

Title: Transposition of the Recast Undertakings for Collective Investments in Transferable Securities (UCITS IV) Directive Lead department or agency: HM Treasury Other departments or agencies: Financial Services Authority	Impact Assessment (IA)
	IA No:
	Date: 12/04/2011
	Stage: Final
	Source of intervention: EU
	Type of measure: Secondary legislation
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Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

The UK must transpose the recast UCITS Directive (UCITS IV) into national law by July 2011. A 2005 Commission Green Paper identified a number of problems with the current UCITS framework which have caused significant inefficiencies in the EU investment fund market, resulting in higher costs and lower returns for investors. These problems included: (1) bottlenecks and failures with the product passport; (2) sub-standard investor disclosure; (3) Proliferation of funds of a sub-optimal size (4) Obstacles to functional and geographical specialisation. After extensive consultation, a 2006 Commission White Paper identified that these inefficiencies were caused by serious failings in the legislative framework and that a number of targeted reforms were necessary for these to be corrected.

What are the policy objectives and the intended effects?

UCITS IV has been broadly welcomed by UK industry. UCITS IV aims to remove market inefficiencies, improving investor disclosure and develop a true single market in investment funds. (1) Improving the single market in investment funds by removing administrative barriers to the cross-border marketing of UCITS, introducing a management company (ManCo) passport and improving supervisory cooperation; (2) Allowing for the consolidation of the UCITS fund market so that it can benefit from greater economies of scale, by facilitating mergers between UCITS funds and providing for asset pooling through 'master-feeder' structures. (3) Increasing investor protection by replacing the simplified prospectus (SP) with the Key Investor Information (KII).

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

On 13 July 2009, the EU approved a reform of the UCITS Directive. This recast Directive is commonly referred to as UCITS IV and repeals all other UCITS Directives (in its consolidated form of 2002 known as UCITS III). UCITS must be implemented by 1 July 2011. This is an EU Directive and the UK has a treaty obligation to implement it into national law by the required deadline. If the UK chooses not to implement this Directive then it will be in infringement of EU law and infringement proceedings may be launched by the Commission. Although it is a minimum harmonisation Directive, it allows Member States little flexibility in how it should be implemented and, as such, HM Treasury has made no substantive policy choices in drawing up draft legislation for consultation.

Will the policy be reviewed? It will not be reviewed. **If applicable, set review date:** Month/Year

What is the basis for this review? Not applicable. **If applicable, set sunset clause date:** Month/Year

Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?

No

SELECT SIGNATORY Sign-off For final proposal stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible SELECT SIGNATORY: _____

M J M

Date: _____

12/4/11

Description:

Price Base Year	PV Base Year	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)			
			Low: Optional	High: Optional	Best Estimate: N/A	
COSTS (£m)						
		Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)		
Low		30	5	70		
High		70	20	260		
Best Estimate		50	10	140		
Description and scale of key monetised costs by 'main affected groups'						
The majority of the costs will be on ManCos. The annual revenue of UK UCITS ManCo industry is approximately £3.5 Billion. The costs include: (1) One-off costs of replacing the SP with a KII and the incremental cost of producing and distributing it instead of SP; (2) All UCITS will have to comply with new harmonised requirements for systems and controls and conduct of business measures. (3) ManCo must now absorb the cost of any merger.						
Other key non-monetised costs by 'main affected groups'						
N/A						
BENEFITS (£m)						
		Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)		
Low		Optional	Optional	Optional		
High		Optional	Optional	Optional		
Best Estimate		Unquantifiable	Unquantifiable			
Description and scale of key monetised benefits by 'main affected groups'						
Not possible to quantify benefits as they will depend on the uptake of new opportunities by industry. Benefits will include: (1) Reducing administrative costs through the introduction of the ManCo passport; (2) Making it easier for UCITS funds to start marketing in new Member States through improved notification procedure; (3) Allowing funds to benefit from economies of scale by improving the mechanism for UCITS funds to merge and the introduction of master-feeder structures.						
Other key non-monetised benefits by 'main affected groups'						
(1) Increasing investor protection by providing improved pre-sale disclosure that enables investors to make better-informed investment decisions and improves the reputation of the UCITS brand (2) Increasing investor protection by improving supervisory cooperation						
Key assumptions/sensitivities/risks						
					Discount rate (%)	3.5
(1)Tax - A number of measures introduced by UCITS IV, in particular those relating to the management company passport, mergers and asset pooling (through master feeder structures), will be affected by the national tax regimes of the home States of both UCITS and management company. (2) Simplified Notification Procedure - FSA would have less control of inwardly passporting funds marketing funds to UK investors. (3) KII - Will reduce the amount of pre-contractual information provided to investors (4) Management Company Passport - may cause some operational and supervisory difficulties which could reduce investor protection.						
Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as		
Costs: 16.26	Benefits: N/A	Net: N/A	No	NA		

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?	United Kingdom				
From what date will the policy be implemented?	01/07/2011				
Which organisation(s) will enforce the policy?	FSA				
What is the annual change in enforcement cost (£m)?	> £1 Million				
Does enforcement comply with Hampton principles?	Yes				
Does implementation go beyond minimum EU requirements?	No				
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)	Traded: N/A		Non-traded: N/A		
Does the proposal have an impact on competition?	Yes				
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?	Costs: 0		Benefits: 0		
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	Micro N/A	< 20 N/A	Small N/A	Medium N/A	Large N/A
Are any of these organisations exempt?	No	No	No	No	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on...?	Impact	Page ref within IA
Statutory equality duties¹ Statutory Equality Duties Impact Test guidance	No	
Economic impacts		
Competition Competition Assessment Impact Test guidance	Yes	7
Small firms Small Firms Impact Test guidance	Yes	7
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	No	
Sustainable development Sustainable Development Impact Test guidance	No	

¹ Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

References

Include the links to relevant legislation and publications, such as public impact assessments of earlier stages (e.g. Consultation, Final, Enactment) and those of the matching IN or OUTs measures.

No.	Legislation or publication
1	http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:0032:0096:EN:PDF
2	http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:176:0001:0015:EN:PDF
3	http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:176:0016:0027:EN:PDF
4	http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:176:0028:0041:EN:PDF
5	http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:176:0042:0061:EN:PDF
6	http://ec.europa.eu/internal_market/investment/docs/legal_texts/framework/100521-impact_assessment_en.pdf
7	http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52006DC0686:EN:NOT
8	http://ec.europa.eu/internal_market/investment/docs/legal_texts/whitepaper/impact_assessment_en.pdf
9	http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52005DC0314:EN:NOT

+ Add another row

Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y ₀	Y ₁	Y ₂	Y ₃	Y ₄	Y ₅	Y ₆	Y ₇	Y ₈	Y ₉
Transition costs	50	0	0	0	0	0	0	0	0	0
Annual recurring cost	10	10	10	10	10	10	10	10	10	10
Total annual costs	60	10	10	10	10	10	10	10	10	10
Transition benefits	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Annual recurring benefits	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total annual benefits	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

* For non-monetised benefits please see summary pages and main evidence base section



Microsoft Office
Excel Worksheet

Evidence Base (for summary sheets)

Background

UCITS stands for undertakings for collective investments in transferable securities. UCITS is an EU Directive which sets out common rules for EU investment funds (including rules on investment policy, risk management and investor disclosure). Funds which meet these rules may be marketed across the EU based on home state authorisation.

The UCITS Directive came into effect in the United Kingdom in 1988 and aimed to offer greater business and investment opportunities for both industry and investors by integrating the EU market for investment funds. The UCITS Directive sets out a harmonised regulatory framework for investment funds that invest in certain classes of assets, providing high levels of investor protection and a basis for the cross-border sale of these funds.

The UCITS Directive has been key to the development of the European investment fund industry. At the end of 2009 the assets under management of UCITS funds were slightly above EUR 5 trillion representing 75% of all investment funds assets in Europe. Total investment fund assets represented 55% of the European Union's GDP at end 2009 and about 10% of European households' financial assets.

