

UCITS



The Definitive Guidebook to UCITS IV Funds

Helping you set up and run UCITS IV Funds



As one of the leading specialists in the fund industry we understand the issues that are most important when dealing with UCITS funds. This guidebook aims to provide a clear and helpful analysis of the advantages of UCITS funds and how they operate. We trust that by using this guidebook you will be equipped for the challenges of managing a UCITS fund, or that you will simply be better placed to decide whether a UCITS fund is right for you.



INTRODUCTION



This Guidebook has been put together for managers and investors alike. It is our second edition, the first having run out of prints very quickly. This second edition is fully updated with available information on the implementation of the new UCITS IV directive. It provides an overview of the legal and regulatory framework under which UCITS funds must operate, including guidance as to the key regulatory amendments introduced with the launch of the UCITS IV Directive as of 1 July 2011.

As one of the leading specialists in the fund industry we understand the issues that are most important when dealing with UCITS funds. This Guidebook aims to provide a clear and helpful analysis of the advantages of UCITS funds including innovative principles of UCITS IV funds and how they operate. We have now also teamed up with

industry risk professionals Independent Risk Monitoring Limited (IRML) to provide comprehensive and specialist information on everything that pertains to UCITS funds.

We trust that by using this Guidebook you will be equipped for the challenges of managing a UCITS fund, or that you will simply be better placed to decide whether such funds are right for you.

In light of the recent developments in the asset management industry, and in particular the increased demand from investors for more regulated, transparent and liquid products, managers of offshore funds are increasingly interested in establishing onshore structures. UCITS funds in jurisdictions such as Luxembourg, Ireland and Malta have made a big impact in the industry and managers are considering the advantages and steps involved in setting up such funds. Investors, fearing the financial complications that left them deprived of their assets following the 2008 crisis, are also keen to buy into structures they can trust, thus increasing the appeal of the UCITS brand.

The UCITS framework offers an appealing combination of transparency and liquidity for investors. With its unique distribution channels throughout the European Union significantly improved as of 1 July 2011, UCITS fund also offers managers a chance to tap into new sources of capital. Some of the largest long only managers have been operating their funds under the UCITS brand for a number of years, helping develop its appeal. A number of absolute return managers have joined them, including the likes of Jabre Capital, GLG Partners, Brevan Howard and Paulson & Co.

Clearly not all absolute return strategies are suitable for a UCITS fund, and managers should pay close attention to the details when deciding to launch a new UCITS product as well as when

choosing a relevant jurisdiction. We help our clients in analysing how their investment strategy may fit in a UCITS fund and in determining whether choosing this route may give rise to further risks, such as counterparty risk. We also assess the benefits of using a platform where this may be relevant to managers uneasy about running their own funds and/or management companies in a new jurisdiction.

This Guidebook is the result of our team work, and combines the knowledge of many experts in their respective fields including Laven Legal Services, Laven Partners, and Laven Financial Services. As such, the Guidebook uniquely combines expertise from lawyers, financiers and compliance experts.

It has been prepared in accordance with Laven's key principles of **Quality, Proactivity and Enthusiasm** and offers a singular view on the UCITS world. We hope you will find this useful as a guide when considering launching a UCITS fund, or as a helpful tool ahead of any investment in a UCITS fund. Do not hesitate to contact any of us should you have any questions.

Jérôme de Lavenère Lussan, CEO, Laven Partners
August 2011

UCITS IV – A NEW ERA OF RISK MANAGEMENT



It is our pleasure to be asked to contribute to this comprehensive booklet on UCITS, and notably to discuss liquidity risk management which is so paramount to the safety of investors. Risk management has never been easy and has had a tendency to be over simplified based on assumptions that are not always realistic.

The calculation of the net asset value at which to issue or redeem shares is based on an optimistic assessment of risks including market liquidity, i.e. the belief that transactions can be settled at or close to the last known trade price without any notable delays or slippage. The obligation for the fund managers and sponsors alike to issue and redeem shares on this basis at any time creates a serious issue which is difficult to manage and which can create serious distortions and asymmetric treatments between the buyers, sellers and holders of the fund's shares. This holds true with the use of value at risk quantitative techniques.

Based on the observation of major systemic liquidity crises there is today a better grasp of the risks arising from the liquidity illusion, according to Arnaud Bervas (Financial Stability Review, Banque de France). However given the uncertainty that surrounds future market conditions, which cannot be satisfactorily measured in terms of probabilities and which can affect liquidation values in critical situations, forecasting remains to be thought of as an illusory task.

This does not mean that quantification techniques should be disregarded. These quantification techniques are relevant in as much as they provide a systematic base for a disciplined framework and for what remains essentially a qualitative assessment process.

Most of the studies and recommendations on liquidity risk do not cover the specific case of open ended funds.

Banks tend to rely on techniques of asset-liability management which they apply to assessing liquidity risk supplemented with stress testing. Similar analyses for funds are more difficult to develop. A general approach using scenario analysis would allow the construction of multiple scenarios for market movements over a given period of time. However, creating scenarios for redemptions under various market circumstances is a far more difficult exercise.

More importantly the fact that a fund with a mix of relatively liquid and less liquid securities would be able to meet large redemptions with its liquid holdings is not an indication that it should do so. The remaining investors in the fund would be unfairly treated, holding a pool of less liquid assets; unless an appropriate haircut reflecting the liquidity risk would have been applied on the redemption price. It results from this that liquidity indicators and liquidity measurements apply at the portfolio level only; and while it is interesting to decompose the liquidity risk at the

position level, the liquidity risk management process cannot solely rest on the principle of having enough liquid assets to meet redemptions.

The impact of a large number of operators selling their relatively liquid assets in extreme situations results in a further deterioration of the illiquidity problem, as observed during the last debt crisis. The mechanism behind partial redemptions in such circumstances is objectionable at best, with early redemptions subsidised by remaining investors.

Against this background, the UCITS IV ambition to better enforce liquidity risk management will be a positive challenge for fund managers. At IRML we will continue to develop and improve indicators and practical tools for monitoring market liquidity and will suggest appropriate processes. However we believe that in the absence of such comprehensive qualitative process and an understanding of their limitations, these indicators can cause more harm than benefits, giving the illusion that because something is measured in some fashion it is controllable and controlled; an issue which is not dissimilar to that of the measurement of market risk.

Yves De Naurois, CEO, Independent Risk Monitoring Limited

CONTENTS

CHAPTER	PAGE
UCITS - THE ADVANTAGES	10
INVESTMENT STRATEGIES	14
HOW TO STRUCTURE A UCITS FUND	19
FUND DOCUMENTS	29
TIMELINE TO LAUNCH A UCITS FUND	35
RISK MANAGEMENT	39
DISTRIBUTION TECHNIQUES	42
ALTERNATIVES - NON-UCITS FUNDS	46
HOW CAN LAVEN HELP YOU?	50
APPENDIX 1: UCITS INVESTMENT RESTRICTIONS	55
DEFINITIONS	61
DISCLAIMER	65

1 UCITS - THE ADVANTAGES

UCITS are Undertakings for Collective Investment in Transferable Securities. A UCITS fund is a European regulated product that is marketable throughout EU Member States. It is open to all investors, including retail investors, and is the most common investment fund type in Europe. The UCITS brand is also recognised internationally, and many UCITS funds are registered in non-European countries such as Switzerland, Hong Kong, Singapore, Taiwan, Bahrain, Chile and Peru.

The UCITS III Directive (as it was commonly known) had its roots in the amended UCITS I directive (Council Directive 85/611/EEC of 20 December 1985), which was amended and adjusted overtime and notably by two main directives: the Management Directive (Directive 2001/107/EC of 21 January 2002) and the Product Directive (Directive 2001/108/EC of 21 January 2002). The UCITS brand continues to evolve notably with the introduction of Directive 2009/65/EC (known as the UCITS IV Directive) which introduced some long anticipated modifications.

ADVANTAGES OF UCITS

UCITS funds offer both managers and investors a number of benefits when compared to the more classic offshore funds. These include benefits with regards to distribution and investment strategies for managers, as well as greater transparency, better risk management and liquidity for investors.

Traditionally UCITS funds were non-sophisticated, being mostly collective investment schemes for plain-vanilla equity and bond strategies. More sophisticated strategies were introduced under the UCITS III Directive which offer investors access to a broader selection of investments and trade a broader array of financial instruments. This will continue under the framework of UCITS IV although a new emphasis will be placed on risk management and controls.

BENEFITS FOR MANAGERS: CROSS-BORDER DISTRIBUTION OPPORTUNITIES

UCITS funds offer distribution opportunities throughout the EU thanks to a simplified and cost effective process known as Passporting. Passporting gives funds significant cross-border marketing and distribution rights, and thereby grants managers greater access to investors' capital. This contrasts heavily with offshore funds which have no Passporting rights and have to register formally in every EU Member State separately under private placement rules if they wish to target certain investors.

The recognised regulated status of a UCITS fund is attractive for retail investors who can rely on a set standard of quality for their funds, as well as for a number of corporate investors, such as pension funds, who may be limited through their own investment restrictions to only invest in regulated funds such as UCITS funds.

The UCITS IV Directive significantly simplifies cross-border distribution for UCITS funds by accelerating and further simplifying the Passport notification procedures in all EU Member States. It also affects the process for the merger of UCITS. The UCITS IV Directive further introduced some key exemptions to the investment diversification limits on single undertakings for collective investment allowing for UCITS funds to be 100% invested in one other UCITS fund thus allowing for a master/feeder structure.

BENEFITS FOR MANAGERS: INVESTMENT OPPORTUNITIES

Managers are increasingly keen to use a wider range of sophisticated alternative strategies within the UCITS framework. UCITS funds with more sophisticated investment strategies are sometimes commonly known in the industry as NewCITS. The term itself is misleading as sophisticated strategies have been available within the UCITS III Directive for some years and continue within the UCITS IV Directive. Perhaps the surge in interest from managers in looking to set up sophisticated UCITS funds after the financial crisis has made this term more accessible for alternative strategies. Some managers may be put off by the UCITS requirements and the need to verify if their strategies are UCITS compatible. UCITS structures allow for a number of strategies to be implemented without unduly prejudicing investment returns. This includes the ability to employ leverage, although in a controlled manner.

KEY SELLING POINTS OF UCITS TO INVESTORS

The true marketability of a UCITS fund stems from a number of key benefits offered to investors. The following summary highlights what often attracts the interest of investors most:

Greater Liquidity

UCITS funds are subject to a regulated liquidity requirement of at least fortnightly dealing with no minimum holding periods. UCITS funds will often have weekly and even daily liquidity and this is one of the strongest advantages of the UCITS framework in relation to investor protection.

Redemption Settlement Periods

The maximum delay from the receipt of a shareholder's redemption request and the settlement of that redemption by a UCITS fund cannot be more than 14 calendar days.

Better Risk Management

UCITS funds provide investors with a detailed risk management framework, which is designed to ensure a minimum level of diversification, and limit exposure to third parties and leverage (which is only possible through the use of derivatives). Every UCITS fund is required to employ adequate risk management processes to measure and monitor risk at all times and it should regularly report to its EU Member State regulator on the types of derivative instruments, underlying risks, quantitative limits and the method of analysing risks in relation to transactions in derivatives. The UCITS fund and/or its Management Company should have in place a detailed Risk Management Policy, which explains how risk management will be controlled.

Better Transparency

UCITS funds are required by EU Member States to report comprehensively to investors on their portfolio holdings and to produce at least a fortnightly net asset value, as well as annual and semi-annual financial reports.

The Prospectus of a UCITS fund must be clear to the investor and must include comprehensive risk warnings, investment restrictions and disclose conflicts of interest. For greater clarity, UCITS funds must also have a Key Investor Information Document (“**KIID**”) in place, replacing the Simplified Prospectus (a previous requirement under the UCITS III Directive). The KIID needs to identify the UCITS fund, include the UCITS fund’s historical performance track record, costs and associated charges, investment risk warnings and a short description of the investment objectives and investment policy.

Investment Restrictions

UCITS funds are required to invest only in defined Eligible Assets (see Appendix I), whilst also maintaining a diversified investment portfolio with set risk management policies. Such policies must be laid out in the Risk Management Policy.

