includes that the competent authorities of the receiving UCITS would not be required to approve the merger and cannot veto the operation. A fund merger will indeed have less significant consequences for the unit-holders of the receiving UCITS. The principal risk would be a possible dilution of the fund performance through increased transaction costs associated with portfolio rebalancing. It is considered that this economic impact can be managed and monitored in other ways, in particular by imposing adequate disclosure requirements on the receiving UCITS and granting unit-holders of the receiving UCITS the right to exit the fund free of charge (see below).

However, to enhance transparency and cooperation between regulators, the competent authorities of the merging UCITS would inform the competent authorities of the receiving UCITS if the common draft terms of merger submitted to them indicate that the receiving UCITS considers that the proposed merger might have a negative impact on its unit-holders and that adequate disclosure to its investors is required (this is to be indicated in the common draft terms of merger). This should enable the regulator of the receiving UCITS to exercise its general supervisory powers on the receiving UCITS and in particular to check whether the disclosure to investors of the receiving UCITS is made in conformity with the provisions of the Directive on fund mergers, as implemented into national law.

*

Draft terms of merger

Member States shall require that the management or administrative body of the investment companies or, in case of unit trust/common funds, the management companies of the UCITS involved in a merger draw up common draft terms of merger. The common draft terms of merger shall include at least the following particulars:

a) the fund rules or instruments of incorporation of the merging UCITS;
b) the fund rules or instruments of incorporation of the receiving UCITS;
c) the reasons for the proposed merger;
d) the expected impact of the proposed merger on the unit-holders of the receiving UCITS, including but not limited to, a potential dilution of performance; and any measures proposed to minimize any negative impact on the unit-holders of the receiving UCITS, including whether the receiving UCITS intends to inform its unit-holders of the proposed merger in accordance with [*relevant article on information of unit-holders*]; and
e) the planned effective date of the merger.

Explanatory comment

The initial orientation taken in respect of the draft terms of merger is that such draft terms should be drawn up in the same terms for each of the UCITS concerned (both merging UCITS and receiving UCITS), irrespective of the fact whether they are domiciled in the same Member State or in another Member State. The minimum content of such common draft terms required for

regulatory approval should therefore be specified, while leaving the funds free to agree on other items. This requirement is similar to the one imposed in Article 5 of the CMBD.

As indicated, the fund merger will have less significant consequences for the unit-holders of the receiving UCITS, although a possible dilution of the fund performance cannot necessarily be excluded. It has been considered that the UCITS involved in the merger, and in particular the receiving UCITS, are best placed to value the expected impact of their proposed merger on the unit-holders of the receiving UCITS. The draft terms of reference should therefore specify the expected impact of the proposed merger on the unit-holders of the receiving fund and what measures are proposed to minimize any negative impact. This provision has to be read in conjunction with the investor protection obligations which would be inserted in the Directive. First, the receiving UCITS should provide all necessary and appropriate information on the proposed merger to its unit-holders if it considers that the proposed merger might have a negative impact on its unit-holders, and second, unit-holders of the receiving UCITS would also have the right to exit the receiving UCITS free of charge.

Whereas Article 6 of the CBMD requires the publication of the common draft terms of the cross-border merger, the envisaged merger regime would not require such publication. Under the CBMD, one of the main purposes of publishing the common draft terms of the cross-border merger is indeed to inform the creditors and minority shareholders of the proposed merger so as to enable them to exercise their respective rights (i.e. vote as a shareholder or oppose against the merger as a creditor). Under the envisaged regime for fund mergers, unit-holders and shareholders would be protected through various other means (disclosure, right to redeem free of charge) whereas creditors' concerns seems less relevant since UCITS (especially if established in contractual form) often do not have any direct creditors at all.

*

Depositary approval

The depositary of the merging UCITS shall review and be satisfied that the common draft terms of merger are in conformity with the law and with the merging UCITS fund rules or instruments of incorporation. It shall inform the merging UCITS in writing of its approval of the common draft terms of merger.