Problem under consideration

A July 2005 Commission Green Paper identified the following shortcomings in the existing UCITS legislative framework which caused significant inefficiencies in the EU investment fund market:

- **Obstacles to functional and geographical specialisation** – A management company passport would allow a UCITS to appoint a management company in another Member State, or to allow a management company to establish a UCITS in another Member State. Provisions for a Management CP were introduced in 2002, yet have not functioned in practice. As a result, fund managers had in effect to establish management companies in the domiciles of each of their funds. This creates a lack of organisational flexibility and increases administrative costs.
- **Sub-standard investor disclosure** – The Simplified Prospectus was intended to ensure retail investors could easily identify and understand key information about the fund pre-contractually. However, the document has in practice often been too long and complex and failed to enable effective comparisons between UCITS funds, ultimately leading to an increased potential for mis-sales.
- **Proliferation of funds of a sub-optimal size** – The European fund market is characterised by a high number of funds of small size: 65% of all funds manage less than €50 million in assets, and the average size of a UCITS is a fifth of that of an American counterpart. Economies of scale have thereby not been exploited, increasing costs for investors. The efficiency of (cross-border) business is furthermore hampered by the difficulty of merging funds (cross-border), or pooling the assets of funds.
- **Bottlenecks and failures with the product passport** – Notification procedures for cross-border marketing (where the management company directly notifies each host Member State authority) have often been cumbersome, time-consuming and expensive, at odds with the intention for a simple notification process and, crucially, raising costs. Significant differences across Member States in their requirements have hindered competition and the development of a single market in investment funds.

Rationale for intervention and policy options

After detailed consultation, a 2006 Commission White Paper concluded that the UCITS Directive was no longer sufficient to support the European fund industry as it restructures to meet new competitive challenges and the changing needs of European investors. Core elements of the Directive did not function effectively. It does not allow fund managers with funds or activities in different Member States sufficient flexibility to organise or restructure businesses. These inefficiencies and constraints are reflected in higher costs and lower returns that are borne by the fund investors. Given these failings with the UCITS legislative framework, the White Paper proposed making a number of targeted reforms to the UCITS Directive.

On 13 July 2009, the EU adopted a reform of the UCITS Directive. This recast Directive is commonly referred to as UCITS IV and repeals the previous versions of the UCITS Directive (in its consolidated form of 2002 known as UCITS III). On 1 July 2010 the Commission completed a programme of

improvements to the EU framework for UCITS funds by adopting four implementing acts (two Directives and two Regulations) which provide more detailed rules. UCITS IV must be transposed into UK law by July 2011. This is an EU Directive and the UK has a treaty obligation to implement it into national law by the required deadline. Although it is a minimum harmonisation Directive, it allows Member States little flexibility in how it should be implemented and, as such, HM Treasury has made no substantive policy choices in its drawing up draft legislation for consultation

Policy objective

UCITS IV introduces a number of targeted reforms to the UCITS Directive with the objective of updating the legislative framework to facilitate a fully integrated European investment fund market that is able to meet the challenges posed by global competition and adjust to recent structural changes to the EU financial market. Specifically these reforms look to improve the UCITS market by removing market inefficiencies, improving investor protection and developing a true single market in investment funds.

- ***Removing market inefficiencies*** – Allowing for the consolidation of the UCITS fund market so that it can benefit from greater economies of scale, by facilitating mergers between UCITS funds and providing for asset pooling through 'master-feeder structures.
- ***Increasing investor protection*** – Improving pre-sale disclosure by replacing the simplified prospectus with the more investor-friendly Key Investor Information
- ***Developing a true single market in investment funds***–Strengthening single market freedoms, by removing administrative barriers to the cross-border marketing of UCITS, introducing a management company passport and improving supervisory cooperation, thereby enabling the fund industry to serve EU and global investors more efficiently.

Benefits

UCITS IV is expected to deliver major competition, efficiency and consumer protection benefits. Both Investors and Industry have generally welcomed these reforms and the new protections and business opportunities it offers. The benefits of this Directive are extremely difficult to quantify because the scale of these benefits depends on the uptake of the new opportunities by the industry, which, at this stage, it is not possible to forecast. However, based on previous Commission impact assessments, industry reaction and our understanding of the proposals, we would estimate that the long term benefits for the industry will be significant and could outweigh the potential costs of implementing this Directive. The Directive also introduces important improvements to investor protection through improved disclosure and supervisory cooperation which will enhance the effectiveness and reputation of the UCITS framework and provide significant benefits to both the industry and investors.

- ***Management Company Passport*** – Currently, management groups need to establish a fully functional authorised management company in each country where they domicile a fund: these must satisfy costly local substance requirements. This pushes up costs and prevents scale and specialisation gains. UCITS IV introduces a management company passport which allows a UCITS to appoint a management company in another Member State, or a management company to establish a UCITS in another Member State which should significantly reduce these unnecessary costs. UCITS IV is expected to deliver major competition, efficiency and consumer protection benefits. Both Investors and Industry have generally welcomed these reforms and the new protections and business opportunities it offers.
- ***Simplified Notification Procedure*** – Before marketing a fund in another Member State, the UCITS Directive requires the fund manager to file extensive documentation with the relevant national regulator and wait for up to two months while the latter verifies compliance with local marketing rules. The deadline of two months is not always respected. Cases have been reported where it has taken eight to nine months to complete the notification process. There are few identifiable benefits from the present notification system. It is a pure cost for market participants. It severely hampers the roll-out of new products across the single market. UCITS IV introduces a new streamlined approach which makes it easier for UCITS funds to access other Member States by removing host regulators' right to vet funds before they start marketing. This should reduce administrative costs, enhance the single market and improve investor choice.
- ***Mergers***– UCITS market is populated by funds of sub-optimal size. Consequently, important economies of scale remain unexploited and the end investor bears unnecessarily high costs. In the absence of a facilitating EU framework, fund mergers are complex, time consuming and expensive –

where at all possible. Cross-border fund mergers are faced with particular hurdles – arising from differences between national legal and supervisory arrangements. UCITS IV provides an improved mechanism for UCITS funds to merge, both within a country and cross-border, allowing for the consolidation of the UCITS fund market which should benefit from the resulting economies of scale.

- **Master-Feeders** – Asset pooling through master-feeder structures allows simultaneous management of assets gathered by different funds – while maintaining a local fund presence in different target markets. The skills and costs of successful management teams can be spread over a wider pool of assets. Pooling is increasingly used in some Member States, and master-feeder structures are now common for other types of fund in many jurisdictions, so their introduction within the UCITS Directive framework should enable fund managers to organise and manage their funds more efficiently and cost-effectively.
- **Key Investor Information** – The Simplified Prospectus was intended to ensure retail investors could easily identify and understand key information about the fund pre-contractually. However, the document has in practice often been too long and complex, and lacked sufficient harmonisation to enable effective comparisons between UCITS funds, ultimately leading to an increased potential for mis-selling. UCITS IV replaces the simplified prospectus with the more investor-friendly Key Investor Information (KII) document which will increase investor protection by providing improved pre-sale disclosure and enabling investors to make better-informed investment decisions.

Costs

- **Key Investor Information** – Each UCITS fund/sub-fund will incur the one - off cost of replacing the Simplified Prospectus with a key investor information (KII) document and then the incremental cost of producing and distributing it instead of the Simplified Prospectus.
- **Management Company Passport** – All UCITS management companies, whether or not they choose to use the management company passport, will have to comply with UCITS IV requirements for systems and controls and conduct of business measures. Although the majority of these measures already apply to UK management companies, a review of existing procedures to ensure continued compliance will be necessary.
- **Mergers** – UCITS are prohibited from passing the cost of a merger on to Investors. The full cost of the merger must be borne by the management companies involved.

Risks and assumptions

Tax – A number of measures introduced by UCITS IV, in particular those relating to the management company passport, mergers and asset pooling (through master feeder structures), are affected by the national tax regimes of the home States of both UCITS and management company.

KII – The KII aims to increase investor protection by providing a more streamlined and investor friendly pre-contractual information document to ensure that important information is clearly presented to investors. Limiting the size and content of the KII to make it easier to understand will reduce the amount of information investors are provided with; this could lead to them relying too heavily on certain items of information (such as the synthetic risk-reward indicator) and not fully understanding the features and risks of the fund as a result.

Simplified Notification Procedure – The Simplified notification procedure removes the right of host regulators to vet funds which are passporting into their jurisdiction. This means that the FSA would have less control of inwardly passporting funds marketing funds to UK investors.

Management Company Passport – The management company passport allows the management company and the fund to be based in different Member States. This may cause some operational and supervisory difficulties which could reduce investor protection as; 1) the depository is based in the same member state as the fund and so will have reduced access to the management company; 2) the management company and the fund will be regulated by different supervisors.

Competition

The net effect on competition will depend largely how funds decide to make use of the opportunities provided for by the UCITS Directive. However, we expect that it will most likely have a positive effect on competition. Examples of some of the key drivers are set out below.

Management Company Passport - Ability to access other EU markets directly should drive competition. UCITS IV allows funds to be managed remotely by a management company in another member state which will allow fund managers in other Member States to compete with managers in the jurisdiction in which the fund is domiciled. This should increase competition in the EU fund management market.