Leverage Limits

UCITS funds have set restrictions on direct borrowing which are different to offshore funds (which have no such restrictions and often will be highly leveraged). Managers have the ability through the use of derivatives to increase the leverage of a UCITS fund up to a total market exposure of 200% of the UCITS fund’s net asset value. However, greater risk management obligations apply to such funds, ensuring an overall commitment to protect investors.

Service Providers

A UCITS fund must always appoint a Custodian (depository) and an independent Auditor authorised and regulated in the EU. The Custodian must be based and regulated in the jurisdiction of the UCITS fund. Depending on the structure, a UCITS fund may be governed by individuals (if incorporated under the form of a self-managed UCITS fund) or it can appoint a Management Company duly authorised and regulated in an EU Member State. The UCITS fund (if self-managed) or its Management Company must show that it has sound administrative and accounting procedures in place to properly administer the UCITS fund. This is usually achieved through delegation of administrative services to a specialist EU regulated Administrator. The introduction of the UCITS IV Directive has put an end to the need to locate the management and administration of a UCITS fund in the same jurisdiction of that UCITS fund. The Custodian and the Management Company are controlling agents and are required by local regulators to monitor the activities of the UCITS fund. They are directly responsible to investors, irrespective of whether they have delegated their duties. The Management Company must not delegate its functions to the extent that it would actually become a “letter box” company. The Custodian also has strict custody requirements, and non-cash assets of a UCITS fund must be segregated.

Promoter

The Promoter of a UCITS fund offers an ultimate financial guarantee to investors for the actions of the Management Company and the UCITS fund. The minimum capital requirement in order to

act as a promoter of a UCITS fund is not set in law but will have to be sufficient to provide added asset protection for the ultimate investors.

FURTHER KEY SELLING POINTS OF UCITS IV TO INVESTORS

The transposition of the UCITS IV Directive into EU national laws as of 1 July 2011 introduced five key modifications in the UCITS regulatory landscape:

Merger of UCITS and Master-Feeder structure

Fund managers will have the opportunity to undertake a strategic reflection on their product range and management structure to pool greater assets and achieve economies of scale, through the merger of UCITS funds irrespective of their legal forms and through master-feeder structures.

Management Company Passport

The Management Company passport will permit the cross-border management of UCITS funds and the centralisation of their asset management, administration and risk management operations.

Acceleration of Cross-Border Distribution through Simplification of Procedures

As explained (see Benefits for Managers: Cross-Border Distribution Opportunities), cooperation and increased information sharing between regulatory authorities will speed up the process of cross-border distribution.

Investor Protection

Transparency is enhanced through the establishment of the KIID. The KIID shall take the form of a short document containing key investor information, the content, form and presentation of which shall be fully harmonised throughout the EU Member States so as to promote clarity and understanding and enhance opportunities to draw direct comparisons between UCITS in various EU jurisdictions.

2 INVESTMENT STRATEGIES

Developments in the UCITS Directive have broadened the scope of Eligible Assets to include derivatives as a main investment strategy (see Appendix I). This has allowed a variety of investment strategies to be introduced within the UCITS framework. As such UCITS funds are not limited to non-sophisticated funds (being long only/plain vanilla strategies), now include sophisticated fund strategies (being alternative funds investing in Financial Derivative Instruments (“**FDIs**”)).

The strategies referred to below provide examples of how the UCITS Directive can accommodate a broad range of investment strategies. The UCITS Directive, and its interpretation, has produced a flexible framework and managers have the option of operating within it without having to significantly compromise on their investment strategies. As with any new fund set up it is nonetheless important to plan ahead and establish that the investment strategy is compatible and that its application is cost effective. As an initial step we encourage managers to work with us to assess their investment strategies through a detailed **UCITS Feasibility Assessment** (see Chapter 9).

UCITS – NON-SOPHISTICATED STRATEGIES

The following are a number of non-sophisticated strategies which can be launched by managers under the UCITS Directive that would qualify as less sophisticated and therefore simpler to run:

LONG ONLY FUNDS

These are funds which exercise discretion and invest with a long bias in traditional Eligible Assets, including:

- Equities;
- Corporate Bonds (including convertible bonds);
- Government Bonds; and
- Money market instruments and deposits.

LONG ONLY INDEX REPLICATING FUNDS

These are funds which seek to replicate the underlying investments of an equity or fixed income market index.

MONEY MARKET FUNDS

These are funds which invest in money market instruments.

UCITS - SOPHISTICATED STRATEGIES

The following are a number of sophisticated strategies (sometimes referred to as NewCITS) which can be launched by managers under the UCITS Directive and for which risk controls will be enhanced:

LONG/SHORT EQUITY

Under the UCITS Directive, Long/Short Equity investment strategies would purchase market listed investments for the long portion of their portfolio and use FDIs for the short portion, thereby avoiding physical shorting which is not permitted. Shorting can be achieved by buying CFDs, swaps or options.

Managers must however bear in mind the following:

- The UCITS fund must not exceed the Coverage Rule (see Appendix I) through the use of FDIs to gain a Net Exposure in excess of 100% of its net asset value.
- The UCITS fund must not have a counterparty risk exposure when investing in over the counter (“OTC”) FDI investments of more than 5% of its net asset value per issuer, or 10% when dealing with any issuer being a bank or a credit institution (see Appendix I).

130/30

130/30 fund strategies are similar to Long/Short Equity strategies, but include an element of long only. The 130/30 reference denotes the purchasing of 30% of the portfolio long and 30% of the portfolio short (through the use of FDIs) and thereby providing a leverage of 60% above the net asset value of the UCITS fund. This strategy is achievable under the UCITS Directive and is also sometimes called 120/20 or 140/40, depending on the weighting of the portfolio.

INDEX TRACKING FUNDS

Index Tracking UCITS funds are those which seek to replicate the composition of an Eligible Index. An Eligible Index must be:

- sufficiently diversified in relation to its invested underlying strategies (i.e. underlying holdings must not be overly correlated to one another);
- an adequately representative benchmark for the market which it refers to;
- liquid and subject to regular rebalancing through a detailed re-balancing methodology;
- calculated in an appropriate manner and published in the public domain; and
- managed independently from the Management Company of the UCITS fund.

The benefit of this specific strategy is that Index Tracking UCITS funds do not strictly have to

comply with the maximum 10% concentration limits when dealing with one issuer of an underlying investment. The EU Member State regulator may permit this limit to be raised to 20%, or if justified even 35%, where the investment policy of the Index Tracking UCITS fund is to replicate an Eligible Index which has been approved by the regulator. The ability to create tailor-made Eligible Indices has resulted in a number of managers creating bespoke market indices for their own Index Tracking UCITS fund's investment strategy, which must be independently managed. Hedge fund indices may also be considered as an Eligible Index subject to the EU Member State regulator's approval.

EXPOSURE TO NON-ELIGIBLE ASSETS

Through the use of swaps, Index Tracking UCITS funds can also invest in Non-Eligible assets (such as commodities). This is permitted so long as the Non-Eligible asset is held by the counterparty issuing the swap. The counterparty will then pay the difference in cash on the net return of the asset to the Index Tracking UCITS funds, avoiding the need to physically deliver the Non-Eligible asset to the UCITS fund. As swaps are mostly OTC transactions, managers should be aware that additional valuation policies may be necessary, especially for swaps representing hard to value Non-Eligible assets.

FUND OF FUNDS

UCITS Fund of Funds will generally invest in other UCITS funds and Eligible Undertakings for Collective Investments ("UCIs"). However, UCITS Fund of Funds are also permitted to invest in unregulated investments (like hedge funds) but only up to a maximum of 10% of the total net assets of the UCITS Fund of Funds.

Additionally, managers should note the following rules apply to UCITS Fund of Funds:

- Unlike other strategies, UCITS Fund of Funds may be able to invest up to 20% of their net assets in a single UCITS fund or other Eligible UCI. Where the underlying UCI is an umbrella fund, each sub-fund of that umbrella fund may be regarded as if it were a separate UCI for the purposes of this limit.
- However, a UCITS Fund of Funds may not invest more than 30% of its total net assets in UCIs that are not UCITS funds.
- Each compartment of an umbrella UCITS Fund of Funds may invest in other compartments of the same umbrella structure provided the invested compartment does not in turn invest within the umbrella.
- A UCITS Fund of Funds may not invest in any other fund which invests more than 10% of its assets in other funds (so called "funds of funds of funds").
- To limit any potential double-charging, a UCITS Fund of Funds must disclose management fees charged by the underlying funds in which it invests. In addition, if the underlying

invested funds are under common management, then no subscription or redemption fees may be charged.

- A UCITS Fund of Funds must not acquire more than: 10% of the non-voting shares, debt securities or money market instruments of a single issuing body, or 25% of the interest (e.g. units or shares) of an underlying UCITS fund or Eligible UCI.

Special rules apply to UCITS funds investing almost all of their assets into one UCITS fund (master/feeder structure). For example, the diversification investment restriction and issuer control limited do not apply to master/feeder UCITS Funds.

COMMODITY TRADING ADVISOR ("CTA") FUNDS

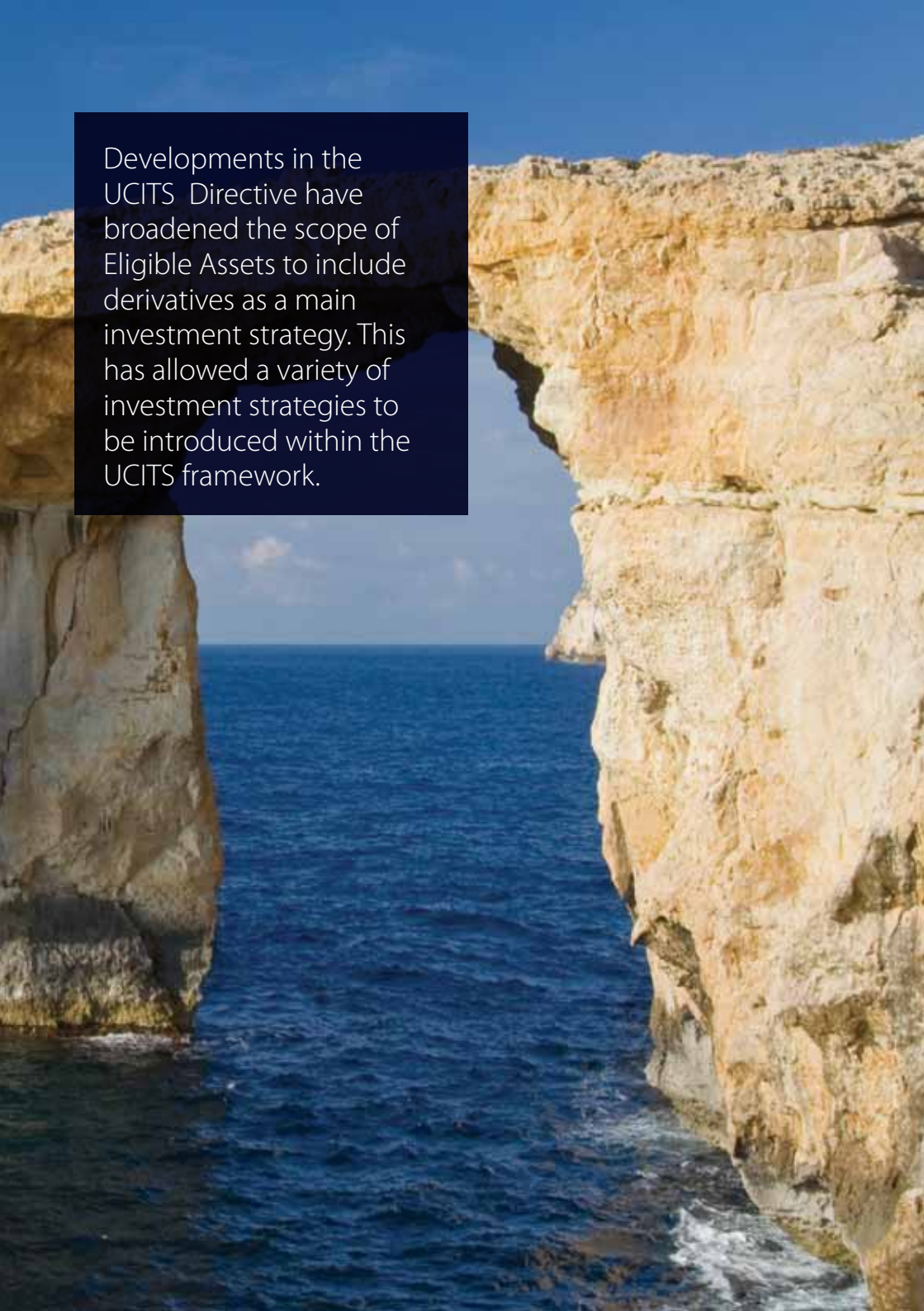
CTA/Managed Futures strategies may be achievable under the UCITS Directive. In circumstances where commodities are included in the overall strategy, which are potentially prohibited in UCITS funds, the following investment techniques can be used as a specific means to gain exposure to commodities without breaching the UCITS Directive.