Explanatory comment

One of the envisaged orientations would be to add an additional level of control by introducing the principle that the depositary of the merging UCITS should review and be satisfied with the common draft terms of merger. The role of the depositary would not be to verify whether the proposed merger is in the interest of the investors but rather to verify whether the merger proposal complies with all legal requirements. The depositary would have to inform the merging UCITS in writing of its approval/non objection to the proposed common draft terms of merger so as to enable the latter to include such information in its application file for regulatory approval.

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Independent auditor report

1. Member States shall require that an independent auditor report be drawn up for the merging UCITS. Depending on the laws of each Member State, such experts may be natural persons or legal entities.

2. The independent auditor report shall audit the valuation method of the assets and, where applicable, the liabilities of the merging UCITS, and the calculation method of the exchange ratio.

Explanatory comment

It would also be envisaged to require that an independent auditor (which can be a natural or a legal person depending on what national law allows) should audit the valuation method of the assets and the exchange ratio in all fund mergers. This follows the recommendation of the Expert Group on this, but intends to go one step further: according to the envisaged possible measures at Level 2, a copy of the independent auditor report would have to be made available to the unit-holders not less than 30 days before the date of the general meeting of unit-holders/shareholders (applicable in such Member States where unit-holders have voting rights and a general meeting to decide on the proposed merger will need to be convened) or not less than 30 days before the proposed effective date of the merger (applicable if unit-holders have no voting rights; which is the case in certain Member States for contractual funds).

*

Information of unit-holders

1. Member States shall require the merging UCITS to provide appropriate and accurate information on the proposed merger to its/their unit-holders so as to enable them to make an informed decision of the impact of the proposal on their investment. They shall furthermore require the receiving UCITS to provide all necessary and appropriate information on the proposed merger to its unit-holders if the receiving UCITS considers that the proposed merger might have a negative impact on its unit-holders.

2. The information shall only be provided to unit-holders after having obtained the approval of the proposed merger by the competent authorities of the merging UCITS in accordance with [*cross-reference to relevant article on regulatory approval*]. It shall be provided not less than 30 days before the date of the general meeting of unit-holders/shareholders, or if no such general meeting of unit-holders/shareholders is provided for under national law, not less than 30 days before the proposed effective date of the merger.

3. The information to be provided to unit-holders of the merging UCITS shall include full disclosure in relation to:

(a) the background to and the rationale of the proposed merger;

(b) the possible impact of the proposed merger on unit-holders of the merging UCITS, including but not limited to any material differences in respect of investment policy, costs, expected outcome and periodic reporting;
(c) any specific rights unit-holders of the merging UCITS have in relation to the proposed merger, including but not limited to the right to obtain additional information and the right to redeem units without charge as specified in [*cross-reference to relevant article on right to redeem free of charge*]; and
(d) the relevant procedural aspects and the proposed effective date of the merger.

4. The information to be provided to unit-holders of the receiving UCITS, where applicable, shall include at least the following items:
(a) the background to and the rationale of the proposed merger;
(b) the possible negative impact of the proposed merger on unit-holders of the receiving UCITS, including but not limited to any possible dilution in performance;
(c) any specific rights unit-holders of the receiving UCITS have in relation to the proposed merger, including but not limited to the right to redeem units without charge; and
(d) the proposed effective date of the merger.

5. If the merging UCITS has been notified to market its units in another Member State [*in accordance with Article 46*], the provisions of Article [*47(1)(b), (d) and (e)*] shall apply accordingly with regard to the provision of the information required under paragraph 3 to its unit-holders.

6. If the receiving UCITS has been notified to market its units in another Member State [*in accordance with Article 46*], the provisions of Article [*47(1)(b), (d) and (e)*] shall apply accordingly with regard to the provision of the information required under paragraph 4 to its unit-holders.

7. In order to ensure the necessary protection of investors and the uniform application of paragraphs 1, 3 and 4, the Commission shall adopt, in accordance with the procedure referred to in Article 53a, detailed implementing measures regarding the following issues:
(a) the detailed content and format of the appropriate and accurate information to be provided to unit-holders of the merging UCITS pursuant to paragraphs 1 and 3; and
(b) the detailed content and format of the necessary and appropriate information to be provided to unit-holders of the receiving UCITS pursuant to paragraphs 1 and 4.