Key Investor Information - The Key Investor Information document (KIID) should produce better-informed investors who are more confident and more skilled at buying good-quality investment products, whereas poor value products should be more easily identifiable and so lose market share. It will provide information about risk / reward and charges which should stimulate more competition in these areas. In longer term, familiarity with KII format should make investors more likely to buy a wide range of products, with potential for increased funds under management and better rates of persistency - which in turn leads to lower costs through economies of scale.

Notifications - The improved notification procedure will make it easier for funds to access the market in other Member States which should stimulate greater competition in these markets.

Mergers/Master-feeder – The introduction of improved mechanisms for fund mergers and asset pooling will encourage the consolidation of UCITS funds market. This will affect the number and size of funds in the market and could have an effect on competition in the industry.

Small Firms

UCITS IV does not have any thresholds and so the requirements will apply equally to small firms. There are however several areas, especially in relation to organisational requirements such as the compliance, risk management and internal audit functions, where the arrangements can be proportionate to the scale and complexity of the firm's business. This should mean that the requirements on a small firm are not unduly burdensome although if it wishes to operate (e.g.) a fund with complex risk features it may face higher cost barriers than now. It is generally likely that smaller firms will have a small range of funds (there are a number of UK managers operating only one or two UCITS schemes) and that those funds will typically have relatively few unitholders, which may enable them to save on costs of (e.g.) provision of KIDs.

Analysis of Costs

This analysis considers each of the areas of change within the UCITS Directive in turn. In order to estimate the costs of implementation on the UK industry, we have used figures of 120 firms authorised as UCITS management companies, and 2400 UCITS schemes authorised in the UK (counting both single schemes and sub-funds of umbrellas). There are six firms who currently act as the depositary of an authorised collective investment scheme.

In preparing our estimates of costs to the industry, we have drawn on published data where available, together with information supplied by a limited number of UK asset management firms in response to a short survey which we carried out in the summer of 2010 and then followed up after the consultation period. The costs shown represent average values, but there is a wide range of values in the underlying data reflecting variations in the size of firms and the complexity of their UCITS management operations.

Summary of costs

The table below summarises the total one-off and ongoing costs to firms currently operating in the UK industry and to the FSA. It does not cover the costs to incoming firms and the costs to the FSCS and FOS.

	One-off transition costs (£ millions)		Ongoing annual costs (£ millions)	
	Industry	FSA	Industry	FSA
Management company passport	3.2	<0.05	1.5	0.09

Key investor information	29 – 65	<0.01	3 – 18	<0.01
Fund notifications	0	<0.01	0	<0.04
Fund mergers	0	0	0.01 – 0.05 per merger	0.02
Master-feeder structures	0.6	0	0	0.08
Supervisory co-operation	0	0	n/a	n/a
Total	33 – 69	<0.07	5 – 20	1

Management company passport

Previous attempts having failed to establish the right of a UCITS management company to operate a UCITS authorised in another EEA member State than its own, the revised Directive represents an innovation to the structure of the European funds industry. The right to passport is bolstered by new provisions to harmonise the governance and conduct of business of management companies.

Costs to the FSA

The FSA will incur one-off costs of training and awareness for relevant staff – mainly those engaged in the supervision of authorised fund managers (AFMs), depositaries and their delegates. We assume this will take an average of 3.5 hours per person and involve approximately 200 staff, at a cost of £40,000.

The ongoing costs to the FSA are likely to arise through the need to deal with a higher level of queries and requests for information, both in relation to the rules applying universally to UCITS AFMs and the issues likely to result from the management company passport being exercised. In the latter case, this includes queries from other EEA regulators where a UK AFM is seeking to establish a UCITS in their jurisdiction, and requests for information or involvement in supervisory activities such as ARROW visits. This figure is likely to be low at first but may be expected to rise over time as more firms take advantage of passporting opportunities.

We suggest that for each of the first three years from July 2011, the average annual increase in workload in respect of any firm that decides to exercise passporting rights is likely to be in the area of 35 man-hours per firm, at an annual cost of £1800. We cannot predict what the uptake will be, but if 50 UCITS management companies were to exercise their rights, the total annual cost would be £90,000.

Costs to industry

These costs fall into two categories; those affecting all UCITS management companies (and the depositaries, auditors and administrators of their UCITS funds), and those affecting companies which take the commercial decision to exercise their passporting rights in order to establish a UCITS in another member State.

All AFMs of UCITS schemes will be required to comply with the prudential and conduct of business measures which we are implementing through the SYSC, COBS and COLL Sourcebooks. The greater part of the provisions in SYSC and COBS are based closely on equivalent MiFID standards which (under the FSA Handbook) already apply to UCITS management companies as guidance. In addition, all firms must already comply with the relevant Principles for Businesses, such as Principle 8 (conflicts of interest). Since it appears that the vast majority of AFMs are already complying with this guidance, we expect the costs of treating it as binding rules instead to be immaterial.

There are however some areas of change or innovation. The obligations to establish a formal risk management process, with a distinct (and where possible independent) risk management function, identification and documentation of relevant risks, and regular reporting to senior management, are specific to UCITS management companies. However, we understand that the majority of these firms have already adopted many if not most of the regulatory requirements as a matter of sound business practice. AFMs will nonetheless need to review and in some places adjust their operations and procedures to ensure compliance, but we do not expect this to be a significant burden for firms, especially given the provisions allowing for proportionate application of the rules.

Directive measures also prescribe certain requirements for the measurement of risk in a UCITS portfolio, such as the calculation of global exposure and the assessment of counterparty risk, and also procedures for assessing the value of OTC derivatives. Some of these measures effectively replace those contained in Commission Recommendation 2004/383/EC, which we implemented as rules in 2005.

All AFMs will have to comply with the general requirements for measuring and managing risk, but the extent to which any AFM needs to comply with specific matters (e.g. in relation to OTC derivatives) will depend on the investment objectives and policy of its UCITS funds. We therefore assume that all AFMs of UCITS funds will at least need to review their procedures and revise their risk management process documentation. Depositaries of UCITS funds will also need to review their interactions with the AFM in relation to the oversight of these areas and their role in reviewing the risk management process for each UCITS.

AFMs are also required to document their strategies for the exercise of voting rights in respect of securities held in the fund's portfolio, and to publish and provide a summary of the strategies to unitholders on request. They should also, if asked by a unitholder, provide information about whether and how they voted in relation to a particular issue.

Any estimate of the costs of compliance with these measures is made difficult by the fact that they will vary considerably from one AFM to another, depending on each firm's size, what investment activities it carries on, its structure (e.g. whether or not it is a member of a larger group, extent of its use of delegation) and the sophistication of its existing systems and controls. It is assumed that each firm will incur one-off costs of reviewing its existing procedures and adjusting them where appropriate. We expect an average one-off cost of £20,000 per AFM for this exercise, giving a total of £2,400,000. On an ongoing basis, allowing for the need for periodic review and reporting and responses to queries, we expect a cost of £10,000 per annum per firm, suggesting a total increase in costs of £1,200,000 per annum.

The cost impact of these measures on depositaries will be mitigated to some extent by economies of scale, as similar procedures will apply to all clients, but we expect a one-off cost of £100,000 for each of the six UK depositary firms, giving a total cost of £600,000. We assume ongoing costs of £50,000 per firm per annum, giving a total annual cost of £300,000.

For AFMs which choose to exercise passporting rights, the costs of doing business in another member State are not within the remit of this analysis. Similarly, we will not attempt to quantify the cost to a UCITS management company established in another State of entering the UK market in order to operate a UK-authorized UCITS scheme.

One area that will impact on all UCITS management companies using the passport is the requirement for an agreement with the UCITS depositary governing procedures for ensuring the effective discharge of the depositary's duties and for it to be able to obtain the information it requires. UK depositaries will face one-off costs in preparing model agreements covering all the areas relevant to them. We estimate these costs to be approximately £25,000 for each of the six UK depositary firms, giving a total cost of £150,000. We estimate that the ongoing costs of

maintaining such an agreement will be absorbed within the usual costs incurred by the depositary, for which they are remunerated by the fund or its operator.

We propose that where the existing AFM for a UCITS scheme is replaced by a new AFM established in a different member State, this should be treated as a significant event and notified to unitholders in advance. The cost of such a notification will depend on the number of unitholders, but is likely to be in the range of £5000 to £15,000 per event. It is not possible to estimate how many such notifications are likely to occur in any given period.

Indirect impact

The increase in regulation may act as a deterrent to new entrants to the market who are not able to put in place all the necessary systems and controls from the outset, or who consider that the cost of doing so will not be offset by the advantages to be gained from operating UCITS schemes. We do not think it is possible to quantify this cost.