Investing in Commodities through Exchange Traded Funds ("ETFs")

Managers can invest in ETFs designed to individually replicate the performance of a commodity. An investment in an ETF would mean that the CTA UCITS fund would not directly be exposed to the underlying commodity, and would settle all proceeds from the ETF in cash.

Investing in Commodities through an Eligible Index

For more complicated strategies, managers could choose to create their own Eligible Index (which must be managed by a third party) and which invests in commodities through the use of FDIs. In this case, up to a 35% exposure to an underlying investment can be achieved if the Eligible Index is approved by the EU Member State regulator.



Developments in the UCITS Directive have broadened the scope of Eligible Assets to include derivatives as a main investment strategy. This has allowed a variety of investment strategies to be introduced within the UCITS framework.

3 HOW TO STRUCTURE A UCITS FUND

When contemplating establishing a UCITS fund, managers should have in mind the following key considerations which will be required by any local EU Member State regulator. We are experts in structuring UCITS funds and for more information on how we may assist you please refer to our **UCITS Structuring Services** (see Chapter 9).

SINGLE STRATEGY FUND STRUCTURE

A UCITS fund can be structured as a single strategy fund. The UCITS fund will have one strategy in which all investors will participate. There is some opportunity to vary the offer terms for different investors through establishing different and distinct share classes for example.

UMBRELLA FUND STRUCTURE

UCITS funds can also be structured as multi strategy umbrella funds. Depending on the legal form of the UCITS fund (i.e. a company form) and the laws of the relevant EU Member State, the UCITS fund entity can have multiple investment strategies represented by the different sub-funds (the equivalent of segregated portfolios, cells or compartments). This option allows the UCITS fund to create new sub-funds in the future to cater for different investors and investment strategies over time. In principle the profits, losses and general liabilities of each sub-fund are segregated and the losses of one sub-fund cannot be recouped from the assets of another.

MASTER/FEEDER FUND STRUCTURE

The UCITS IV Directive allows for the use of master/feeder UCITS fund structures, which was previously prohibited under the UCITS III Directive. This development creates another framework for managers to pool greater assets and improve efficiencies as to costs and lower overall expense ratios. Coupled with the existing European Passport, master/feeder UCITS fund structures will improve cross-border marketing opportunities. From a marketing perspective managers may strategically favour establishing feeder UCITS funds in certain EU Member States as opposed to using Passporting rights.

The UCITS IV Directive offers an exemption to the usual investment diversification limits for any feeder UCITS fund seeking to invest at least 85% of its assets in one master UCITS fund. The remaining 15% of the assets, if not invested in the master UCITS fund, can only be used for ancillary liquid investments, derivatives for hedging purposes or movable or immovable property essential for the business of the feeder UCITS fund (e.g. business premises). The master UCITS

fund must have at least one feeder, not hold any shares in any feeder UCITS, must not be a feeder UCITS itself and must not charge the feeder UCITS fund any subscription and/or redemption fees.

Express prior approval of the relevant EU Member State's regulator must be granted prior to a feeder UCITS fund investing into a master UCITS fund. For this purpose a formal application must be provided to the relevant EU Member State regulator and key information must be presented including the rules and fund documentation of the master/feeder UCITS funds, prospectuses and KIDs and the agreement and/or conduct of business rules to be in operation between the master UCITS fund and feeder UCITS fund.

The master UCITS fund and feeder UCITS fund can be in different EU Member States and can have different service providers including different Custodians and Auditors. In this situation however formal information sharing agreements will need to be entered into between the different Custodians and Auditors and these agreements will need to be provided to the EU Member State regulator as part of the application for approval of the master/feeder UCITS fund structure.

MERGER OF UCITS

The UCITS IV Directive introduced a formal process for the cross-border and domestic merger of UCITS. This has offered new opportunities for the cross-border distribution of UCITS funds through effectively being able to re-domicile a UCITS fund to other EU Member States. Further, managers now have new opportunities to consolidate their operations and/or significantly increase the size and assets of a single UCITS fund, potentially creating greater economies of scale. The merger of UCITS funds will involve the transfer of assets and liabilities from an existing UCITS fund or sub-fund to another sub-fund of that same UCITS fund or to a separate UCITS fund (newly created or existing). The interests of the investors will also move with the merger and they will acquire an interest in the new UCITS fund or sub-fund.

The requirements to obtain EU regulatory approval for a merger of UCITS funds and the type, form and clarity of the information to be presented to the EU regulators and investors are subject to uniform rules across the EU. However, specific laws in different EU Member States and the varying requirements of the Constitutional Documentation of the UCITS fund (e.g. its articles of association, trust deed, or management regulations) may dictate the type of merger that can take place.

CUSTODIAN

Safekeeping of the assets of a UCITS fund must be entrusted to a Custodian which must segregate all assets, with the exception of cash. The Custodian is responsible for the day-to-day administration of the assets in accordance with instructions received from the manager or the UCITS fund directly. Depending on the form of the UCITS fund (e.g. a Luxembourg 'Fonds Commun de Placement' ("FCP")), the Custodian will also ensure that the sale, issue, re-purchase, redemption, cancellation and valuation of the units of the UCITS fund are effected in accordance

with the law and the UCITS fund's own rules as detailed in the Prospectus and UCITS fund's corporate documentation. These are some of the points you should consider when appointing a Custodian for a UCITS fund:

- A Custodian must either have its registered office in the EU Member State in which the UCITS fund is situated or it must have a branch in the same Member State of the UCITS fund.
- It must be approved to act as a Custodian to UCITS funds by the relevant EU Member State regulator. For example Luxembourg and Ireland require that Custodians are credit institutions (i.e. banks).
- A Custodian cannot act as a Management Company and Custodian to the same UCITS fund.
- The Custodian can act solely as Custodian, or they can act as Custodian and Administrator.
- The Custodian may be willing to act as a Promoter. However in the current environment, Custodians may be less willing to act as Promoters and therefore managers are seeking to become their own promoters.
- Managers should evaluate the distribution network of the Custodian, and how it may assist the UCITS fund in seeking investor capital throughout the EU.
- Where the Management Company is not based in the same jurisdiction as the UCITS fund, the Custodian and Management Company shall need to enter into a detailed formal written agreement regulating the flow on information necessary to allow the Custodian and Management Company to perform their roles.

Managers should evaluate the IT systems and reporting methods for the custody of the UCITS fund's assets. There are special circumstances which may apply to alter the role of the Custodian. For example in Luxembourg where the UCITS fund is constituted as a contractual mutual fund (e.g. a FCP) the Custodian will have additional functions akin to those of a Management Company. In this case it should ensure that the value of the UCITS funds' units are calculated in accordance with the law and the fund rules, as set out in the Prospectus.

PRIME BROKER

Managers should be aware that the use of Prime Brokers under the UCITS Directive will differ from traditional offshore funds structures. A Prime Broker in an offshore fund will hold a significant portion of the fund's assets, often in non-Segregated Accounts. In a UCITS fund, assets are predominantly held by the Custodian in Segregated Accounts, with limited assets being transferred to a Prime Broker as required, and sometimes on a daily basis, to control the counterparty concentration limits per Prime Broker of the UCITS fund's net assets. The counterparty concentration limits can leave little room to work with. Fluctuations in the market, variations on margin calls and cushions which Prime Brokers may require as a deposit will put a further strain on the counterparty concentration limits.

Unless well structured and planned, it is likely that the use of a Prime Broker in a UCITS fund will create onerous operating and risk management tasks or be prohibited outright. Managers should therefore consider the following when appointing a Prime Broker:

- Can your Custodian provide the services of a Prime Broker? This could simplify the arrangement and reduce the number of parties involved. Furthermore the Custodian will be well informed of the obligations and restrictions on the UCITS fund and will have a vested interest in ensuring the UCITS fund complies with the rules. The manager should ensure that the Custodian will adhere to the segregated account requirements of the UCITS Directive. When negotiating elements of the prime brokerage agreement a restriction on the Prime Broker could be included preventing the rehypothecation of the UCITS fund's assets. We can assist you in reviewing any prime brokerage agreement or custodian agreements as part of our **UCITS Launch Services** (see Chapter 9).
- Alternatively, an account can be opened with an independent Prime Broker, which can operate as a counterparty (including for OTC derivatives). Note that margin calls and counterparty concentration limits may be burdensome for managers to control. To ensure compliance with the UCITS Directive and to simplify operations, managers could look to involve the Custodian and seek to specify restrictions in a tripartite arrangement between the Management Company, the Custodian and the Prime Broker. In particular, an arrangement can be agreed whereby daily margin collateral calls are strictly managed and processed by all parties, so that the counterparty concentration of the UCITS fund with the Prime Broker is not breached. In this way a traditional Prime Broker arrangement can be made to work for a UCITS fund.
- Managers trading different asset classes can also set up a relationship with multiple Prime Brokers (which, in this case, would act more as executing brokers) and thereby spreading the UCITS fund's counterparty risk without prejudicing the investment strategy. In this scenario, the majority of the assets would remain with the Custodian, and would only be transferred to the Prime Brokers at the discretion of the managers.

ADMINISTRATOR

A UCITS fund Administrator processes the net asset value of the UCITS fund and manages the shareholders' register. The Administrator will also act as the fund's registrar and transfer agent and will provide certain shareholder services. These are some of the points you may wish to consider when appointing an Administrator for a UCITS fund:

- Following the introduction of the UCITS IV Directive it may be possible, subject to the relevant EU Member State regulator's approval, for the UCITS fund to appoint an Administrator based in a different jurisdiction to that of the UCITS fund.
- Certain managers may have long-standing relationships with a specific Administrator which is familiar with the manager's operations. The UCITS IV Directive has opened the doors to cross-border fund administration. The pressure is on the Management Companies

to elect an appropriate Administrator that has sufficient skills, expertise and resources to administer a UCITS fund in a cost effective manner in any EU jurisdiction.

- For Administrators it is important to note that they do not necessarily need to use the same IT systems throughout their other offices. You may wish to review whether the IT systems are modern and of a high standard. For those that do not work with UCITS funds you should confirm that they can produce daily net asset values.
- You should ensure that the Administrator has appropriate valuation systems and policies, particularly for the valuation of OTC investments. As per the UCITS IV Directive, the valuation of non-exchange traded investments for a UCITS fund must be provided by both the Custodian and the Administrator.
- You should check that the Administrator conforms to the appropriate accounting standards and it has relevant expertise in valuing the targeted investments of the UCITS fund.
- It is very useful to confirm that information can be easily captured from and exported to third parties (e.g. Custodian / Management Company).
- It is useful for the purpose of business continuation to ensure that the Administrator has sufficiently secured systems and a robust business continuity plan.
- It is increasingly common for Administrators to offer some middle office / risk management controls, and you should check whether this will be advantageous to the operations of the UCITS fund.
- Some Administrators offer Domiciliation Agent services (as described below) and this could be another advantage when selecting an Administrator that is based in the jurisdiction of the UCITS fund.

DOMICILIATION AGENT

The Domiciliation Agent is responsible for providing the registered office address of the UCITS fund, office accommodation and other facilities and will keep all correspondence sent to the UCITS fund as well as arrange for the payment of bills. The Domiciliation Agent must be incorporated and approved in the EU Member State in which the UCITS fund is established.