Example of possible detailed information requirements to be provided pursuant to paragraph 3 which could be included at Level 2

(a) [a copy of the common draft terms of merger] or [background and rationale of the proposed merger and the proposed effective date];
(b) [a copy of the independent auditor report];
(c) [a copy of the depositary approval]
(d) a description of the receiving UCITS which must be sufficient to enable unit-holders of the merging UCITS to make an informed judgment of the proposal being put to them. In particular, this description should highlight any material differences between the receiving UCITS and the merging UCITS (comparison of investment policy, charges,

differences in periodic reporting and manner in how to acquire and redeem shares) ; a description of the valuation of the assets and, where applicable, the liabilities which are transferred from the merging UCITS to the receiving UCITS;

(e) [the method of calculating] the ratio applicable to the exchange of units or shares, and the amount of any proposed cash payment;

(f) the procedures to be adopted for transferring the assets and, where applicable, the liabilities, and for exchanging units or shares;

(g) the option for unit-holders of the merging UCITS to redeem their units or shares without charge till at least the effective date of the merger;

(h) where relevant, information on the voting process;

(i) details on how unit-holders of the merging UCITS, if they so require, may obtain [key investor information], the full prospectus, the constitutional documents and the annual report of the receiving UCITS;

(j) all relevant costs including, where applicable, costs associated with the liquidation of the merging UCITS and who will bear these costs; and

(k) any other material information [concerning, inter alia, tax treatment, details of the local contact points where additional information may be obtained if needed.]

Example of possible detailed information requirements to be provided pursuant to paragraph 4 which could be included at Level 2

(a) [a copy of the common draft terms of merger] or [background and rationale of the proposed merger and the proposed effective date];

(b) the possible impact of the proposed merger on the unit-holders of the receiving UCITS, in particular any possible dilution of performance impact, and the measures the receiving UCITS has taken to minimize such impact;

(c) the option for unit-holders of the receiving UCITS to redeem their units or shares without charge till at least the effective date of the merger;

(d) all relevant costs and who will bear these costs;

Explanatory comment

One of the main objectives which should be ensured is that the investors which are most concerned (i.e. the investors of the merging UCITS) are duly protected in case of a fund merger. The envisaged merger regime therefore would require each of the merging UCITS, the "disappearing" entities to provide appropriate and accurate information relevant to the proposed merger to their unit-holders so as to enable them to make an informed decision of the impact of the proposal on their investment. This is particularly important in Member States where unit-holders have no voting rights, but also in Member States where a voting mechanism exists. In practice, very often few unit-holders do exercise their voting rights. Adequate disclosure is therefore crucial.

In addition, in certain cases, the proposed merger might have a negative impact on the unit-holders of the receiving UCITS. If this would be the case, the unit-holders of the receiving UCITS should also be entitled to receive all necessary and appropriate information to enable them to decide whether or not to exit the fund. This has lead to the inclusion of a specific obligation for the receiving UCITS which would have to consider the possible negative impact of

the proposed merger on its unit-holders and if relevant, would have to provide adequate disclosure to its unit-holders. It is currently not envisaged that such disclosure would have to be subject to prior regulatory scrutiny. The regulator of the receiving UCITS could however intervene on the basis of its general supervisory powers if it considers that investor disclosure by the receiving UCITS to be in breach of the applicable rules contained in this Directive (as implemented under national law).

The specific requirements to provide information to unit-holders of the merging/receiving UCITS which would be developed in the section on fund mergers would not set aside any other information/publication requirements imposed by national law to enable unit-holders to exercise their voting rights in such Member States where the unit-holders of the merging/receiving UCITS would be entitled to vote on a fund merger.

To ensure adequate investor protection, prior regulatory approval would be required before the merger could be presented to unit-holders. It would also be specified when unit-holders should, at the latest, be informed of the proposed merger so as to enable them to have sufficient time to take their decision whether or not to exit the fund.