Management company passport proposals relating to complaints-handling

We set out the CBA in this section in two parts: first looking at application of rules in the DISP module other than those concerning complaints "resolution" and then consider the proposals relating to the provision of referral rights to the FOS.

Regarding the first set of issues, we propose extending the application of DISP in certain respects from "eligible complainants" to all unitholders in a scheme (for example, in terms of firms providing information about their complaints procedures). We also propose to apply similar requirements to incoming EEA management companies operating through a branch in the United Kingdom, but not to those conducting the activity on a cross-border services basis, to whom only complaints reporting rules will apply.

Costs to the FSA

In terms of reporting complaints to the FSA (DISP 1.10), UK management companies operating UK UCITS schemes already have to report this data. Our proposal would mean they would need to include in this data complaints about non-UK UCITS schemes they operate, but it does not affect the method by which they report. The reporting rules also cover certain incoming firms passporting via a branch at the moment, but not incoming firms passporting on a services basis. If a significant number of firms chose to passport inwards on this basis, some systems development work would be required.

Costs to industry

As noted in the CP, some of the changes needed to implement the UCITS Directive changes were included in Chapter 4 of CP10/21. This noted that the Directive requirements reflected what we already expect and require from firms, and that there would not be any increase in costs of more than minimal significance. We do not expect that extending the requirement for complaints information to be provided free of charge to all investors in a fund, as opposed to just eligible complainants,¹ will increase costs by more than minimal significance (as the same information can be provided but omitting material referring to the Financial Ombudsman Service (FOS)).

We are applying similar requirements to United Kingdom branches of incoming EEA management companies. We anticipate that these rules are likely to be applied by the management company's home state, in which case there will be no increase in costs, but if their competent authority takes the view this is a host state matter, the firm will need to extend its

¹ Broadly an eligible complainant is a person who is a consumer, a micro-enterprise or a smaller charity or trust. Investors in UCITS schemes may include other UCITS or institutional investors who would not be eligible claimants.

domestic complaints processes to its United Kingdom branch – again, we would not expect this to generate a material increase in costs.

UK management companies will need to add any complaints received about operating non-FSA UCITS via an outward passport to their current complaints return (as already required under DISP 1.10). We do not consider the costs of doing this will be material. We propose that non-UK management companies using an inwards passport will be subject to DISP 1.10, which is also not a new requirement for firms passporting inwardly via a branch. It would however be a new requirement for firms passporting into the UK on a services basis. CP49 (published in 2000), which imposed the original reporting requirement, reported that when surveyed,

“a large proportion of the returns [from firms] reported that the proposals would create nil, negligible or minimal extra costs over and above internal complaints procedures already in place.”

Since then, changes have been made to the complaints return which simplify it (see CP07/17 in July 2007, which proposed a significant reduction in the data collected).

DISP 1.10A requires a firm to publish a summary of its complaint data if its report to the FSA under DISP 1.10 indicates more than 500 complaints. We do not propose to apply this requirement to incoming UCITS management companies, so no costs will arise. UK management companies already have to comply with this requirement, but under our proposals the summary will also have to include complaints received by a branch of a UK management company in another Member State (if it is passporting outwardly on this basis). We do not believe the costs of including these complaints in the summary data will be material.

Disclosure requirements: our COBS requirements mean that, where a UCITS scheme is sold in the UK, there will be a requirement on the firm involved to disclose information about complaints handling, which would include a reference to the FOS. In many cases, this disclosure will be by an intermediary firm rather than the management company itself. The costs are included in the one-off costs to industry for implementing key investor information.

With respect to our proposals about under which scenarios a complainant should be able to access the FOS, currently an “eligible complainant” may refer their complaint against a UCITS management company in the UK operating an FSA-authorized UCITS scheme to the FOS, where they have complained to the management company and are dissatisfied with the outcome. In the context of the management company passport, we propose that FOS referral rights are additionally made available to eligible complainants in the situations where:

Scenario 1 – an FSA-authorized UCITS is operated by a non-UK management company on a branch basis;

Scenario 2 – an FSA-authorized UCITS is operated by a non-UK management company from outside the UK on a cross-border services basis.

We have also asked whether, in addition to Scenarios 1 and 2 above, FOS referral rights should be made available in:

Scenario 3 – a UK management company operating a UCITS authorized by a regulator in an EEA member State other than the UK, on a cross-border services basis;

We cannot predict how many firms will passport into the UK, so cannot quantify a total cost for the industry. For this reason, the CBA looks to estimate the individual costs these firms will face, the costs for the FSA and the FOS, and to analyse the benefits the market as a whole is likely to experience.

Costs to the FSA and the FOS

We have not identified any significant costs to the FSA. However, costs to the FOS will arise.

Firstly, costs to FOS will arise from dealing with complaints received from eligible complainants in UCITS schemes. These will include consideration of the complaint, and the costs of contacting the management company and obtaining information as part of the investigation.

It is reasonable to assume that the costs to the FOS of dealing with a management company without a physical presence in the UK (scenarios 2 and 4 above) may be higher than where the firm has an establishment in the UK. In its 2009/10 Annual Review, the FOS identified its "unit cost" (total costs before financing and bad debt divided by number of cases completed) as £555. However, it is difficult to predict the level to which the FOS unit cost might increase for dealing with non-UK management companies, as it will depend on the nature and complexity of the complaint and the firm's level of co-operation.

In scenarios 1 and 2, many complaints will relate to UK UCITS scheme rules contained in the FSA Handbook; whereas in scenarios 3 and 4, the FOS may be called on to make judgements related to rules laid down in other EU States to implement the UCITS Directive, which could potentially be more difficult. Again, it is difficult to predict the extent to which the FOS unit cost might increase.

Secondly, costs to FOS will also arise from operational changes required to prepare the service to respond to jurisdiction changes, if scenarios 2 and 4 are covered. Currently FOS has a simple compulsory jurisdiction which covers financial services provided in or from branches in the UK. FOS handles almost one million enquiries a year, and if scenarios 2 and/or 4 are to be covered, frontline staff would need to be re-trained so they can accurately describe the service's jurisdiction to consumers (e.g. over the phone).

As an initial preliminary estimate, FOS suggest they would incur initial costs of £20,000, and then ongoing costs of £3500 a year to achieve this. The initial costs would include the necessary knowledge transfer, systems and training costs; and the ongoing costs would include training new recruits and transferees and maintaining the expanded knowledge systems and controls.

Costs to industry

Management companies will be subject to FOS levies and case fees. The 2010/11 general levy for industry block 5 (fund managers) is £200; for industry block 6 (operators, trustees and depositaries of collective investment schemes) it is £50. The 2010/11 FOS case fee, payable by a management company for the fourth (and each subsequent) chargeable case, is £500.

We understand that complaints about collective portfolio management represent a very small part of the FOS's current workload. For example, for the year ended 31 March 2010, FOS classified 192 new cases about "unit trusts", and a similar number for open-ended investment companies, out of a total of 163,012 new complaints, although some of these would have related to – for example – mis-selling by intermediaries rather than complaints against the management company itself.

Management company passport proposals relating to investor compensation

In this section, we assess the likely impacts of the proposed introduction of rules, requiring UCITS management companies authorised in another EEA member State, who passport into the UK, to participate in the Financial Services Compensation Scheme (FSCS).

Where a UCITS management company has been determined to be in default, and all the valid conditions for a compensation claim are met, the FSCS currently provides coverage with respect to an FSA-authorised management company managing an FSA-authorised UCITS scheme.

The proposal is to extend FSCS coverage so that in addition to the current coverage, UCITS management companies authorised in another member State, who passport into the UK to operate an FSA-authorised UCITS scheme, will also be covered when they have been determined to be in default and a valid compensation claim arises in respect of the operation of their FSA-authorised UCITS schemes.

We cannot predict how many firms will passport into the UK, so cannot quantify a total cost for the industry. For this reason, the CBA looks to estimate the individual costs these firms will face, the costs for the FSA and the FSCS, and to analyse the benefits the market as a whole is likely to experience.

Costs to the FSA and the FSCS

Information will be required from incoming UCITS management companies about their tariff base, and if necessary levies must be invoiced and collected. The FSA acts as the FSCS's agent for these activities and the FSCS pays the FSA a fee for so doing. We do not expect the costs of extending these current processes to cover UCITS management companies to be material, but if a significant amount of firms choose to passport, some systems development work may be required.

Costs to industry

Management companies are expected to incur the following types of compliance costs:

Reporting requirements: as explained above, the FSA will contact inwardly passporting management companies to obtain tariff information, and to send and collect invoices where necessary. The relevant tariff information for management companies will relate to the income they earn from the FSA-authorised schemes they are operating ("annual eligible income"), and so we do not expect the costs of obtaining this information to be material for them.