AUDITOR

UCITS funds must appoint an Auditor to audit their annual reports. The Auditor must also intervene and has certain reporting requirements in the case of errors and breaches of investment restrictions and the calculation of the net asset value of the UCITS fund. These are some of the points you may wish to consider when appointing an Auditor for a UCITS fund:

- It must be an independent Auditor authorised by the relevant EU Member State regulator of the same jurisdiction in which the UCITS fund is established.

- You should check and negotiate the Auditor's fees to ensure they are competitive, specifically regarding additional charges per sub-fund should the UCITS fund be an umbrella structure.
- It is often important to check that the Auditor can work with the relevant preferred accounting standards of the UCITS fund and whether there are any additional costs involved in doing so.

In master/feeder UCITS fund structures it may be possible for the feeder UCITS fund and master UCITS fund to have different Auditors. In such circumstances managers should be aware of the additional requirement for the relevant Auditors to enter into a formal information sharing agreement prior to the investment by the feeder into the master UCITS fund.

MANAGEMENT COMPANY

The Management Company is the entity which has the ultimate responsibility for the management and administration of a UCITS fund and its investments. The Management Company shall oversee the administration function and the distribution function, which is usually delegated to specialist service providers. However prior to any such delegation, the Management Company is required to carry out due diligence in order to determine whether the third party that would perform the outsourced activities can be considered as qualified and capable of undertaking the functions in question. Thereafter, the Management Company is also required to undertake ongoing monitoring of the services provided by the third party. Legally the Management Company will remain ultimately liable for all the delegated activities.

The Management Company of a UCITS fund is in principle established and authorised to provide management services in its European home jurisdiction which need not be where the UCITS fund is domiciled and regulated.

The biggest development introduced by the UCITS IV Directive is the Management Company Passport. Under this Passport, the Management Company can manage UCITS funds established in a different EU Member State to where the Management Company is based. The Management Company can achieve this by establishing a branch in the jurisdiction of the UCITS fund and complying with the local rules of that jurisdiction. Alternatively the Management Company can seek to rely on the supervision and regulation of its own EU Member State regulator without the need to establish a branch in the jurisdiction of the UCITS fund. The Management Company Passport will cover the traditional services that the Management Company provides. A Management Company is responsible for the administration of the UCITS fund and it can delegate this to an Administrator. Therefore the Administrator may no longer need to be domiciled in the jurisdiction of the related UCITS fund. Further, depending on the local rules applicable to the Management Company, it may be possible for the Management Company to appoint an Administrator which is based in a different jurisdiction to both the Management Company and the relevant UCITS fund. The Management Company Passport should promote cross border centralisation of a Management Company's asset management, administration and risk management operations.

Harmonised organisational and conduct of business rules are now applied to Management Companies, closely aligned to the existing rules of the Markets in Financial Instruments Directive ("MiFID"). This now facilitates mutual recognition between European regulators in the context of the Management Company Passport.

In most EU Member States, a regulated Management Company is required to have a "local presence" which usually consists of having a minimum of at least two persons of sufficient repute and experience and authorised by the EU Member State regulator. These individuals are usually referred to as the Senior Managers or Directors. For the purposes of this guide we shall refer to Senior Managers. The Senior Managers must be able to supervise certain "delegated functions", which can include the following:

- Investment management decisions of the Management Company;
- Fund management and accounting services, which are often provided by the Administrator;
- Valuation and pricing methodologies applied by the Administrator, or any other third party;
- Regulatory compliance and risk management;
- Distribution of income to shareholders of the UCITS fund; and
- Marketing.

It is essential that the Senior Managers are directly contactable by the local regulators and in some jurisdictions, as for example in Luxembourg, at least one Senior Manager must be a local resident.

The Senior Managers will help to integrate your operations in the EU Member State through their specialist knowledge of local operations and their contacts with service providers, and will provide a direct access to the local regulator. The Senior Manager can also be appointed as a Director of the UCITS fund or the Management Company. We can assist by providing Senior Managers through our **UCITS Senior Manager Services** or introduce you to local independent Directors (see Chapter 9).

We should note again that a UCITS fund is not required to appoint a Management Company and can elect to be self managed. In such circumstances, it will have to comply with the equivalent EU Member State regulator's conditions for a Management Company when seeking approval, including the preparation of a Business Plan.

DIRECTORS

Directors are key individuals in the structure of a UCITS fund who are required to be authorised and approved by the EU Member State. The experience and reputation of the Directors is often a fundamental consideration for investors when scrutinising fund structures for investment. Directors are ultimately responsible to the investors and will be held to account by the local

regulator on the operations of the UCITS fund. The Directors are responsible for managing the investments, overseeing compliance with the UCITS Directive and monitoring the key service providers to which certain tasks have been delegated. Managers should be aware that any proposed Director will need to provide various documents to the local EU Member State regulator in order to become authorised, including:

- a completed questionnaire (for some EU Member States);
- signed and dated CVs;
- description of their past experience;
- bankruptcy records;
- a signed affidavit confirming the Directors have no previous criminal convictions (including any pending convictions), and sometimes a relevant clean criminal record; and
- a declaration of honour (for some EU Member States).

Most UCITS funds structures will require a number of independent Directors and depending on the EU Member State, some of those Directors may be required to be resident in the EU Member State in which the UCITS fund is established. Ireland, for example, requires two local Directors whereas Luxembourg does not require local Directors.

PROMOTERS

EU Member State regulators require that Promoters of a UCITS fund have a significant capital base. Promoters are expected to compensate for loss caused to third parties by a fault in the management or administration of the UCITS fund. Without a Promoter, a UCITS fund cannot be launched.

EU Member State regulators must be provided with at least the following regarding Promoters for a UCITS fund:

- Sufficient information concerning the Promoter to be satisfied that the Promoter has sufficient expertise and integrity and has adequate financial resources; and
- Details of shareholders, latest audited accounts and details of overseas regulatory status (if any) of the Promoter.

Although a Management Company can be approved as a Promoter to a UCITS fund, managers should bear in mind that this will require a sufficient minimum capital, which varies between EU Member States. For example, in order to be approved as a Promoter in Luxembourg, a company could be required to have a minimum capital holding of as much as EUR 7.5 Million, while in Ireland this is only EUR 635,000. However, please note that following the implementation of UCITS IV as of 1st July 2011 we are expecting significant changes on the Promoter requirements, which, unfortunately at the time of the drafting of this booklet are not yet confirmed.

DISTRIBUTORS

In most EU Member States, units of UCITS funds may be distributed by independent distributors or by the fund's distribution agent (e.g. the Custodian or other financial services institutions) in accordance with the terms of a distribution agreement. The following considerations should be taken into account when preparing a distribution agreement for a UCITS fund:

- Anti-money laundering obligations;
- Controls over any sub-distributors;
- Sales tax and other relevant taxes (negotiating the burden of any applicable tax); and
- Payment of rebates (with regards to the payment of fees and terms).

Establishing the right network of Distributors and ensuring the UCITS fund's rights are properly represented in the terms of the distribution agreements is essential, and should be reviewed and negotiated carefully. We can help review and negotiate these agreements and for more details, please refer to our **UCITS Launch Services** (see Chapter 9).

When contemplating establishing a UCITS fund, managers should pay attention to a number of key considerations which will be required by any local EU Member State regulator.



4 FUND DOCUMENTS

The UCITS IV Directive sets out a number of key documents which are required by EU Member State regulators prior to approving a UCITS fund.

PROSPECTUS

This document is intended to provide sufficient information in order to allow the investor to make an informed decision prior to investing in a UCITS fund. The document will set out details on the investment strategies, objectives, restrictions, risk factors, fees involved, and will detail the process of subscription and redemption. The Prospectus will also identify the Directors, the Custodian, the Administrator, the Management Company and any other third party service provider. The Prospectus will be subject to scrutiny by the local EU Member State regulator and the Directors will be required, especially if seeking a listing, to confirm that the information in the Prospectus is correct. Managers, with the assistance of a legal counsel, should consider the following points for inclusion in the Prospectus:

Valuation Policy

This section should clearly set out the valuation methodologies used by the Administrator in calculating the net asset value of the UCITS fund. It should specifically include how the valuation of 'hard to value assets' will be calculated.

Global Risk - method of calculation

Management Companies of UCITS funds will need to disclose the method used to calculate the global risk exposure of the UCITS fund (i.e. using the commitment approach, relative VaR or absolute VaR). The method chosen will have to reflect the sophistication of investments made by the UCITS fund. For example the commitment approach may not be adequate for UCITS funds using complex investment strategies with a more than negligible exposure to exotic derivatives.

Fees

This section is essential to inform investors of the different levels of fees which will apply to their investment in the UCITS fund, such as:

- the management and performance fees, including the frequency of their payment (monthly, quarterly, annually);
- any applicable Highwatermarks or Hurdle Rates, or a combination of both, which are applicable to performance fees as well as whether Highwatermarks are constant or reset every year;
- whether shares will be issued by Series or will an Equalization methodology be used to ensure the fair treatment of the investor and the manager when determining performance fees; and whether subscription or redemption fees, or any other fees apply.

Feeder UCITS

Feeder UCITS funds will need to include additional compulsory information including a declaration that it is a feeder fund with at least 85% invested in a master UCITS fund, a description of the master UCITS fund and its investment objective and policies, a description of the fee flows between the master/feeder UCITS funds and information summarising the arrangement with the master UCITS fund.

Limitations on Redemptions

There are strict controls on any limitation on redemptions. Subject to the EU Member State regulator's approval and a high standard of corporate governance, UCITS funds may only in very limited circumstances be able to introduce limitations and if justified in order to protect the interest of shareholders in the event of excessive redemptions occurring at the same time. Although provisions are usually included in Prospectuses, one of the main advantages of UCITS is the comfort that is provided by the UCITS Directive and the regulators in the EU that 'gates' will not be applied as they are with with unregulated funds.

Side Pockets

This is another area of concern for investors and is highly restricted and limited under the UCITS framework. Although some Prospectus will include a mechanism under which they can segregate illiquid assets from the liquid assets of the UCITS fund, thereby avoiding detrimental effects to the overall performance, this will be strictly subject to any EU Member State regulator's approval.

KEY INVESTOR INFORMATION DOCUMENT - KIID

Formally under the UCITS III Directive there was a need for UCITS funds to have a Simplified Prospectus as a condensed version of the Prospectus summarising key information in the Prospectus for investors. The Simplified Prospectus would include some additional information, such as the performance history of the UCITS fund, the Total Expense Ratio ("**TER**") and the portfolio's turnover rate. This document was also reviewed and approved by the EU Member State regulator. Through market practise, however, the Simplified Prospectus could often become a complicated and extensive document not achieving the tenet of the UCITS III Directive to provide clear and concise information to the investors.

To counter this development the UCITS IV Directive has now introduced an obligation for UCITS funds to prepare a 'short' document containing key investor information (the "**Key Investor Information Document**" or "**KIID**"). The KIID replaces the requirement for a Simplified Prospectus and a separate KIID must be prepared for each sub-fund within an umbrella UCITS fund and even for each class of shares within a UCITS fund. The KIID provides information to investors in an easy-to-understand format, and should be no longer than a couple of pages so as to facilitate understanding. Key elements of the KIID will need to be kept up-to-date and investors should have free access to the KIID via a website or in paper form at their request. A UCITS fund must also provide the KIID and any amendments thereto, to the relevant EU Member State regulator.

In a clear, concise and non-misleading way the KIID should include the following information:

- the name of the UCITS fund;
- a short description of its investment objectives and investment policy;
- past performance presentation, or where relevant, performance scenarios, costs and associated charges; and
- risk/reward profile of the investment, including appropriate guidance and warnings in relation to the risks associated with investments in the relevant UCITS.

Some investment managers are already seeing the benefits of preparing KIIDs to promote UCITS funds across Europe. The succinct form of document is a major asset for marketing purposes.

Existing UCITS funds subject to the UCITS III Directive must replace their Simplified Prospectus with the KIID by 1 July 2012. We recommend that all Management Companies consider drafting and circulating a KIID ahead of the deadline for the purposes of good governance and potential marketing benefits. We can help review and prepare the KIID and for more detail, please refer to our **UCITS Launch Services** (see Chapter 9).