The basic principles of investor disclosure to the unit-holders of the merging UCITS and the receiving UCITS would be specified in the Directive. More details of what the information should specifically include would be provided through implementing measures (see below). Not all of the elements considered to be important for the unit-holders of the merging UCITS might be relevant for the unit-holders of the receiving UCITS. The main principle would be that the information provided should be appropriate, adequate and sufficient to enable the investor to take an informed decision of whether or not he/she wants to stay in the fund.

One of the other elements to be considered is how investor information to be provided to unit-holders in case of a fund merger, should be provided to investors in another Member States where a UCITS has been notified to market its units. It would be envisaged to retain the principle, set out in other parts of the Directive dealing with the notification mechanism, that the information should be provided/made available to the public in the manner prescribed by the laws, regulations and/or administrative provisions of the host Member State and in the or one of the official languages of the host Member State or in a language approved by the competent authorities of the host Member State. The translations would have to be produced under the responsibility of the UCITS.

Given the fact that the Directive would contain principles only, it is envisaged to insert a specific delegation clause on the basis of which the Commission could adopt implementing measures to specify the detailed content and/or format of the information to be provided to investors of the merging and the receiving UCITS. As indicated above, such information might differ for both categories of investors since not all of the elements considered to be important for the unit-holders of the merging UCITS might be relevant for the unit-holders of the receiving UCITS.

*

Approval by unit-holders

Where the national laws of Member States require approval by the unit-holders of the merging UCITS and/or the receiving UCITS of mergers between UCITS, Member States shall ensure that this decision shall require not more than 75% of the votes attached to the units/shares present or represented at the general meeting of unit-holders/shareholders.

Explanatory comment

The envisaged initial orientation would be that approval by unit-holders would only be required if provided for by national law. This would apply both to the unit-holders of the merging UCITS and the receiving UCITS.

In order order to prevent excessively demanding voting thresholds from impeding merger completion, the envisaged solution would be to provide for a maximum threshold/ceiling of 75% of the votes cast. The threshold would not be calculated on the basis of the total number of votes attached to the units representing the capital, which is considered to be too burdensome. The envisaged approach would not aim at fully harmonizing voting practices in Member States or imposing the introduction of voting rights for unit-holders in Member States where this is not required for domestic mergers.

*

Right to redeem

1. The laws of Member States shall provide that unit-holders of the merging UCITS and the receiving UCITS have the right to redeem their units/shares without charge. This right shall become effective from the moment the merging UCITS and, where applicable, the receiving UCITS, have sent out the required information on the proposed merger to unit-holders in accordance with [*relevant article on information of unit-holders*], till at least the effective date of the merger.

2. By way of derogation from paragraph 1 of Article 37, Member States may allow the competent authorities to require the temporary suspension of the re-purchase or redemption of units for mergers between UCITS provided that such suspension is justified having regard the interests of the unit-holders.

Explanatory comment

Unit-holders would have the right to redeem units or shares without costs prior to the merger. This right would apply to unit-holders of the merging and the receiving UCITS. This right would start from the moment the UCITS has informed its unit-holders of the proposed merger. In practice this would mean that unit-holders of the receiving UCITS would be able to exercise their right to redeem free of charge if the receiving UCITS would consider that the proposed merger

has a negative impact on its unit-holders and that disclosure therefore is required. It would enable dissenting unit-holders and/or unit-holders in jurisdictions where there is no right to vote to exit a merging UCITS without charge. It would also enable unit-holders of a receiving UCITS to exit free of charge if the fund merger might have a negative impact on their investment.

It is also considered useful to try to deal with the following practical issue: suspension of re-purchase or redemption of units might be required to enable the merging and receiving UCITS to determine the final exchange ratio. In practice, such suspension already exists in several Member States and is – in certain cases – provided for by national law. Although it can be argued that such situation is already covered by paragraphs (a) or (b) of Article 37(1) it might be preferable, for clarity, to provide for a specific exemption related to mergers.