Disclosure requirements: our COBS requirements mean that, where a UCITS scheme is sold in the UK, there will be a requirement on the firm involved to disclose the extent of compensation coverage to the purchaser. In many cases, this will be an intermediary firm rather than the management company itself. The costs are included in the one-off costs to industry for implementing key investor information.

FSCS levies: the FSCS will place each incoming management company into one or more "sub-classes", based on the business it is carrying out, which determine its levy payment.

In respect of the business being carried out by a UCITS management company, the relevant sub-classes are likely to be D1 ("fund management" – relevant FSA permissions: establishing, operating or winding up a collective investment scheme, managing investments) and potentially D2 ("investment intermediation" – relevant FSA permissions: dealing in/arranging investments).

The FSCS levy can be made up of three types of levy: compensation costs, base costs and specific costs. The precise method by which FSCS levies are calculated can be found in the FEES module of the FSA's Handbook, but broadly a firm's share of a levy is based on the amount of business it does.

For 2010/11, the FSCS has announced a levy of £3m for sub-class D1 and £24m for sub-class D2. In 2009/10, initial levies of £4m and £30m respectively were made, with an additional interim levy of £80m also made in respect of sub-class D2. The table below shows, for example "small", "medium" and "large" firms, what their payments towards the 2009/10 FSCS specific and compensation cost levies were:

<i>(levy amounts are</i>	<i>D1</i>	<i>–</i>	<i>specific</i>	<i>and</i>	<i>D2</i>	<i>–</i>	<i>specific</i>	<i>and</i>
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<i>rounded to nearest £100)</i>	<i>compensation costs</i>		<i>compensation costs</i>	
	<i>Income (£)</i>	<i>Levy (£)</i>	<i>Approved persons</i>	<i>Levy (£)</i>
<i>Small</i>	500,000	200	1	1,800
<i>Medium</i>	35,000,000	11,700	25	45,300
<i>Large</i>	100,000,000	33,400	500	905,700

(note: in 2009/10 the tariff base for sub-class D2 was based on the number of approved persons and not annual eligible income, so comparisons with future levies may not be relevant. The population of sub-class D2 includes advisory firms who do not carry out activity regarding the operation of CIS and may have considerably more approved persons than a UCITS management company. The tariff base for sub-class D1 in 2009/10 used "net income" rather than the current definition of "annual eligible income".)

We expect that incoming management companies might face similar costs according to the size of their business. These costs are initially borne by firms who, in the longer term, are likely to pass them on to their customers through higher charges. There will be incremental costs in terms of higher levies in the event of the failure of an incoming management company because of the extension of coverage and investors in FSA-authorized UCITS (likely to be in the main UK consumers) will bear a greater proportion of this cost. The fact that, to date, no valid claim has been received on UK management companies operating FSA-authorized UCITS schemes suggests that such a failure should be a relatively rare event.

Furthermore, in the event of a failure, the scale of any additional increase in levies will be positively related to the size of the business. As the assets of a UCITS scheme are entrusted to an independent depository, this should mean that in the event of a default of a management company, we would not expect material losses to the UCITS scheme to arise as a matter of course.

On the basis of these factors, in the unlikely event of an incoming management company failing, the associated increase in compensation costs due to the scope of the extension is not expected to be significant.

The base costs levy refers to the basic costs of running the FSCS irrespective of its level of activity, and so we would not anticipate our proposals having a material impact on this element of the levy. The specific costs levy depends on the number of claims and the type of defaults: as we expect compensatable events to be rare, there should not be a material increase to this element of the levy either.

Key Investor Information

AFMs are currently required to produce a simplified prospectus (SP) for each UCITS scheme but will need to replace it with a key investor information document (KID) by 30 June 2012.

Costs to FSA

The FSA does not check or pre-approve every SP, and will not do so for the KID either. A copy of every published SP must be submitted to us, and the same rule will apply for the KID; since this is normally done electronically, we do not expect there to be any significant impact in the amount of resource needed to deal with the incoming documents. Similarly, since we take a risk-based approach to the supervision and monitoring of firms' literature, we would determine within our normal budget for such activities whether the implementation of the KID warrants increased attention.

We expect there to be a one-off cost of providing training and awareness for staff dealing with AFMs of UCITS schemes. We have allowed for this in the estimate for costs in relation to the management company passport, as set out above. We assume that there will be some additional internal training needs, so we are budgeting an additional £7000. We also expect

that, during the early period after implementation, the CIS Authorisations team will experience an increase in queries and time spent on UCITS authorisation cases. We estimate this will be in the area of 3.5 man-hours per week for the first 12 months, giving a total of £9000 per annum.

Costs to industry

To quantify the costs of the KID we need to establish the current cost to the industry of producing the SP for all UCITS schemes.

Based on information from a number of product providers, we estimate the current cost of producing a SP for distribution in the UK to be in the range of £500 to £5000 per fund per annum. We believe that relatively few AFMs produce different versions of the SP for different unit classes of the same fund, but to allow for this we can increase the estimated number of funds by 10%. Multiplied by the cost per fund, this gives an overall cost to the industry in the range of £1,300,000 to £13,200,000 for UK production and distribution of the SP.

In addition, numerous UK UCITS schemes use the existing fund passport for marketing in other member States, and accordingly have an SP prepared in one or more official languages of each State. We don't know exactly how many such SPs there are, but will assume that 50% of UK UCITS schemes are marketed in at least one other member State², which we will increase by a further 5% to allow for extra versions for additional unit classes, giving a total of 1320 documents. By increasing the range of the average production cost per fund from £500 - £5000 to £1700 - £6200, to allow for keeping each translation up to date, this gives UK AFMs an overall cost range of £2,200,000 to £8,200,000 for EEA distribution of the SP. Combined with the UK figure above, we get a total in the range of £3,500,000 to £21,500,000; this is the baseline cost range against which the costs of KID should be measured.

The one-off costs of replacing the SP with KID can be broken down into the following categories:

- preparation of text and data, including calculation of the synthetic risk-reward indicator;
- design and formatting of documents;
- consequential changes to other marketing material (including provision of information currently published in the SP which will instead appear elsewhere);
- printing and production costs (including consequential adjustments to functionality of the AFM's own website);
- distribution costs;
- staff training and stakeholder awareness costs.

The first two items will fall to the AFM, who will need a significant amount of resource and lead time to design the new documents, and to prepare text which meets all requirements as to content while being sufficiently concise to fit the prescribed 2-page document size, and sufficiently plain in style to be accessible to the average investor. As part of this, each AFM will have to set up a risk-reward indicator procedure, involving the collection of unit price data and the calculation of the figure.

It is assumed that most AFMs will incur one-off costs in obtaining legal / technical advice for such a project.

The other costs listed will fall on both the AFM and other firms in the distribution chain, such as platforms and financial advisers. AFMs will have to adjust their marketing literature to reflect the introduction of KID, and also possibly to provide supporting information for it such as a glossary of terms or an explanation of essential points not covered in the KID (such as complaints handling and compensation rights). Providers of wrapper products such as ISAs, CTFs and SIPP will also have to adjust their marketing literature, since the KID relates to the fund alone

² This is an average, based on the assumption that the total number of passported funds is smaller but many among that number are marketed in several member States.

and not the wrapper in which it is held. The extension of the transposition deadline until July 2012 should mean that all firms are able to factor these changes into their planning and avoid costs caused by having to discard large quantities of obsolete literature.

In cases where a UCITS scheme offers two or more classes of units for sale to investors, the manager will have to determine whether a separate KID is required for each class, or whether it is possible to take advantage of the representative class provision in the Commission Regulation. It is likely that the more prescriptive KID requirements in relation to unit classes will result in a greater number of different documents being produced for the same number of funds.

Since the use of compendium documents³ will no longer be possible, both AFMs and other firms (such as platforms) will have to adjust the way they fulfil requests for information about a fund or range of funds. Distribution costs will also need to take account of the fact that there are no exemptions from the requirement to provide a KID to every purchaser of units. The current rules allow a SP to be offered (rather than provided) to non-retail clients in certain situations, but these exemptions cannot be carried over to the new regime.

For firms which passport some or all of their UCITS schemes into other member States, the new documents will have to be translated into one or more local languages of that State, in a way that respects the length requirement and plain language principles. In some cases the unit classes used for non-UK distribution will differ (e.g. Euro-denominated classes) so an entirely separate document will be needed.