CONSTITUTIONAL DOCUMENTS

The Constitutional Documents (the articles and memorandum of association, partnership rules or trust deed depending on the structure) of the fund will set out the rules under which the UCITS fund will operate and will stipulate the rights and powers that the Directors/partners/trustees and shareholders/unitholders/beneficiaries will have in relation to decisions regarding the UCITS fund operations. The Constitutional Documents will differ depending on the form of the UCITS fund.

SERVICE PROVIDER AGREEMENTS

UCITS funds need to engage service providers under the following types of service provider agreements:

- Custodian Agreement;
- Administrator Agreement (often appointed as a delegated function of management whose services can include registrar and transfer agent services);
- Auditor Letter of Engagement;
- Investment Management Agreement and possibly an Investment Advisory Agreement;
- Domiciliation Agent Agreement;
- Paying Agent Agreement; and
- Miscellaneous agreements (e.g. distribution agreements, corporate services agreements, etc).

The manager should be aware that a number of these agreements will need to be provided to the local EU Member State regulators as part of the application for authorisation. We can help review and negotiate these agreements and for more details, please refer to our **UCITS Launch Services** (see Chapter 9).

RISK MANAGEMENT POLICY

Management Companies of all UCITS funds or self managed UCITS funds will need to prepare a detailed Risk Management Policy defining a set of measures, limits and procedures that will cover all the risks faced by the respective UCITS fund. The European Securities and Markets Authority (“**ESMA**”) established Guidelines on Risk Measurement and the Calculation of the Global Exposure and Counterparty Risk for UCITS, harmonising the definition of global exposure and setting out detailed methodologies to be followed by UCITS funds.

UCITS funds are no longer required to determine whether they are sophisticated or non-sophisticated however it is their responsibility to select an appropriate methodology to calculate their global exposure based on their risk profile resulting from their investment policy.

They must use an advanced risk measurement methodology supported by a stress testing program such as the Value at Risk approach where:

- they engage in complex investment strategies which represent more than a negligible part of their investment policy;
- they have more than a negligible exposure to exotic derivatives; or
- the commitment approach doesn't adequately capture the market risk of the portfolio.

A UCITS fund must calculate its global exposure on at least a daily basis and where necessary, also carry out intra-day calculations.

The Risk Management Policy should comprise procedures which enable the Management Company or self managed UCITS fund to assess the UCITS fund's exposure to market risk, counterparty risk, liquidity risk and the exposure to all other risks including material operational risks, Coverage Rule breaches, concentration risks, and credit risks.

The Risk Management Policy goes beyond the underlying risks of the UCITS fund. Under UCITS IV, increased focus by the regulators has been put on the risk management functions of Management Companies. Through the Risk Management Policy the Management Company will need to demonstrate to the EU Member State regulator that it has implemented organisational practices and has applied appropriate conduct of business rules that are more akin to the MiFID standards of operations. In particular the Management Company (or self-managed UCITS) will need to demonstrate that it has:


- established procedures for compliance including clear systems of periodic and hierarchical reporting to Directors and / or Senior Managers, proper allocation of risk responsibilities within the Management Company and definitive decision-making practices throughout the Management Company;
- clear policies safeguarding the security, integrity and confidentiality of information;
- a detailed business continuity plan;
- sufficient resources, technologies and staff expertise to properly monitor the activities of delegated functions including evidence of the level of reporting and the frequency of reporting from key delegates such as the Custodian, Administrator, and, where relevant, any third party risk management service provider;
- a compliance office that operates independently (e.g. not linked to trade executions) and whose responsibilities include the monitoring and assessment of the Management Company's risk management policies and procedures;
- an internal auditor that operates separately and independently (e.g. cannot also be responsible for monitoring compliance) who is responsible to periodically conduct an independent internal audit of the risk management functions of the Management Company;
- prescribed procedures in place to manage and control potential conflicts of interest;
- sufficient procedures in place regarding best execution, control of personal account dealing by Management Company staff, order handling and reporting on portfolio transactions; and
- formal client complaints handling policies in place.

The risk management functions must be continually reviewed and any material changes to the Risk Management Policy must be notified to the relevant EU Member State regulator.

We can analyse your risk management policies and assist you to prepare your Risk Management Policy for submission to the local EU Member State regulator as part of our **UCITS Launch Services** (see Chapter 9).

BUSINESS PLAN

Prior to submitting an application to the local EU Member State regulator, a self managed UCITS fund, or its Management Company (where relevant) must compile a detailed Business Plan which includes a clear demonstration of substance. The UCITS fund, or Management Company, must satisfy the regulator that it has adequate policies to comply with the corporate governance requirements.



All UCITS funds will need to prepare a detailed Risk Management Policy. This document should reflect the complexity of the investment strategy of the UCITS fund.

5 TIMELINE TO LAUNCH A UCITS FUND

PRE LAUNCH

FEASIBILITY ASSESSMENT

Knowing whether your investment strategy is compatible with the UCITS Directive is the key starting point. Through a prudent assessment of your investment strategy, we are able to determine whether the proposed fund will conform to the UCITS Directive.

For further information, please refer to our **UCITS Feasibility Assessment** (see Chapter 9).

CHOICE OF JURISDICTION

When choosing an EU Member State jurisdiction, you should consider the following:

Geographical Location

The accessibility of the EU Member State jurisdiction is key, as meetings will need to be held there occasionally and also proximity to your investor base is important. Strategically you may also wish to establish a base in more than one EU Member State taking advantage of the new opportunities to create master/feeder UCITS fund structures under the UCITS IV Directive.

Tax Considerations

Differences here may be minimal, for example UCITS funds established in Luxembourg, Ireland or Malta are lightly taxed or even tax neutral. However Management Companies, being local companies, are usually exposed to tax and as such it is worth considering whether the local EU Member State has systems in place under which comfort on fee flows and transfer pricing between various international companies can be given.

Quality of Service Providers

The quality of service providers in different EU Member States can vary. Recently however a number of the more recognised service providers are extending their operations throughout Europe, taking advantage of the right to establish a light presence in one jurisdiction while providing the bulk of services from their main hubs of operation.

Local Regulatory Requirements

EU Member State regulators will have different regulatory requirements. For example Ireland requires local Directors and a lower capital base for Promoter activities, whereas Luxembourg does not require local Directors but has a higher capital base for Promoter activities.

Language

This is a consideration in relation to a UCITS fund's investor base. It is also a potential factor to consider when liaising with local regulators and service providers, even though most EU Member States in this industry are predominantly English speaking.

For more information, please refer to our **UCITS Structuring Services** (see Chapter 9).

3-6 MONTHS FROM LAUNCH**PROMOTER**

Most EU Member States will require a regulated Promoter to be appointed, which can be the Custodian, the Management Company or a third party institution. It may be necessary to make a separate application at this stage for the Management Company to be approved as Promoter. The capital requirements of the specific EU Member State should be considered as they will vary.

We can assist with the application for Promoter status of Management Companies. For more information please refer to our **UCITS Launch Services** (see Chapter 9).

SHORTLIST SERVICE PROVIDERS

A Custodian, an Administrator and an Auditor are all key service providers a UCITS fund will appoint. Notably the Custodian will need to be authorised and based in the same EU Member State as the UCITS fund. Their fees, their systems and the scope of services are all factors to consider. The ability to segregate assets (Custodian), the valuation methods (Administrator) and the ability to provide the appropriate accounting standards (Auditor) should specifically be taken into account.

ENGAGE LEGAL COUNSEL

Laven Legal Services are specialists in providing practical legal solutions when incorporating a UCITS fund structure. We will assist with preparing key fund documentation, such as the Prospectus, KIID and the Constitutional Documentation of the UCITS fund entity. We will also assist with advising on and negotiating service providers' agreements and preparing the regulatory application for the local EU Member State regulator. For more details, please refer to our **UCITS Launch Services** (see Chapter 9).

1-3 MONTHS FROM LAUNCH**DIRECTORS**

Depending on the structure of the UCITS fund and the EU Member State chosen, there may be a requirement to have a minimum number of Directors (for example, a Luxembourg S.A. fund

requires three Directors) or for those Directors to be local (which is a requirement in Ireland). Directors will need to show sufficient experience and must be of good repute as part of their approval submission process to the regulator.

DOMICILIATION AGENT

The UCITS fund should appoint a Domiciliation Agent which will provide the registered office and office accommodation, and will process any correspondence of the UCITS fund.

FINALISE SERVICE PROVIDER AGREEMENTS

Once service providers have been chosen, the service provider agreements will have to be provided to the local EU Member State regulator. There will also be a need to finalise information sharing agreements between different Custodians and/or Auditors if you are setting up a master/feeder UCITS fund structure. These can, if necessary, be provided in draft form.

BUSINESS PLAN

Prior to submitting an application to the local EU Member State regulator, a Management Company (or a self managed UCITS fund where relevant) must compile a detailed Business Plan which includes a clear demonstration of the substance of the operations of the Management Company. This document will explain the organisational structure of the entity and how it intends to run its operations. It will identify the base of operations, the Directors and their responsibilities (including the frequency of meetings) and the financial projections of the Management Company where relevant.

RISK MANAGEMENT POLICY

The Risk Management Policy will detail the methods in which the UCITS fund will seek to calculate its overall risks so as not to breach the UCITS Directive requirements. It will also demonstrate the risk management functions of the Management Company. EU Member State regulators' requirements regarding the content of a Risk Management Policy shall be in line with the UCITS Directive, CESR Guidelines 10-788 and standards and conditions akin to MiFID standards.

FINALISE THE FUND DOCUMENTATION

The UCITS fund documents being the Prospectus, the KIID, the Constitutional Documents and the other documents referred to above, should be finalised ahead of an application to the local EU Member State regulator.

APPLICATION LETTER/FORM

As part of our **UCITS Launch Services** (see Chapter 9) we will assist in creating the application letter/form which will introduce the proposed UCITS fund to the EU Member State regulator.

Some jurisdictions, such as Ireland, require a form to be completed when making the application. The application letter/form expressly requests that the EU Member State regulator commences a formal review of the UCITS fund, for the purposes of their approval.

SUBMIT APPLICATION

When making an application to the local EU Member State regulator for a UCITS fund launch, managers should include the following:

- Constitutional Documents;
- Prospectus and KIID;
- Details of the service providers;
- Evidence that the Management Company is regulated in its home EU Member State (if the Management Company is based in a different EU Member State);
- Service provider agreements;
- Information sharing agreements (master/feeder structures);
- Investment management agreement (unless the UCITS fund is self managed) with the Management Company;
- Information on the Promoter (including financial statements and evidence of its suitability);
- Directors' details;
- Details of Domiciliation Agent;
- Business Plan;
- Risk Management Policy; and
- Application Letter/Form.

AUTHORISATION PROCESS

Managers should note that the EU Member State regulator will likely provide comments and feedback on the UCITS fund application and may require changes to some of the documents, as a condition for their final approval. EU Member State regulators may take 1-3 months to respond and eventually approve the UCITS fund.

6 RISK MANAGEMENT

Managers of a UCITS fund should be aware that they need to apply a high degree of risk controls to satisfy the regulatory requirements imposed by the UCITS Directive. These controls will be outlined in the Risk Management Policy, which is a key document scrutinised by the local EU Member State regulator as part of the approval process of a UCITS fund. We can assist managers in preparing the Risk Management Policy, and in particular we will focus on the following types of risk and how they affect your UCITS fund's investment strategy.

GLOBAL EXPOSURE

UCITS funds must calculate their global exposure on at least a daily basis and, where necessary and depending on their investment strategy, carry out intra-day calculations. UCITS funds or their Managers should set out an appropriate methodology to calculate their global exposure on the basis of their investment policy, including their use of financial derivative instruments, in their Risk Management Policy, and should calculate their global exposure by using either:

The Commitment Approach

The commitment conversion methodology for standard derivatives is always the market value of the equivalent position in the underlying asset. This may be replaced by the notional value or the price of the futures contract where this is more conservative. By using this approach, the sum of the absolute leverage of the individual positions of the UCITS fund is aggregated at the portfolio level. For example, leverage may be calculated as follows:

Bond futures: number of contracts x notional value of the futures x market value of the cheapest to deliver reference bond.