*

Costs

Member States shall ensure that any legal, advisory or administrative costs associated with the preparation and the completion of the merger shall not be charged, either directly or indirectly, to the merging and/or the receiving UCITS and/or any of their unit-holders.

Explanatory comment

The envisaged approach is to ensure that the responsibility for the costs of the merger does not lie – directly or indirectly – with the unit-holders of the merging and/or receiving UCITS. This is in line with the conclusions of the IOSCO report referred to above, which indicates that the general view put forward by members was that any costs associated with the merger, should be borne by the manager/promoter on the basis that most, if not all, mergers are commercially driven.[24]

Such principle should be considered together with the envisaged obligations to provide information on the merger to unit-holders. The latter would indeed provide that adequate disclosure should be provided to the unit-holders of the merging UCITS / receiving UCITS. Such disclosure would include information on the level of the costs related to the merger and on who would be responsible for these costs.

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[24] Although some dissenting opinions were expressed. See IOSCO report, page 5, item 7. Members were however unanimous on the view that the cost and the entity responsible for those costs should be clearly disclosed in the circular/information to investors.

Entry into effect of the merger

1. The laws of Member States shall provide that the merger shall take effect as soon as all assets, and where applicable, all liabilities have been transferred from the merging UCITS to the receiving UCITS and unit-holders in the merging UCITS have received units in the receiving UCITS in exchange of their units in the merging UCITS.

2. The depositaries of the merging UCITS and the receiving UCITS shall be responsible for the actual transfer of assets from the merging UCITS to the receiving UCITS.

3. While ensuring observance of the principles laid down in Article 25(1), the Member States may allow receiving UCITS in a merger falling within the scope of this Section to derogate from Article 25(2) for maximum three months following the effective date of the merger.

4. The entry into effect of the merger shall be made public through all appropriate means in the manner prescribed by the laws of the Member State of the receiving UCITS. In addition, it shall be made public in all Member States where the receiving UCITS has been notified to market its units. In the latter case, the provisions of Article [*47(1)(b), (d) and (e)*] shall apply accordingly.

Explanatory comment

It seems useful to specify in the Directive when a merger takes effect: i.e. upon the transfer of assets and liabilities (if applicable) and the exchange of units.

Some Member States provide for an additional reporting by an independent auditor who is to confirm that the merger has been duly completed. This initial orientation does not reflect this option since it is considered that adequate investor protection is already offered through different other mechanisms.

The initial orientation followed for fund mergers does not follow the approach taken in the CBMD. Article 12 of the CBMD does indeed provide that the law of the Member State to whose jurisdiction the company resulting from the cross-border merger is subject shall determine the date on which the cross-border merger takes effect. In the envisaged fund merger regime, preference would be given to clarifying at the EU level the exact moment when the merger takes effect.

The role and responsibility of the depositary of both the merging UCITS and the receiving UCITS to carry out the actual transfer of assets (and, where applicable, liabilities) would be explicitly stated.

Some flexibility might be required to take into account such situations whereby, after a merger and due to the transfer of assets from the merging UCITS to the receiving UCITS, the thresholds provided for in Article 25 of the Directive (corporate governance rules) might be exceeded. Although the general corporate governance principle laid down in Article 25(1) should remain respected at all times, a temporary derogation from the specific thresholds provided for in Article 25(2) seems justified to allow the receiving UCITS to adjust its portfolio.

Investors and other third parties should be informed of the merger taking effect (i.e. the completion of the merger). The idea would be to require that the completion of the merger be published in accordance with the national laws of the Member State of the fund resulting from the merger (the receiving UCITS). In addition, it would also be required that completion of the merger be published in all Member States where the receiving UCITS is distributed in accordance with the provisions of Article 47(1)(b) and (c) of this Directive. This would take into account local languages requirements and differences in publication mechanisms in each Member State where the fund is marketed and has (potential) investors (i.e. publication through press, through individual circulars etc.). Since one of the conditions for regulatory approval would be that the receiving UCITS has been notified to market its units in all Member States where the merging UCITS is authorized or has been notified to market its units, it would seem sufficient to limit the publication of completion of the fund merger to the Member State of the receiving UCITS and all Member States where the receiving UCITS is marketed in accordance with Article 46 of the Directive (which, in principle, should also include the Member State of the merging UCITS).