Taking all these factors into account, we believe it is reasonable to estimate the one-off cost of preparing and publishing a KID for one unit class of one fund, to be distributed in the UK, to be in the range of £5,000 to £15,000. This gives a base cost in the range of £12,000,000 to £36,000,000 assuming one KID per fund. Although it is difficult to know how many different versions will be produced, because of the possibility of using representative classes, we will assume that for 80% of UCITS schemes there are two UK versions of the document, and that for each extra version the cost is £2,500 (the figure is lower since the design and content will be substantially the same as the primary version). This gives an additional 1920 documents at a total cost of £4,800,000, giving an overall one-off cost in the range of £17,000,000 to £41,000,000 for replacing the SP with the KID in the UK.

For funds which are passported in the EEA, we increase the one-off cost to take account of translation costs, resulting in a range of £6,500 to £16,500 per document. Using our assumption that 50% of UK funds are marketed in one other member State, we get a base cost in the range of £7,800,000 to £19,800,000 assuming one KID per fund. Again, although we cannot say for sure how many additional versions will be required for multiple unit classes, we will assume every notified UCITS offers two versions of the KID and that each second version costs £3,500, resulting in a total cost of £4,200,000. This suggests a total one-off cost to UK AFMs in the range of £12,000,000 to £24,000,000 for replacing the SP with the KID in the EEA. Taken with the UK figure, this gives an overall one-off cost to the industry in the range of £29,000,000 to £65,000,000.

Ongoing costs of maintaining the KID are likely to be more readily comparable with the existing costs of maintaining the SP. The factors affecting costs are likely to be:

- new elements to be disclosed, principally review and recalculation of the SRRI;
- more frequent revision of each document (must be done at least annually, and more frequent changes may be triggered by a material change in the SRRI);
- greater number of documents to maintain;
- shorter length of documents (because of more concise text, omission of data no longer required such as effect of charges tables, portfolio turnover calculation).

³ By this we mean brochures or booklets which provide details of several funds or sub-funds, organised so that (e.g.) the objectives of all the funds appear on the same page.

To take account of these factors, we estimate that the annual cost of producing one KID will be 20% higher than the equivalent annual cost of the SP. Using the same estimate of the number of KIDs to be produced that we took for the one-off costs above, this gives us ongoing costs in the range of £2,300,000 to £23,000,000 for the UK and £4,200,000 to £16,200,000 for the EEA (the latter figure including an amount for translation).

This results in a total ongoing cost in the range of £6,500,000 to £39,200,000 per annum. We can deduct from this our estimate of the current ongoing cost of producing the SP to arrive at the incremental cost of producing the KID. This figure will be in the range of £3,000,000 to £18,000,000 per annum.

We propose to require AFMs to publish, as part of the periodic manager's report, the figure for the synthetic risk reward indicator during the period under review. Since this information is readily available and can be easily integrated into each report, we consider that the costs of the proposal are immaterial.

Fund notifications

The UCITS Directive currently provides a mechanism for a UCITS scheme authorised in any EEA member State to be marketed in any other State, upon notification by the AFM to the host State regulator. The revised Directive will change that procedure so that notification is carried out by the UCITS home State regulator. The host State regulator will lose its right to delay the fund's access to the market while it reviews the notification.

Costs to the FSA

We assume for this exercise that neither we nor any of the host State regulators change the notification fee. It is arguable that the new procedure, which imposes an increased burden on the UCITS home State regulator, should result in UK AFMs being charged a fee by the FSA, but we are not making any such proposal in this consultation.

The FSA will incur both one-off and ongoing costs in relation to this change. The one-off costs relate to the establishing of new procedures (including new forms and changes to our website), training and awareness of staff, informing stakeholders, and liaising with other member State regulators. The costs of training and awareness are captured in the estimate above for the management company passport. We estimate the other activities will require 20 man-days at a cost of £7000.

The ongoing charges relate to the increase in resource needed to deal with incoming notifications by UK AFMs within the ten working days' limit. This may be offset by a limited reduction in the resource needed to process notifications by s.264 recognised schemes. We estimate that an average notification case will require 2.5 man-hours to process. We are unable to quantify exactly the number of notifications we will be asked to make, but if 25% of UCITS funds were to make one new notification in the course of a year, the resource required would be 200 man-days of an administrator's time at an annual cost of £35,000.

Costs to industry

At present, any decision by an AFM to notify one of its UCITS schemes is entirely commercial in nature, but in order for the notification to be effective, certain costs have to be incurred. These include:

- translation of all scheme documents (constituting instrument, prospectus, simplified prospectus, reports and accounts) into a language approved by the Host State regulator;
- preparation of a notification letter (European regulators have agreed a standard format through CESR but can ask for additional information);
- obtaining legal advice and assistance in the host State;

- payment of a fee to the host State regulator.

As part of the process, the UCITS home State regulator must provide an attestation that the fund in question complies with the UCITS Directive. The FSA does not charge a fee for providing this.

A UCITS scheme authorised in another member State that wishes to become a recognised scheme in the UK under s.264 of FSMA must notify the FSA and pay a notification fee of £600. (Such funds must also pay periodic fees, but since those are not affected by the UCITS IV changes they are not within the scope of this exercise.)

Based on information supplied by several product providers, we estimate the current cost of notifying a single UCITS scheme (fund or sub-fund of an umbrella) into one other EEA State to be in the range of £10,000 to £70,000. Once the notification is effective, the operator of a notified fund must provide up to date copies of its scheme documents to each host State regulator. We estimate the ongoing cost of notifying one fund into one other member State to be approximately £5000 per annum.

The revised procedure is intended to be simpler and more harmonised. The notification form is prescribed and cannot be amended or added to by any regulator. The requirement to translate all the scheme documents into an official language of the host State is modified, so that (except for the KID) documents in a language "customary in the sphere of international finance" may be submitted. Since English is accepted to be such a language, this will be beneficial to UK AFMs.

The procedure will also be completed more quickly, since the AFM must send its notification to its home State regulator, which in turn must complete its review and notify the host State regulator within ten working days. This will give the AFM greater certainty about when it can begin marketing, which is important if it intends to begin doing so with a publicity campaign requiring booking of advertising space / airtime, etc.

Taking these factors into account, together with the more flexible rules on translation which should benefit UK AFMs, we think that an AFM should typically be able to achieve some savings in its costs per scheme, although we do not think it is possible to quantify those benefits.

Fund mergers

Although mergers between UCITS established in the same member State are common enough, and mergers between UCITS in different States have always been possible provided terms can be agreed, the Directive now provides a harmonised process for mergers. This process will apply to all cross-border mergers, and to domestic mergers where at least one of the UCITS involved is notified for marketing in another member State.

Costs to the FSA

Each current merger proposal must be submitted to the FSA for approval, and is reviewed and if necessary challenged by a specialist team. In the case of a merging fund, approval is usually given conditionally on the proposal being approved by a meeting of unitholders. The cost of a merger, in terms of FSA staff man-hours, is typically in the range of £200 to £400.

For a domestic UCITS merger, bearing in mind the need to review compliance with the new requirements within specific time limits, we estimate that FSA costs will rise by a little over 10% giving a cost range of £225 to £450 per merger. For a cross-border merger, the increase in costs is likely to be more significant because of the need for liaison between the two regulators. For this reason, we estimate an increase of 50% in time spent per case, giving a cost of £300 to £600 per merger. We do not think it is possible to estimate the number of mergers that will take

place, but if there were to be 20 domestic mergers and 20 cross-border mergers in a year, the upper range of the annual costs would be £21,000.

Costs to industry

The decision to terminate a fund by merging it with another fund is entirely commercial, although in the UK there is a strong preference for terminating a fund in this way rather than winding it up and distributing the proceeds. Since each merger is a one-off process, the costs to industry will arise on a case by case basis. We have not been able to identify any UK funds that have carried out a cross-border merger in the recent past.

The key differences for UK managers under the new process will be:

- obligations to ensure the contents of the merger document and the circular to unitholders conform to regulatory requirements;
- a timetable that (in the case of cross-border mergers) accommodates a period for each regulator to consider and respond to the proposals;
- a need to ensure that where the merging fund is currently notified for marketing in any other member State, the receiving fund is similarly notified in that State;
- a fixed minimum period of notice to allow unitholders at least 30 days in which to request redemption of units before the merger becomes effective; and
- a ban on the costs of the merger being charged to the fund itself.

Merger documents and unitholder circulars are already subject to extensive legal and compliance review, so the cost of ensuring the prescribed details have been included is not likely to be significantly greater. In fact, the prescribed list may simplify the task of preparing the document by eliminating debates about whether certain information needs to be included or not. The longer period needed for carrying out the merger is unlikely to create direct costs, although the AFM will need to undertake careful planning to minimise the indirect costs (e.g. continued expense of running an uneconomic fund, opportunity costs of investments not made).