When calculating global exposure using the Commitment Approach, netting and hedging arrangements may be taken into account to reduce global exposure.

The Value at Risk ("VaR") Approach

The approach measures the maximum potential loss at a given confidence level over a specific time period under normal market conditions. This is achieved through an analysis of VaR which can be broken down as follows:

Relative VaR: this risk calculation is based on the VaR of an unleveraged reference portfolio of the UCITS fund. When this method is applied the Relative VaR limit is set to double the VaR of the reference portfolio in order to ensure a limitation of the global leverage ratio of the UCITS fund to 2.

Absolute VaR: this risk calculation is applied when there is no reference portfolio and is measured at the UCITS fund level instead. An Absolute VaR figure, when calculated, must not exceed 20% of the value of its total net assets.

To calculate VaR, the following should be applied:

99% confidence levels: VaR should be calculated at a confidence level of 99%, with a holding period of 1 month and a historical observation period of no less than 1 year.

Back testing: used to compare the actual portfolio return to the predicted VaR, and which should be carried out at least on a monthly basis subject to always retroactively comparing the daily positions.

Stress testing: used to assess the potential impact of extreme movements in interest rates, currencies and stock markets, and must be carried out at least once a month or whenever market conditions change that would likely affect the test results.

COUNTERPARTY RISK

Counterparty Risk is defined as the risk UCITS funds may face should a counterparty not meet its contractual obligations. The maximum concentration for any stock lending or repurchase agreement made by the UCITS fund is limited to 20% of the net assets of a UCITS fund. For OTC investments, concentration must be limited to 10% of the net assets in the case of a credit institution (bank, etc.) and 5% in the case of non-credit institutions.

The UCITS Directive however allows for a number of alternatives when determining Counterparty Risk. For example, the Luxembourg regulator (CSSF) provides guidance to UCITS funds in the form of a three step approach, and specifies that in the calculation of Counterparty Risk:

- Netting may be authorised;
- Financial assets provided as collateral can be used to reduce the overall Counterparty Risk;
- Appropriate “haircuts”, depending on the type of collateral, can be applied.

CONCENTRATION RISK

Concentration Risk is a diversification risk which UCITS funds must manage when applying their underlying investment strategies. There are prescribed concentration and diversification limits under the UCITS Directive which the UCITS fund cannot breach. This risk is particularly pertinent when a UCITS fund is extensively investing in FDIs.

LIQUIDITY RISK

Liquidity Risk is defined as the risk UCITS funds may face should they be unable to unwind their portfolio's positions at a suitable market price. Notional leverage achieved through the use of FDIs must be carefully managed to ensure that the UCITS fund can at all times adequately cover its obligations.

CREDIT RISK

Credit Risk is defined as the risk UCITS funds may face should one or more of their investment related counterparties fail to meet their own financial obligations. Credit Risk exposure is calculated as the maximum potential loss incurred by the UCITS fund in the event of an investment counterparty defaulting. This can be reduced by obtaining collateral from the counterparty as deposit.

INTEREST RATE AND CURRENCY RISKS

Interest Rate and Currency Risks are defined as the risks UCITS funds may face from currency and interest rates movements.

7 DISTRIBUTION TECHNIQUES

The UCITS brand provides managers with a regulated product of global appeal, which is attractive to retail and institutional investors (e.g. pensions funds). Institutional investors are usually bound by internal policies which are favourable to investing in regulated funds, such as UCITS funds. The UCITS IV Directive has introduced procedures to provide investment managers with unprecedented opportunities to market and distribute their UCITS funds cross-border. Notably the UCITS IV Directive has:

- significantly streamlined the procedures to Passport a UCITS fund;
- established clear processes for the merger of UCITS funds; and
- developed the law allowing for master/feeder UCITS fund structures to be created.

In addition to the European Passport, the UCITS fund retains the right to distribute in non-EU Member States. It can do so on a limited private placement basis, which may avoid the need to register locally, but will likely restrict investments from retail investors. Alternatively it can choose to register with a local regulator, which depending on certain restrictions, will allow access to retail investors outside of the EU. As a globally recognised brand of quality, the process of registration can be streamlined with most international regulators. Some countries like Switzerland have a favourable framework for example when working with approved UCITS funds.

OVERVIEW OF THE PASSPORTING PROCESS

The UCITS IV Directive has simplified the cross-border notification procedures with a view to significantly accelerate the process. Under the simplified process a notification letter needs to be filed in the Home State including a description of how the UCITS fund intends to market itself in the Host State.

The UCITS fund will need to provide supporting documentation (Prospectus, KIID, Constitutional Documentation and the semi-annual and annual reports). Provided the other documents are in a language that is customary to international finance (e.g. English, French, German etc.) then only the KIID would need to be translated into the appropriate language of the Host State. This should save costs and time.

The benefit of the new simplified process is that once the relatively straightforward filing has been completed the Home State regulator will within 10 working days of receipt of the duly completed notification transmit the file (along with an attestation/certificate confirming the UCITS fund is duly regulated in the Home State) to the Host State regulator. Once all the documentation has been sent by the Home State regulator the UCITS fund would be able to market itself in the Host State.

Any subsequent changes to relevant documents must be communicated to the Host State regulator by the UCITS fund directly.

OVERVIEW OF THE UCITS MERGER PROCESS

The UCITS IV Directive has implemented a simplified process for the merger of UCITS funds allowing managers to pool assets, improve cost efficiencies and enter new jurisdictions through cross border mergers. Prior to effecting a merger the merging UCITS fund (i.e. the UCITS fund transferring its assets to another UCITS fund) should submit the following to its Home State regulator:

- information on the terms of the merger setting out the following particulars:
 - a confirmation of the type of merger and of the UCITS funds involved;
 - the background to and rationale for the proposed merger;
 - the expected impact of the proposed merger on the unit-holders;
 - the criteria adopted for valuation of the assets;
 - the calculation method of the share/unit and assets exchange ratio;
 - the planned effective date of the merger; and
 - the rules applicable, respectively, to the transfer of assets and the exchange of units.
- an up-to-date version of the Prospectus and the KIID of the receiving UCITS fund if established in another jurisdiction;
- a statement by each of the Custodians of the merging and the receiving UCITS funds confirming that they have verified compliance of the particulars of the terms of the merger agreed between the merging and receiving UCITS funds; and
- the information on the proposed merger that the merging and the receiving UCITS funds intend to provide to their respective unit-holders.

To facilitate the speed of this process the UCITS IV Directive sets out a detailed time frame in which the relevant EU regulators must respond. For example the Home State regulator of the merging UCITS fund should confirm within 10 working days of receipt of the above information, whether additional information is required.

It is the responsibility of the merging UCITS fund's Home State regulator to immediately share the above documentation with the Host State regulator where the receiving UCITS fund is based. The laws of some EU Member States may require shareholders' approval to the merger. The UCITS IV Directive sets the limit of shareholder approval to a maximum of 75% and national laws may need to be adjusted to meet this limit. Further, investors in the UCITS fund should be permitted to redeem or exchange their investment free of charge prior to the proposed date of the merger.

OVERVIEW OF THE MASTER/FEEDER PROCESS

The UCITS IV Directive has introduced new rules allowing for master/feeder UCITS fund structures. This should promote opportunities for Management Companies to broaden their distribution opportunities throughout the EU. Strategically managers may elect to use this option as an alternative to Passporting a single UCITS fund, benefitting cultural preferences for some investors who are able to invest in a UCITS fund domiciled in their own jurisdiction. Further, this development will allow Management Companies to pool investments and possibly to establish larger more cost efficient UCITS fund structures.

There is an opportunity for existing UCITS funds to reform as a master UCITS fund or feeder UCITS fund to take advantage of this development.

Any master/feeder UCITS fund structure will need to be approved by the EU Member State regulators and the UCITS funds will need to show that:

- The feeder UCITS fund will invest at least 85% of its assets in the master UCITS fund and the remaining 15% of its assets in liquid assets, derivatives for hedging purposes only and/or movable/immovable property necessary for its business.
- The master UCITS fund is a genuine master fund i.e. it is not a feeder itself and does not invest in the feeder UCITS.
- An information sharing agreement has been entered into between the master UCITS fund and feeder UCITS fund. If both UCITS funds share a common Management Company then it is sufficient for the Management Company to implement internal conduct of business procedures to avoid the need for a formal agreement.
- Auditors of the master and feeder UCITS funds (if they differ) have entered into an information sharing agreement.
- Custodians of the master and feeder UCITS funds (if they differ) have entered into an information sharing agreement.

The feeder UCITS fund's prospectus and KIID will need to include sufficient information detailing the master/feeder UCITS fund structure, including confirmation that it is a feeder fund, information on the master UCITS fund, details of any remuneration and/or rebates payable to the feeder UCITS fund. The managers will need to demonstrate to the EU Member State regulators that no double charging between the UCITS master/feeder funds will occur, in particular the master UCITS fund cannot charge any subscription or redemption fees to the feeder UCITS fund.



Luxembourg, Ireland, Malta and other European jurisdictions offer alternatives to UCITS funds which allow managers to have less restricted alternative investment strategies while still offering investors a fund within the European Union with a European standard of company and fund laws.

8 ALTERNATIVES - NON-UCITS FUNDS

Luxembourg, Ireland, Malta and other European jurisdictions offer alternatives to UCITS funds which allow managers to have less restricted alternative investment strategies while still offering investors a fund within the European Union with a European standard of company and fund laws.

LUXEMBOURG NON-UCITS PART II FUND

A Luxembourg non-UCITS Part II fund is a form of alternative investment fund which does not need to meet the criteria of a UCITS fund and is widely used to create alternative investment funds in Luxembourg. Non-UCITS Part II funds can be offered to retail investors however the initial minimum subscription investment must not exceed EUR 125,000 otherwise it will lose its status as a retail fund. These funds are less regulated than a UCITS fund, but are nevertheless recognised as a highly regulated product in the industry. Unlike a UCITS fund, they do not benefit from a European Passport, but a simplified registration process may apply for some EU Member States. There are for example no legislative provisions regarding investment and borrowing rules. The investment and borrowing rules are instead specified in Luxembourg by the CSSF on a case-by-case basis and through the issue of CSSF circulars such as Circular 02/80. Non-UCITS Part II funds offer an opportunity to agree a set of bespoke rules that will apply to the newly created fund, thus allowing the Management Company to negotiate reasonable investment restrictions with the regulator in order to gain the approval of the intended investment strategies.

LUXEMBOURG SIF

The 2007 Law on Specialised Investment Funds (SIFs) allows for the set-up of a regulated European alternative investment vehicle. SIFs, which have been popular, are not open to retail investors and are limited to institutional, professional and any other certified “well informed” investors who must invest a minimum of EUR 125,000. SIF funds are not open to retail investors and cannot benefit from the European Passporting rights of UCITS funds. SIFs have very few investment restrictions imposed on them: for example, there are no limits on leverage or on the types of eligible investments however there is a requirement to maintain a 30% risk diversified portfolio rule. SIFs can be open as well as close-ended and require only an annual calculation of net assets as opposed to a minimum of twice a month as set out under the UCITS Directive. Thus a SIF is an attractive vehicle for investment managers wishing to have a European registered vehicle while using sophisticated investment techniques. SIFs can be launched one month prior to their approval by the CSSF.

IRELAND NON-UCITS RETAIL FUND

Managers employing fund strategies which may not be compatible with the UCITS Directive, but who still want a retail product, can consider a non-UCITS retail fund in Ireland. Provided that the fund has a minimum subscription that does not exceed EUR 100,000, it can be considered as a non-UCITS retail fund. Unlike UCITS funds, this type of fund does not benefit from the European Passport, however a simplified registration process may apply for some EU Member States. A non-UCITS retail fund is slightly less regulated than a UCITS fund and its investment and borrowing restrictions are less stringent, although there are some similarities. For example the non-UCITS retail fund cannot invest more than 10% of its net assets in securities which are not listed or traded on an approved market, cannot invest more than 10% in any one issuer, and cannot borrow more than 25% of its net assets.