The initial orientation would be not to require publication in the appropriate public register, as provided for under the CBMD. The CBMD only applies to cross-border mergers of limited liability companies as defined therein. The envisaged fund merger regime however deals with mergers between funds with different legal forms (both corporate form, contractual form, unit trust) for which publication mechanism can vary considerably and no common publication regime so far exists. It therefore seemed preferable to leave it to the relevant national law to decide on the exact manner of publication of the completion of the merger.

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3. Questions

Legal questions ***(section 2)***

1. Does the proposed approach represent the most effective basis for achieving the stated objective to create an effective framework for fund mergers? How could the proposed approach be improved and what alternative approaches could/should be envisaged?
2. Do the proposed definitions and scope of the proposed measures adequately capture the main features and characteristics of fund merger activity? Do they take sufficient account of differences between different fund types (corporate, contractual, trust) and legal systems (common law, civil law)?
3. Are the interests of unit-holders in the merging/dissolving and receiving fund sufficiently safeguarded by the proposed arrangements? In particular, is the reliance on information provision coupled with the right to redeem free of charge a suitable basis for protecting investor interests?
4. Does the proposed minimum content of the common draft terms of merger correspond with current practice? Should any other items be added to it? Do you consider it preferable to grant implementing powers to the Commission to further define the content thereof?

Economic questions ***(section 1)***

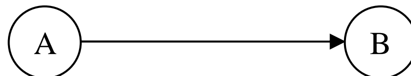
5. Do you agree with the analysis of the expected impacts? Are there any other economic or investor protection implications that should be taken into account?
6. Is the assumption regarding the number of potential cross-border mergers right (i.e. the fact that option 3 would encourage a considerable lower number of mergers than option 1)? Will the envisaged solutions be more effective in facilitating fund mergers that other approaches considered?
7. Which additional possibilities could be considered in order to reduce the regulators' and industry's administrative burden and other compliance costs further?
8. Have countries with a history of domestic mergers, observed identifiable positive or negative impacts for investors?

ANNEX

POSSIBLE MERGERS CO-OPERATION ARRANGEMENTS

Co-operation mechanism pre-merger

Scenario 1: A fund in country A merges into a fund in country B (merger by absorption).



Option 1 *preferred option*

Principles:

- Authority A is responsible for the approval /rejection of the merger proposal (i.e. the management company or investment company (if self-managed) of A submits the common merger proposal and related documents only to Authority A)
- Authority A's decision will be based on the verification of compliance of the merger proposal with all information and other conditions imposed by the Directive.
- Interests of B investors taken into account: If fund B considers that the proposed merger might have a negative impact on its unit-holders, it shall provide its unit-holders appropriate and adequate information on the proposed merger[25]. The merger proposal is to specify whether such disclosure will be made.
- Authority A has a maximum of 15 working days from the submission of a complete file[26] by MC A to assess the merger proposal and issue its decision. Reasons shall be given whenever an authorization is refused.

Comment: this seems the most time- and cost-effective option. It avoids that a complete re-examination of the file is done by authority B. It relies on the fact that authority A takes a first view on whether the merger fulfils all the (information, third-party control) requirements imposed by the Directive. Authority B might be reluctant to give up its powers to decide / veto against the merger. However, such reluctance could probably be reduced if there is a sufficient degree of harmonisation of the information that the merging fund needs to file with its authority (e.g. achieved through level 2 measures) or if a mediation mechanism within CESR is foreseen.

Alternative:

- First two bullet points remain the same

[25] B investors will also have the possibility to redeem free of charge and, if national rules foresee it, to vote on the merger proposal.
[26] Completion of the dossier may be assessed taking into account the required documents listed in the (new) Directive, as well as particular national rules (e.g. publication modalities…). Possibility could be given to the introduction of level 2 provisions harmonising the content of the merger proposal dossier.