In the case of cross-border mergers, there is a need to factor in the likelihood that satisfying the requirements of the two regulators involved will increase the amount of time and resource needed, especially if new notifications for cross-border marketing have to be undertaken for the receiving fund. Finally, although it is by no means uncommon for the AFM to bear the costs of a merger, the fact this will become obligatory (even in cases where the unitholders rather than the AFM have proposed the merger) may have a significant impact on the AFM.

It is not possible for us to predict with any certainty what the costs will be, especially since current costs of a merger can vary considerably as they are highly dependent on the number of unitholders involved. Based on a limited sample, we estimate the average current costs of carrying out a domestic UCITS merger (including the involvement of depositaries and auditors) to be in the range of £40,000 to £250,000. Taking all the above-mentioned factors into account, we believe the costs of a domestic UK merger are likely to rise by approximately 20%, giving an incremental cost range of £8,000 to £50,000. For a cross-border merger, we predict the costs will be somewhat higher, although since there is no harmonised procedure at present, there is no baseline cost to compare with so these cannot be said to be incremental costs.

Master-feeder structures

The UCITS Directive has not previously recognised any form of master-feeder structure, under which one fund invests substantially all of its assets into another single fund. UCITS IV establishes the right of UCITS to operate as both feeder and master funds and prescribes the basis on which this may be done.

Costs to the FSA

Any application for the authorisation of a new feeder UCITS, or the conversion of an existing fund into a feeder UCITS, will be submitted to the FSA and considered in the usual way. We estimate the approval of a simple UCITS case, where all the necessary information has been provided, to require up to two days' work, which equates to costs of about £750.

Since it will be necessary for the FSA to take account of some additional complexities, such as the agreements between the funds, their depositaries and auditors, we assume there will be an increase in time spent on this type of case. For a situation where both master and feeder UCITS are UK authorised funds, we estimate the time needed to complete a case to be up to three days' work in total, resulting in a cost of up to £1000 per case. Where one of the funds is authorised in another member State, the workload will be more substantial still and we estimate the time needed to be up to four days, resulting a cost of up to £1400 per case. Although we cannot predict the number of applications, if we were to receive 10 applications for entirely UK structures and 50 for cross-border structures in the course of a year, the upper range of the resulting annual cost would be £80,000.

There will also be some work to be done where a UK-authorized fund becomes the master UCITS of a feeder established in another member State. We estimate that an average case will involve 2 hours of an associate's time, resulting in a cost of about £100. If we were to receive 25 such applications in the course of a year, the resulting cost would be £2500.

Costs to industry

Since any decision to establish a master-feeder structure will be entirely commercial in nature, there are no obligatory costs for AFMs. It is assumed however that depositaries and auditors will need to be able to support such structures in order to secure and retain the business of those AFMs who wish to use them. Since the Directive imposes new obligations in relation to the sharing of information between the respective depositaries and auditors of a feeder UCITS and its master, as well as enhanced reporting requirements, such firms will need to devise appropriate procedures and will incur costs for staff training and awareness.

For depositaries, we estimate that each of the six firms will incur average costs of £50,000 giving a total of £300,000. For auditors, we estimate that approximately ten firms will incur average costs of £30,000 giving a total of £300,000.

Supervisory co-operation

UCITS IV provides for an enhanced framework of co-operation between regulators in member States, specifically in the context of the management company passport but more generally in terms of information sharing. Each regulator is obliged to respond promptly to requests for information or assistance from other regulators, and to be pro-active in identifying issues which may be of interest or concern to other member State regulators and communicating them accordingly.

The FSA expects to absorb the costs of such activities within its usual budgeted responsibilities, so there is no specific cost attached to Directive implementation. Since the FSA's operating costs must be recovered from the fees paid by regulated firms, any significant increase in workload generated by co-operation activities would ultimately be passed on to authorised fund managers. Under our current fees policy, this would be a general cost spread proportionately among the fee-paying base.

For the present financial year (2010/11), AFMs and depositaries are contributing £5.9 million in fees to the FSA, and an amount of £1.7 million is levied from regulated collective investment schemes. Those incremental costs to the FSA that we have been able to quantify in the other parts of this analysis amount to less than £500,000 a year, which would probably be attributable between the two sources of revenue. If additional co-operation costs were to amount to

£500,000 a year it would potentially represent a 5.8% increase in fees which would be payable by AFMs.

Analysis of Benefits

Overall we expect the UCITS IV Directive to provide significant benefits for UK industry and investors. The UK industry played an active role in lobbying for many of these provisions and have broadly welcomed the final Directive.

We do not believe that it is possible to accurately quantify the benefits of this Directive as:

- The benefits will depend substantially on the uptake of the new opportunities by the industry and firms are unwilling or unable to disclose their business plans at this stage.
- It would require data, such as, the number of UK fund passports into other EU jurisdictions and the average cost of running a UCITS management company, which are not readily available and would require disproportionate effort to gather or calculate.
- Many of the most valuable benefits are quite abstract, like the increased EU competition from the improved notification process and the management company passport.

However, we have expanded our analysis of the benefits to include a much wider narrative and have provided illustrative figures for some of the benefits. These figures are based on an informal industry consultation and FSA estimates. They are designed to give some context as to the scale of the potential benefits and are not formal estimates. We have therefore not included them as part of the front page.

The Management Company Passport

Currently, the UCITS Directive requires fund management groups to establish a fully functional authorised management company in each country where they domicile a fund: these must satisfy costly local substance requirements. Based on our informal survey of the industry and data provided by the relevant trade association (the IMA) we estimate that the average annual cost of running a management company per fund is in the range of £100,000 to £1,000,000. There are some 2400 funds based in the UK so the total cost of running a management company in the UK is likely to be within the range of £240 million to £2.4 billion.

UCITS IV introduces a management company passport, which allows a UCITS to appoint a management company in another EEA Member State, or a management company to establish a UCITS in another Member State.

This should significantly reduce costs associated with running management companies by:

- Allowing funds to consolidate management activity. Currently funds will appoint a management company in the same jurisdiction as the fund (as required by the UCITS Directive) but the management company will then typically delegate some of the management activities (e.g. the investment decision-making) to companies in other jurisdictions. Removing the requirement to have a management company in the same jurisdiction as the fund will allow funds to consolidate and use a single management company.
- Increase choice of management companies available to funds which should increase competition and reduce management costs.

The UK industry lobbied for the management company passport during UCITS IV negotiations and have indicated that they believe that it will reduce their costs and provide new business opportunities. Using the management company passport is optional and will be a commercial decision made by funds. The benefits of this provision will depend entirely on the uptake by UK funds / management groups. In order to accurately quantify the benefits of the management company passport we would need to know how many funds intended to use the management

company passport and for what reason (e.g. to consolidate fund management activities or to access new markets). We would also need to understand the anticipated cost saving per fund which will depend on the scale of the uptake but based on their understanding of the industry the FSA estimate that this is unlikely to exceed 20%. We have not been able to get this information as industry are either still developing their plans or are reluctant to disclose this information because they believe it is commercially sensitive. Without this data we cannot accurately quantify the benefits of this measure but have provided an illustrative range of figures to provide some context of potential scale of these benefits:

% saving provided by management company passport	Total cost to UK fund of running management company	Net Saving for industry
0	£240 million to £2.4 billion	0
10	£240 million to £2.4 billion	£24 million to £240 million
15	£240 million to £2.4 billion	£36 million to £360 million
20	£240 million to £2.4 billion	£48 million to £480 million

The management company passport is also expected to deliver major unquantifiable benefits in terms of competition, efficiency and investor protection.

- An improvement in the operational efficiency of some AFMs (e.g. an improved risk management process) resulting in better investor protection through earlier identification and correction of problems, with the possibility of savings in costs as a result;
- An general enhancement of market confidence from the knowledge that all such firms are operating systems and controls of a comparable standard;
- Greater competition in the UK market as management companies from other EEA States seek to establish new product offerings in the UK;
- Ability of UK AFMs to enter other EEA markets, potentially enhancing the international competitiveness of the UK.

Fund notifications

Before marketing a fund into another Member State, the UCITS Directive requires the fund manager to file extensive documentation with the relevant national regulator and wait for up to two months while the latter verifies compliance with local marketing rules. The deadline of two months is not always respected. Cases have been reported where it has taken eight to nine months to complete the notification process. There are few identifiable benefits from the present notification system. It is a pure cost for market participants and severely hampers the roll-out of new products across the single market.