IRELAND QIF

Qualifying Investor Funds (QIFs) represent another regulated alternative to the traditional offshore funds. They are limited to sophisticated and institutional investors and require an initial minimum subscription investment of EUR 100,000. QIFs are not open to retail investors and cannot benefit from the European Passport. QIFs are not subject to heavy scrutiny from the Irish Financial Regulator and offer a greater choice of Eligible Assets, where the general leverage and diversification rules of UCITS funds do not apply. They have very few investment restrictions: for instance, QIFs are not subject to investment or borrowing restrictions and there are no diversification requirements except that the QIF fund cannot invest more than 50% in any one unregulated scheme. QIFs can be authorised by the regulator in Ireland in a very short time frame.

MALTA PIF

Professional Investors Funds (PIFs) are Malta's equivalent to Luxembourg SIFs and Irish QIFs. These are lightly regulated with very limited investment restrictions. PIFs are not open to retail investors and can be set up as open- or closed-ended funds. PIFs are unique when compared to SIFs and QIFs, as the Malta Financial Services Authority does not require the service providers of PIFs to be based in Malta. This option is not available for non-UCITS funds based in Luxembourg and Ireland. PIFs divide their investors into three classes: Experienced investors, Qualified investors and Extraordinary investors. Each category has slightly different investment requirements. For example, Experienced investors are required to submit an initial subscription investment of at least EUR 10,000; their class must have an appointed Custodian (who does not need to be based in Malta); and their borrowing is restricted to 100% of the fund's net assets. The Qualified and Extraordinary investors classes, on the other hand, do not need to have a Custodian; their borrowing is practically unrestricted; and their subscription capital requirement is EUR 75,000 and EUR 750,000 respectively.



The Laven companies are some of the industry's largest investment consultancies which can offer fund set up, structuring, regulatory compliance, legal and tax services to asset managers with the time and budget efficiencies that only independent and segregated companies like ours can offer – effectively the only true one-stop shop in this industry.

9 HOW CAN LAVEN HELP YOU?

Laven Partners (London and Geneva) is a global consulting firm focused on the alternative investment industry. Together with Laven Legal Services (London and Luxembourg), a specialised law firm focusing on alternative investments, and Laven Financial Services (Barbados and Luxembourg) we make up a group of independent companies each with their own strengths and expertise but which are able to offer a one-stop-shop solution for clients' regulatory needs from advice to implementation. The Laven companies abide to three key principles; quality, proactivity and enthusiasm. The Laven companies' client base includes a number of international fund management companies in Europe, the USA and Asia representing in excess of USD 60 Billion of assets under management. Laven Partners and Laven Financial Services together form one of the industry's most focused investment consultancies which can offer fund set up, structuring, regulatory compliance and tax services to asset managers with the time and budget efficiencies that only an independent and segregated group like ours can offer.

Laven Partners is also one of the largest dedicated hedge fund due diligence providers, and we offer services to investors through our internationally recognised and certified Independent Process of Operational Due Diligence available with full statistical data online. This gives us a unique insight into the way the operations of funds should be performed, combined with a modern understanding of the demands of the market today.

For UCITS funds, the Laven companies offer the following services:

- UCITS Feasibility Assessment
- UCITS Structuring Services
- UCITS Launch Services
- UCITS Senior Manager Services

UCITS FEASIBILITY ASSESSMENT

Converting absolute return strategies into UCITS funds may be a complicated process, especially for traditional overseas hedge funds. Through Laven Financial Services we provide an in-depth review for managers contemplating structuring their investment strategies as UCITS funds. We can assist with and perform an in-depth feasibility assessment of the investment strategy and of the types of financial instruments which managers wish to use in their investment strategy, in order to assess whether they would fit into a UCITS vehicle. Our expertise on the subject will help managers make the right business move. Our feasibility assessment is based on a detailed review of the portfolio traded and allows managers to understand:

- The eligibility of the assets traded;
- The investment strategy's compliance with applicable laws and regulations; and
- The broad risk management implications of the strategy once it is in a UCITS format.

UCITS STRUCTURING SERVICES

Through the law firm Laven Legal Services we provide advice on the formation of corporate entities including corporate structuring and restructuring. Laven Legal Services advises on all aspects of corporate structuring and specialises in cross border transactional work from both corporate and commercial perspectives, with a focus on the investment management industry. Laven Legal Services provides comprehensive international structuring advice including tax optimisation.

Within Laven Legal Services we specialise in fund incorporation and have a keen insight and understanding of the key issues which should be considered when preparing fund documentation. We work in a focused way and always seek to tailor our advice to your needs. We work closely with managers to determine the type of fund they might need and in which jurisdiction depending on targeted investors and investment policies – delivering the required results. We also consider future ambitions and goals such as listing aspirations, as all these factors influence and guide the manager's choice of jurisdiction and structure. We can also help managers establish a Management Company and assist with relevant levels of authorisation required. We are experts in liaising with the local regulators in the EU including in the United Kingdom, Luxembourg, Ireland and France and are used to working with the relevant government bodies, by being proactive about securing relevant authorisations.

UCITS LAUNCH SERVICES

AUTHORISATION AND ADVICE

The authorisation process for UCITS funds in many EU Member States takes on average around three months from the date of filing, but this will depend on the response time of the local regulator and the completeness of the initial file, which is something we excel in. We project manage the process and liaise with local counsels, regulators and service providers to ensure that our clients receive the correct advice, as efficiently as possible, on the conduct of business rules of each EU Member State. The Laven companies can provide clients with a variety of services in relation to UCITS funds, including:

- Structuring
- Tax Advice
- Operational Advice

- Drafting of Constitutional Documents (including Prospectus and Simplified Prospectus)
- Authorization
- Passporting

We can also assist in preparing and commenting on third party agreements and in particular we have negotiated with numerous service providers (i.e. Prime Brokers, Custodians, Administrators and Distributors) to obtain the right results for our clients. Knowing that the success of our clients is often determined through meeting their commercial objectives in a timely manner, our intention is to offer our expertise and manage the project to ensure prompt delivery at all times.

RISK MANAGEMENT SOLUTION

The containment of risk, often a neglected area, is the key to a sound investment practice as investors and EU regulators are paying closer attention to risk management than ever before. Managers who adopt strong risk governance practices are at the forefront of the investment curve. The challenges in risk assessment today lie in finding a centralised solution to statistical analysis. Our tailored risk management solutions assist clients in meeting the regulatory risk requirements as set out by the ESMA/CESR Guidelines. We may at times work in collaboration with risk management specialists to provide a tailored solution to our clients. We can provide you with:

- Tailored Risk Management Processes;
- Assistance with risk identification and measurement; and
- Risk monitoring and reporting.

Our risk management solution covers producing regular reports on the risk exposures of the portfolio through to assisting with setting up risk management systems and controls. We can develop your risk assessment skills using our proprietary performance review and attribution software built with the investor in mind. Data can easily be populated in CSV format from any prime broker or in-house system. Additionally, we can review your risk assessment processes and make recommendations. We bring together expertise from compliance, investment and risk management professionals to provide you with a comprehensive and practical solution.

UCITS SENIOR MANAGER SERVICES

Laven Financial Services provides Senior Managers in Luxembourg. We can also organise for Senior Managers in other jurisdictions. Our Senior Managers will help to integrate your operations in the EU Member State through their specialist knowledge of local operations, their contacts with service providers, and will provide another contact to the local regulator. They will also oversee a number of delegated functions including investment management decisions, valuation policies and risk management. Laven Financial Services can also introduce you to local independent Directors.

By choosing to work with a Laven company, managers will benefit from a wealth of experience and expertise which will prepare them to set up their activities in Europe's largest fund centres. For further information, please contact us at the following locations

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APPENDIX 1: UCITS INVESTMENT RESTRICTIONS

ELIGIBLE ASSETS

- Transferable Securities (e.g. stocks, bonds) and money market instruments either listed on a recognized stock exchange or dealt on a market which is regulated, operated regularly and is open to the public
- Recently issued Transferable Securities to be dealt on a regulated market within 12 months (pre IPOs).
- Investments in UCITS funds and other eligible UCIs (being collective investment schemes which the EU Member State regulator considers to be of an equivalent standard of recognition to that of UCITS funds).
- Deposits with credit institutions (repayable on demand and maturing in no more than 12 months).
- Financial Derivative Instruments (“**FDIs**”).
- Financial indices (sufficiently diversified and properly listed).
- Repos, reverse repos, swap and forwards (provided that they are used within an Efficient Portfolio Management oversight and are ancillary to the UCITS fund’s investment strategy, and are used mostly for risk management).
- Transferable Securities and money market instruments not listed on a recognized stock exchange or dealt on a market which is regulated (e.g. investments in hedge funds), are allowed, up to a maximum limit of 10% of a UCITS fund’s assets.
- Ancillary liquid assets (cash).

FINANCIAL DERIVATIVE INSTRUMENTS (“**FDI**’S”)

FDIs should be based on an underlying Eligible Asset, and either traded on a regulated market or OTC with institutional recognised counterparties (e.g. foreign exchange swaps, S&P 500 index futures). It is important to note that FDIs on commodities, including non-financial indices, are not considered to be Eligible Assets.

FDIs and OTC FDIs should meet the following criteria:

- They must be cash settled and not result in the delivery or in the transfer to the UCITS fund of assets other than Eligible Assets. Their risks must be adequately captured by the Risk Management Policy of the UCITS fund.

The Laven companies work with a number of international fund management companies in Europe, the USA and Asia representing in excess of USD 60 Billion of assets under management.

- They must be valued accurately and sufficiently verified. For example, according to the UCITS Luxembourg Law of 17 December 2010 (Article 41 (1) g), UCITS funds must apply a “reliable and verifiable valuation on a daily basis for the OTC FDIs” in order to establish a fair value. The UCITS fund will ensure that the valuation:
 - Does not rely on market quotations given by the counterparty.
 - Is based on reliable up to date market value or on a pricing model using an adequate methodology.
 - The UCITS fund remains in all cases responsible for the correct valuation of OTC FDIs through its own valuation systems.

NON-ELIGIBLE ASSETS

Investments either directly or indirectly (i.e. through the use of derivatives) are not generally permitted in the following:

- Property/Real Estate;
- Commodities, including precious metals or certificates representing them, and any other non-financial indices; or
- Private Equity.

Within limits, UCITS funds may however be permitted to gain exposure to the above by investing in a FDI representing the returns of a recognised index.

SHORT SELLING

Physical (uncovered) short selling is not permitted in UCITS funds, although certain synthetic shorting strategies are possible through FDIs.

CONCENTRATION LIMITS

A key investor protection measure of the UCITS Directive is risk diversification or risk-spreading obligations. The concentration limits can be summarised as follows:

DEALING WITH ONE ISSUER – TRANSFERABLE SECURITIES AND MONEY MARKET INSTRUMENTS – 5/10/40 RULE

Generally, no more than 10% of net assets of a UCITS fund can be invested in Transferable Securities or money market instruments issued by the same issuer (“**10% Rule**”).

- Where investments in Transferable Securities and money market instruments each represent more than 5% of net assets of a fund, these investments in aggregate must not exceed 40% (“**40% Rule**”) of the total net assets of the fund (“**5% Rule**”).

- The 10% Rule limit does not apply to:
 - Deposits and OTC FDIs made with financial institutions subject to prudential supervision.
 - Certain Transferable Securities.
 - Investments in other UCITS funds or UCIs.

For Index replicating UCITS funds however, the 10% Rule can be raised to 20% (or, if justified, 35%) whereby the investment policy is to replicate an index recognised by the regulator.

INVESTING IN UCITS FUND OR UCIS

- UCITS Fund of Funds may be able to invest up to 20% of their net assets in a single UCITS fund or other Eligible UCI. Where the underlying UCI is an umbrella fund, each sub-fund of that umbrella fund may be regarded as if it were a separate UCI for the purposes of this limit. This prohibition does not apply to feeder UCITS fund investing almost all of its assets into a diversified portfolio of a master UCITS fund. These restrictions would apply however to the master UCITS fund’s strategy.
- UCITS Fund of Funds may not invest more than 30% of its total net assets in UCIs that are not UCITS funds.
- A UCITS Fund of Funds may not invest in any other fund which invests more than 10% of its assets in other funds (so called “funds of funds of funds”).