- Upon reception of the merger request, authority A has the obligation to inform and transmit the merger proposal and related documents to authority B. Authority B has one week (upon reception of the documents) to forward to authority A any remarks it has regarding the merger proposal.
- If authority B considers that the merger may have an important negative impact on B investors, it may decide (together with authority A) of appropriate measures in order to mitigate the consequences for B investors. *(There may be a need to include the possibility to define the way those measures will be decided at level 2)*
- Last two bullet points remain the same.

Comment: this variant is more time-consuming and less cost-effective since it implies on a systematic basis the sending of all merger proposals from one authority to the other. In order for authority B to decide whether the merger might have a material negative impact on B investors and whether any appropriate measures need to be taken to protect such investors it will need to re-examine the file. It also seems difficult for authority A to impose certain additional requirements on B since it is not directly supervising B.

Option 2

Principles:

- Both authorities A and B are responsible for the approval /rejection of the merger proposal (i.e. the management companies of A and B need to submit the proposal to their respective authorities). They adopt a common decision (i.e. no individual decisions)
- The decision will be based on the verification of compliance of the merger proposal and related documents with all information and other conditions imposed by the Directive.
- Authorities A and B need to work closely. Two possibilities then: they agree on bilateral co-operation modalities or these are developed by CESR (at level 2 or 3). The basic principles of such co-operation could be provided by Level 1 and detailed at level 2. This cooperation could, for example imply that:
    - Upon submission of the merger proposal, each authority will designate the person/s that will be following up the file and will communicate their name(s) to the other authority
    - Each authority should make sure that the necessary logistic and human means (e.g. IT, communication channels, mission budget, linguistic capabilities…) are in place to ensure a smooth and effective co-operation.
- Authorities A and B have a maximum of 20 working days from the submission of a complete file by A and B to assess the merger proposal

Comment: At a first stage (before the adequate co-operation mechanisms are effective), there is the risk of the procedure being long. It will also require a certain level of efforts (and maybe also investments) on the side of authorities in order to set up the new co-operation mechanism. Management companies A/B will be interfacing right from the start with two regulators which may make the process more complicated.

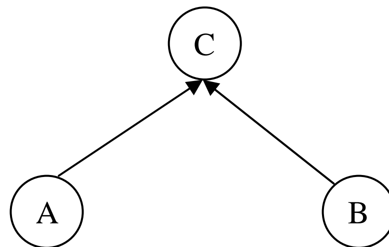
Option 3

Principles:

- Both authorities A and B are responsible for the approval /rejection of the merger proposal (i.e. the management company/ies needs to submit the proposal to both authorities[27]). Each authority decides on the merger separately (i.e. two parallel individual decisions).
- The decisions will be based on the verification of compliance of the merger proposal with all information and other conditions imposed by the Directive.
- Possibility for authorities A and B to develop cooperation arrangements in order to provide each other all relevant information that could affect their decisions.
- Authorities A and B have a maximum of 15 working days to assess the merger proposal and issue their decision. The period starts once the merger proposal file is complete.

Comment: risk of a quite lengthy procedure. There would be also a problem if authority A approves the merger but then authority B requires important changes in the merger file in order to give its approval (would the decision of authority A have to be reconsidered in this case?) Deadlines might run from different moments: i.e. Authority A may consider that the file submitted is complete while authority B may have another view on this.

Scenario 2: Two possibilities[28]: a) A fund in country A and a fund in country B merge into an existing fund in country C (merger by absorption); b) A fund in country A and a fund in country B merge into a new fund located in country C (merger by creation of a new fund)



Option 1 *preferred option*

Principles:

- Both authorities A and B are responsible for the approval /rejection of the merger proposal (i.e. the management company or investment company (if self-managed) of respectively A and B need to submit the proposal to respectively authority A and B). Two possibilities: if the A and B authorities have to adopt a common decision, the relevant bullet points of option 2 in scenario 1 are applicable; if an individual decision is foreseen *(preferred variant)*, the relevant bullet points of option 3 in scenario 1 are applicable.