Based on our informal survey of the industry, we believe that the current cost of notifying one UCITS scheme ranges from £10,000 – £70,000 and our best estimate is around £20,000. We do not have any data on the number of UK funds which are currently passported into another Member State but, using the same assumption which we made for the costs of the KID, we estimate that 50% of UK UCITS schemes are marketed in at least one other Member State⁴. Based on these estimate we believe that the total costs of ranges between £12 million and 84 million with our best estimate being £24,000,000

Cost of notification	Number of funds	Total Cost
10,000	1200	12,000,000
20,000	1200	24,000,000
70,000	1200	84,000,000

⁴ This is an average, based on the assumption that the total number of passported funds is smaller but many among that number are marketed in several member States.

UCITS IV introduces a new streamlined approach to fund notification which makes it easier for UCITS funds to access other Member States by removing host regulators' right to vet funds before they start marketing. This should reduce administration and marketing costs, as funds:

- Will no longer have to translate their constituting instrument and prospectus into an official language of the host State;
- Should incur substantially lower costs in employing local legal advisers to assist them in preparing documents for the host State regulator;
- Can plan marketing campaigns to begin as soon as notification takes place (i.e. the uncertainty of when the notification might be approved by the host State regulator is removed from the consideration).

In order to accurately quantify the benefits of this provision we would first need data on the number of funds which are currently passported out of the UK, the number of jurisdictions into which they are passported and the anticipated saving per notification as a result of the UCITS IV notification. We would also need data on the number of new notifications likely to be made as a result of the process being simplified, but this is entirely dependent on commercial decisions by management groups. We have not been able to gather this information but based on estimates by the FSA we have provided an illustrative range of figures to give some context as to the scale of the potential benefits.

% reduction in cost of notifications	Low Cost 12,000,000	Middle Cost 24,000,000	High Cost 84,000,000
5%	600,000	1,200,000	4,200,000
10%	1,200,000	2,400,000	8,400,000
15%	1,800,000	3,600,000	12,600,000

The simplified notification process should also deliver a number of major unquantifiable benefits through enhancing the single market and improving investor choice.

- An increase in the number of funds / classes notified as certain markets become easier to access, resulting in an increase in the number of transactions and a higher level of funds under management;
- improved ability of UK funds to compete effectively with domestic funds in other jurisdictions (since there are already a substantial number of recognised schemes in the UK, we believe that a competitive market exists here already, but it is possible that the new process will encourage more EEA UCITS to access the retail market);
- stimulation to innovation as improved marketing opportunities provide incentives for new product offerings.

Master Feeder

The UCITS Directive places strict limits on the amount of a fund's assets that it can invest in another UCITS. However, UCITS IV will allow a UCITS fund (called a 'feeder' fund) to invest the majority of its assets into another single UCITS fund (called a 'master' fund), in what is referred to as a master-feeder structure. This new structure will allow funds to benefit from economies of scale, reducing costs and increasing returns for investors.

Asset pooling through master-feeder structures allows simultaneous management of assets gathered by different funds – while maintaining a local fund presence in different target markets. The skills and costs of successful management teams can be spread over a wider pool of assets. Pooling is increasingly used in some Member States, and master-feeder structures are now common for other types of fund in many jurisdictions, so their introduction within the UCITS

Directive framework should enable fund managers to organise and manage their funds more efficiently and cost-effectively.

There are currently no master-feeder UCITS structures and we have no information as to how what the uptake of this structure is likely to be amongst UK funds. Nor is it possible to predict whether take-up of such structures will result in UK funds under management being reduced as UK funds become feeders of master UCITS in other EEA jurisdictions, or whether the reverse will be true. We are therefore unable to quantify the benefits of this proposal for the UK industry but we believe that, depending on the scale of the uptake of this model, the benefits are potentially significant for the following reasons:

- a stimulus to innovation as firms take advantage of greater regulatory flexibility to launch feeder funds or to adapt existing funds to become master funds;
- improved competition as AFMs will be able to establish feeder funds in other member States and link them to an existing fund, thus increasing the number of investment opportunities available in such markets;
- lower-cost funds, as feeders will have relatively low operational costs and the pooling of their assets into a master will create economies of scale that should be reflected in lower costs to the master's investors; in addition, key investor information will present the combined costs of feeder and master to investors, thus incentivising them to keep the combined costs low enough to be competitive with other non-feeder products;
- an increase in quantity and quality of transactions as investors take advantage of new investment opportunities.

Key investor information

A quantification of the benefits of replacing the simplified prospectus with key investor information (KII) might start from the basis that the contribution of regulatory information to an investor's decision-making process can be quantified against other elements such as pure marketing literature, commentary by (e.g.) journalists, and financial advice (from professionals or other trusted sources). Although data is available from work carried out by the FSA in 2009 on the percentage of simplified prospectuses that were found to be effective (only 5 out of 34), from which it might be concluded that the impact of the document on the decision-making process was probably low, it is not possible to be more precise about this.

Since it is clearly not possible to discriminate in this way, another possible approach would be to assume that improved information about a fund would result in a quantifiable increase in the number of consumers investing in it. This would be dangerous as, although on the one hand better-quality product information might make a fund more attractive by explaining its benefits more clearly, conversely it might reveal problems (such as a high level of risk or poor past investment performance) that had been omitted, understated or obscured before. Consequently, a reduction in the number and value of purchases of that fund would arguably be a quantifiable benefit (although even then, such an analysis might be simplistic since it makes assumptions about the drivers of investor decisions). We do not have sufficient data or adequate tools to undertake any kind of analysis as to what level of beneficial increase or decrease, if any, could be expected in the number or value of UCITS transactions as a result of the introduction of KII.

A better measure might be persistency of the holding of the investment, which is used as a regulatory indicator since poor persistency is a common indicator of mis-selling or poor comprehension of the product. If KII were already being used as a disclosure tool for other products it might be possible to read across from available data, but since KII is entirely new it is not possible to carry out any ex-ante analysis of persistency rates.

Consequently, it is only possible to indicate unquantifiable benefits, among which:

- a clearer and shorter document should prompt more consumers to read KII than did so with the simplified prospectus and results in them having a better understanding of individual fund features (as borne out by the consumer research undertaken by the European Commission on the KII prototype)
- consumers should improve their ability to make comparisons between funds and select a suitable product for their needs
- more transparency around product features (total charges, risk and reward) and performance history should drive stronger competition among product providers to develop new products to fill gaps in the market (such as funds with a lower level of volatility) or to make existing products more attractive (e.g. by reducing charges).

Fund mergers

The original European Commission proposal for UCITS IV cited various statistics in relation to the size of UCITS funds. It suggested that 54% of all European UCITS had a value of less than €50 million, a size regarded as sub-optimal. More recent (2009) figures for the UK industry indicate that of the 2400 UK funds, 50% are less than £60 million in size. The Commission also notes that there is a considerable disparity between the total expense ratios of very small funds and very large funds, because of economies of scale in relation to fixed cost elements (although it may be noted that management fees, which are generally the largest single cost element in the TER, are typically calculated on an ad valorem basis so do not affect this equation significantly).

It is not possible to estimate a particular number of small funds that can be expected to merge as a result of the proposals except by carrying out a detailed study looking at such aspects as who runs them, what sector they are invested in, and what other funds (whether in the UK or other jurisdictions) might represent a suitable "match". This leaves aside any other complexities (such as fiscal considerations) that might make an otherwise attractive merger proposition unviable in practice. Fund mergers in the UK are most frequently triggered as a result of consolidation between management companies, rather than fund-specific considerations.

Other unquantifiable benefits may include opportunities for innovation where managers establish a new fund and are able to merge existing funds into it more cheaply and simply; and a potential reduction in consumer detriment from the improvements in information disclosure before the merger, and statutory rights of redemption without charge.

Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. If the policy is subject to a sunset clause, the review should be carried out sufficiently early that any renewal or amendment to legislation can be enacted before the expiry date. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

Basis of the review: [The basis of the review could be statutory (forming part of the legislation), i.e. a sunset clause or a duty to review, or there could be a political commitment to review (PIR)];

N/A

Review objective: [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?]

N/A

Review approach and rationale: [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach]

N/A

Baseline: [The current (baseline) position against which the change introduced by the legislation can be measured]

N/A

Success criteria: [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives]

N/A

Monitoring information arrangements: [Provide further details of the planned/existing arrangements in place that will allow a systematic collection of monitoring information for future policy review]

N/A

Reasons for not planning a review: [If there is no plan to do a PIR please provide reasons here]

The Commission has stated its intention to make further reforms to the UCITS Directive with regard to the roles and responsibilities of UCITS depositaries and expects to publish these proposals in spring 2011. We will make arrangements to review the UCITS Directive once these changes have been implemented

Add annexes here.