DEPOSITS – DEALING WITH ONE ISSUER

- No more than 20% of the UCITS fund’s net assets can be invested in deposits made with the same body.

FDIS AND OTC FDIS – DEALING WITH ONE ISSUER

- Maximum OTC FDI counter party risk exposure is limited to 5% of the UCITS fund’s net assets. This is increased to 10% where the counterparty is a credit institution, i.e. a bank.

OVERRIDING LIMITS – DEALING WITH ONE ISSUER

- No more than 20% of the net assets of a UCITS fund may be invested in any combination of the following with the same issuer:
 - Transferable Securities or money market instruments
 - Deposits
 - OTC FDIs

INCREASING CONCENTRATION LIMITS

These concentration limits may be increased in the following circumstances:

- The 10% Rule can be increased to 35% if the Transferable Securities are issued or guaranteed by an EU Member State or its local authorities, by a non-Member State or by a public international body.
- The 10% Rule can also be increased to 25% for certain debt securities (i.e. bonds) if they are issued by a credit institution whose registered office is situated in an EU Member State and follows applicable regulation (i.e. public supervision). However under the 5% Rule principle, such investments must not in aggregate exceed 80% of the net assets of the fund.

The transferable securities and money market instruments referred to in the above two points shall not be taken into account for the purpose of applying the limit of the 40% rule. However the concentration limits in the increased limit situations above cannot be combined with the normal limits on dealings with one issuer so that exposure to a single issuer exceeds in total 35% of the net assets.

ISSUER CONTROL LIMITS

- A UCITS fund, or its Management Company overseeing a number of funds, may not acquire any voting shares which would enable it to exercise significant influence over the management of an issuer.
- A UCITS fund may acquire no more than the following issuer control limits:
 - 10% of the non-voting shares of the same issuer
 - 10% of the debt securities of the same issuer
 - 25% of the units of the same UCITS funds and/or other UCIs
 - 10% of the money market instruments issued by the same issuer

Other than for non-voting shares, the issuer control limits laid down may be disregarded at the time of acquisition if at that time the gross amount of the debt securities or of the money market instruments, or the net amount of the securities in issue cannot be calculated.

Issuer control limit restrictions do not apply to:

- Transferable Securities and money market instruments issued or guaranteed by EU Member States or its local authorities as well as non-EU Member States.
- Transferable Securities and money market instruments issued by public international bodies of which one or more EU Member States are members (i.e. OECD).

- Shares held in an intermediary incorporated in a non-EU Member State which invests mainly in securities issued by that state and where such holding is the only way in which the UCITS funds can hold these securities.

BORROWING LIMITS

A UCITS fund generally cannot borrow, except under the following borrowing limits. The combined amount of the following borrowing limits may not exceed 15% of the net assets of the UCITS fund:

- To finance redemption requests from its investors, it may borrow up to 10% of its net assets, provided that the loan is on a short term basis.
- Up to 10% of the net assets can be borrowed in relation to the acquisition of immovable property essential for the direct pursuit of its business (i.e. business premises).

Despite the above, UCITS funds can be leveraged up to 100% of its net assets through the use of FDIs. However at all times, the UCITS fund must be in a position to pay back all of its obligations (the “**Coverage Rule**”).

OTHER LIMITS FOR UCITS FUNDS

- A UCITS fund may invest no more than 10% of its net assets in Transferable Securities and money market instruments which are not listed on a regulated market.
- A UCITS fund may not grant loans and acting as guarantor to third parties is not permitted.

DEFINITIONS

Administrator

An entity responsible for administrative tasks such as maintaining statutory books, attending to net asset value calculations and dealing with shareholder/unit holder services for a fund.

Auditor

An entity responsible for ascertaining the validity and reliability of accounting information in relation to the assets and value of a fund. An Auditor to a UCITS fund is an independent entity authorised by the relevant EU Member State of the UCITS fund's domicile to audit UCITS funds.

CFDs

Contracts For Difference are a form of FDI which is a contract between parties in which the value of underlying assets are determined by the contract and the overall value of the contract is determined by the future price movement of the underlying asset.

CESR

Committee of European Securities Regulators partly reformed as ESMA. CESR was responsible for introducing key EU guidance notes notably guidance on Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS - CESR/10-788 guidance note.

Commitment Approach

A risk management approach used by UCITS funds in order to calculate the sum of the absolute leverage of the individual positions of the fund at the portfolio level.

Commodity Trading Advisors (CTA)

An entity registered with the Commodity

Futures Trading Commission in the United States that receives compensation for managing and trading options and futures. Registration for CTAs is done through the National Futures Association in the United States, a self-regulated organisation responsible for reviewing and accepting registrations.

Concentration Risk

The risk UCITS funds must manage when applying their underlying investment strategies.

Constitutional Documents

The documents of a UCITS fund which set out the rules by which the fund will operate. This will include the articles of association, partnership agreement terms, trust deed etc depending on the structure of the UCITS fund.

Counterparty Risk

The risk UCITS funds may face should a counterparty not meet its contractual obligations.

Coverage Rule

A rule whereby a UCITS fund must always be able to cover 100% of its outstanding obligations.

Credit Risk

The risk UCITS funds may face should one or more of their investment related counterparties fail to meet their own financial obligations.

Custodian

A banking institution that holds the securities and other assets of funds and other institutional investors. A Custodian to a UCITS

fund is an independent entity domiciled in the same jurisdiction as the UCITS fund and authorised by the EU Member State regulator of the UCITS fund.

Directors

Key individuals appointed as directors to a fund entity who are ultimately responsible for the investors and will be held to account by the local regulator on the operations of the UCITS fund. They are required to be authorised and approved by an EU Member State.

Distributors

Usually a corporate entity in charge of distributing the units of a UCITS fund in an EU Member State.

Eligible Asset

As referred to in **Appendix I**, Eligible Assets are the prescribed investments authorised under the UCITS Directive in which a UCITS fund can invest subject to certain limits.

Eligible UCIs

Undertakings for Collective Investments which are determined by EU Member State regulators to be an Eligible UCI for the purposes of an investment by a UCITS fund. EU Member States determine Eligible UCIs on the basis that such UCI is subject to an equivalent level of recognition and control to that of a UCITS fund.

Equalisation

An accounting method used to ensure the fair treatment amongst investors and managers regarding the payment of performance fees, whereby the profits and losses can be tracked by way of an additional income or expense accounted to the investor.

ESMA

Formerly CESR, the European Securities and Markets Authority is an independent EU

authority that contributes to safeguarding the stability of the EU's financial industry. It offers guidance notes and sets EU standards of operations.

ETFs

A fund that tracks an index, but can be traded like a stock. ETFs are generally passively managed investments that seek to invest in the exact holdings of an index, and are usually never actively managed. ETFs are traded on stock exchanges and can be bought and sold at any time during the trading day (unlike most mutual funds). Their price will fluctuate from supply and demand, just like any other stock's price.

EU Member State

A Member State of the European Union being any one of the 27 sovereign states that make up the European Union (EU).

European Passport

A passport which allows a UCITS fund to be marketed throughout the European Union.

FCP

Fonds Commun de Placement is a Luxembourgish form of a fund entity that is constituted as a contractual mutual fund.

FDI or Financial Derivate Instrument

A Financial Derivative Instrument (including swaps, futures contracts and options) which is an Eligible Asset under the UCITS Directive. It is a form of contract entered into between parties, the value of which is determined by an underlying asset to which it is linked and specifically the future price movement of that asset.

Highwatermark

The highest value that has been reached by a fund throughout its historical track record. This value is used when determining the

performance fee earned by the manager. Managers usually need to outperform their previous highest value before charging a performance fee.

Home State

The EU Member State in which the UCITS fund has been established.

Host State

The EU Member State which the UCITS fund wishes to distribute to.

Hurdle Rate

The required rate of return above which a manager may charge a performance fee. Should a manager not meet its hurdle rate no performance fee would usually be charged.

Interest Rate and Currency Risks

The risk UCITS funds may face from currency and interest rates movements.

KIID or Key Investor Information Document

A document introduced by the UCITS IV Directive which will provide information in an easy to understand format. KIIDs have replaced the need to have a Simplified Prospectus.

Liquidity Risk

The risk UCITS funds may face should they be unable to unwind their portfolio's positions at a suitable market price.

Management Company

A corporate entity that is responsible for organising, managing, administering and generally attending to the daily operations of a fund. In respect of a Management Company to a UCITS fund, it is an entity authorised by an EU Member State regulator to provide management services to a UCITS fund. The Management Company need not be domiciled in the same jurisdiction as the UCITS fund it manages.

Management Company Passport

A passport which allows a management company the cross-border management of UCITS funds.

Market Risk

The risk UCITS funds may face from losses due to adverse movements in equity, bond, commodity, currency and other market prices.

MiFID

The EU Markets in Financial Instruments Directive 2004/39/EC (as amended).

Net Exposure

Net exposure takes into account the benefits of offsetting long and short positions in a portfolio and is calculated by subtracting the percentage of the fund's capital invested in short positions from the percentage of its capital used for long positions.

NewCITS

Common term used to describe UCITS funds that employ a sophisticated investment strategy.

Paying Agent

Usually a corporate entity responsible for the payment of dividends in an EU Member State as declared by a UCITS fund.

Promoter

A Promoter of a UCITS fund is an entity, with sufficient financial resources, authorised as a Promoter by the EU Member State of the UCITS fund.

Prospectus

A formal written document that describes the securities offered by a fund. In respect to a UCITS fund, a prospectus is a formal written document that is prepared in accordance with the UCITS Directive and approved by the EU Member State regulator. The prospectus

will contain risk warnings and descriptions of the investment strategies, restrictions and policies in order to allow a potential investor to make an informed decision when making an investment in a UCITS fund.

Risk Management Policy

Risk Management Policy is a key document scrutinised by the local EU Member State regulator as part of the approval process of a UCITS fund. It is meant to set out how the UCITS fund will ensure that risk in its investment strategy is controlled and how the Management Company shall manage the risks of its operations.

Segregated Accounts

A separate account created by the Custodian in which the assets of a UCITS fund should be deposited. The assets in a Segregated Account are separate from the assets of the Custodian.

Senior Managers

Individuals, usually with a local presence to the UCITS fund who supervise a number of delegated functions including investment management decisions, valuation policies and risk management controls. They can also be referred to as conducting persons.

Series

Separate classes or series of shares which are created from time to time within a class of shares for new investors in a UCITS fund. Each Series within a class of shares is distinct, and the profits and losses of that Series can be tracked. The creation of Series of shares in a UCITS fund is a method by which each investor is only liable to pay the fees attributable to their specific performance within the UCITS fund.

Simplified Prospectus

A formal document that was a requirement under the UCITS III Directive and has now been replaced by the KIID. The Simplified Prospectus would summarise the full

Prospectus and provide information on the UCITS fund's historical financial performance as well as detailing the relevant fees payable by investors in the UCITS fund. UCITS funds authorised under the UCITS III Directive must replace the Simplified Prospectus with the KIID by 1 July 2012.

Transferable Securities

Shares in companies (or other securities equivalent to shares in companies), bonds or other forms of securitised debt or other negotiable securities which can be bought, sold or exchanged.

UCI

Undertaking for Collective Investments.

UCITS

Undertaking for Collective Investments in Transferable Securities.

UCITS III Directive

Originally based on the UCITS I directive (Council Directive 85/611/EEC of 20 December 1985), which was amended and adjusted overtime and notably by two main directives, being the Management Directive (Directive 2001/107/EC of 21 January 2002) and the Product Directive (Directive 2001/108/EC of 21 January 2002).

UCITS IV Directive/UCITS Directive

The UCITS Directive 2009/65/EC.

Value at Risk (VaR)

VaR is a widely used risk measure of the risk of loss on a specific portfolio of assets. For a given portfolio, probability and time horizon, VaR is defined as a threshold value such that the probability that the mark-to-market loss on the portfolio over the given time horizon exceeds this value (assuming normal markets and no trading in the portfolio) on the given probability level.

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