[27] It is up to the management company/ies whether the proposal is sent simultaneously to both authorities or whether it will be only sent to authority B once authority A has given its approval.
[28] Or any other combination involving two (or more) national authorities responsible for one of the absorbed/disappearing funds (e.g. when fund C is located in one of the countries of the absorbed funds).

- The decisions will be based on the verification of compliance of the merger proposal with all information and other conditions imposed by the Directive.
- Interests of C investors taken into account: If fund C considers that the proposed merger might have a negative impact on its unit-holders, it shall provide appropriate and adequate information on the merger to them.
- Authorities A and B have a maximum of 15 working days from the submission of a complete file by respectively MC A and MC B to assess the merger proposal and issue their decision.

Comment: this seems the most time- and cost-effective option given the number of national authorities involved. It avoids that a complete re-examination of the file is done by authority C. It relies on the fact that authority A and B take a first view on whether the merger fulfils all the (information, third-party control) requirements imposed by the Directive. Cooperation between A and B authorities may be necessary (simultaneous submission of the file to both authorities would be recommended to ensure that deadlines run in parallel). Authority C might be reluctant to give up its powers to decide / veto against the merger. However, such reluctance could probably be reduced if there is a sufficient degree of harmonisation of the information that the merging fund needs to file with its authority (e.g. achieved through level 2 measures) or if a mediation mechanism within CESR is foreseen.

Option 2

Principles:

- All authorities involved (i.e. A, B and C) are responsible for the approval /rejection of the merger proposal (i.e. the management company/ies of A, B and C each need to submit the proposal to their respective authorities[29]). Two possibilities: if common decision, the relevant bullet points of option 2 in scenario 1 are applicable; if (three) individual decisions, the relevant bullet points of option 3 in scenario 1 are applicable.
- The decisions will be based on the verification of compliance of the merger proposal with all information and other conditions imposed by the Directive.
- Possibility for authorities A, B and C to develop cooperation arrangements in order to provide each other all relevant information that could affect their decisions.
- Authorities A, B and C have a maximum of 30 working days from the submission of a complete file by respectively MC A, B and C to assess the merger proposal and issue their decision.

Comment: risk of a quite lengthy procedure if the possibility 'individual decision' is retained. Simultaneous submission of the file to all authorities would be recommended to ensure that deadlines run in parallel, but it cannot be guaranteed that the approval would be simultaneous since problems could arise at three levels blocking the procedure (as in option 3 of scenario 1). [If 'common decision', the 30 working days deadline could be too short]

[29] It is up to the management company/ies whether the proposal is sent simultaneously to all authorities or whether it prefers to proceed approval by approval.

Co-operation mechanism post-merger

For the authority A, the receiving UCITS (B) will be as any other UCITS notified for marketing in its territory. Thus, the provisions contained in Section IX of the Directive should suffice. For instance, art. 50.1 reads "The authorities… shall collaborate closely in order to carry out their task and must for that purpose alone communicate to each other all information required"(subsequent paragraphs deal with the modalities of such information exchange)[30]. Likewise, art. 52.3 obliges authority B to inform A of any decision regarding the UCITS B. In addition to such collaboration and information requirements, art. 52.2 allows authority A to take action against UCITS B if Section VIII rules (notification articles) are infringed.

Therefore, the emphasis should be, in any case, on supervisory control of the obligations of the fund promoters at the moment of the cross-border merger and not on additional (post-merger) obligations/rights for national authorities.

(Merger/post-merger) obligations for the fund promoter(s)

- Before the effective date of the cross-border merger (i.e. date on which assets are transferred and exchange of units/shares takes place), the receiving UCITS (B) needs to be notified in all Member States where the disappearing UCITS (A) is (authorised or) notified.
- Disappearing UCITS (A) needs to inform A investors that after the merger the information they were used to receive (or the way/frequency in which it was received) may change.
- *+ all other obligations to be complied with during the merger procedure (information requirements, third- party control, costs of the merger …)*

[30] In fact, some of the bullet points of the options described above seem redundant in view of this collaboration obligation.