

## UCITS Mergers and Master Feeder Structures

### Introduction and Background

A number of significant reforms to the UCITS regulatory regime were implemented in July 2011, designed to modernise and enhance the UCITS framework, increase efficiencies for industry participants and reduce operating costs. These reforms were introduced by what is known as the UCITS IV directive, which also consolidated into one piece of legislation all of the previous UCITS legislative measures (with the exception of the 2007 Eligible Assets Directive.)<sup>1</sup>

The UCITS IV directive sought to encourage asset managers to look at new ways of driving efficiency by consolidating their fund ranges. The 2011 amendments to the UCITS regime facilitate the establishment of UCITS master-feeder structures in Europe, both domestic and cross-border. It also provides for domestic and cross-border mergers between UCITS funds.

Ireland is internationally recognised as a leading fund domicile of choice due to its robust regulatory regime and favourable and effective tax environment. Asset managers seeking to rationalize their existing fund structures can avail of the provisions of the UCITS Directive to merge overseas funds into an authorised vehicle established under the favourable Irish regulatory framework, while avoiding the impediments to cross border merger which existed under the previous merger regime. These impediments chiefly related to quorum requirements traditionally imposed by local regulators as a barrier to cross-border mergers. The UCITS Directive prescribes that, where the national laws of a member state require unit-holder approval for the merger, such requirement cannot be set at greater than 75% of the votes actually cast. This restriction on the quorum requirements constitutes a significant step forward in facilitating cross-border mergers of UCITS.

An overview of the merger regime and the requirements for establishing master-feeder structures is set out below.

### Key Steps Necessary in Order to Effect a Merger under the UCITS Directive

Mergers under the UCITS Directive are subject to the prior authorisation by the Central Bank of Ireland (the “**Central Bank**”). The Irish merging fund must provide the following information to the Central Bank for the purposes of the merger application:

- The common draft terms of the proposed merger duly approved by the manager of the merging and receiving fund.

The UCITS Directive requires the respective managers of the merging UCITS and the receiving UCITS to prepare and agree a common draft terms of merger. The common draft terms of merger must set out prescribed particulars, including an identification of the type of merger; the background to and rationale for the proposed merger; the expected impact of the proposed merger on the unit-holders of both the merging and the receiving funds; the criteria adopted for valuation of the assets and the calculation method of the exchange ratio. Once prepared, the common draft terms of merger must be reviewed by the depositories of the merging and receiving UCITS.

- An up-to-date version of the prospectus and the key investor information document (“**KIID**”) of the merging UCITS.
- A statement by each of the depositories of the merging UCITS and the receiving UCITS confirming that they have verified compliance with the requirements of the UCITS Directive and the fund rules or instruments of incorporation of their respective UCITS. This involves a validation of the criteria adopted for valuing: (i) the assets and liabilities of each UCITS; (ii) the exchange ratio in relation to shares in each UCITS; and (iii) the cash payment per unit. This is to be completed by the depository or the auditor of either the merging or the receiving UCITS in advance of the merger and the reports of the relevant depository / auditor (as the case may be) shall be provided on request to unit-holders in the merging and receiving UCITS and their respective regulators.

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1. The consolidated UCITS provisions as set out in Directive 2009/65/EC and later amended by Directive 2014/91/EU are referred to in this briefing note as the UCITS Directive

- The information on the proposed merger that the merging funds intend to provide to their respective unit-holders to enable them to take an informed decision on the possible impact of the merger on their investments. This includes the preparation of a circular to investors in the merging UCITS seeking their approval of the merger along with the preparation of a circular to investors in the receiving UCITS advising them of the proposed merger and the impact on their investments. The information to be provided to unit-holders of the merging and receiving UCITS must include the prescribed particulars set out by the UCITS Directive including, for unit-holders of the merging UCITS, the background to and the rationale for the proposed merger; the possible impact of the proposed merger on unit-holders; any specific rights unit-holders have in relation to the proposed merger and the planned effective date of the merger. A copy of the KIID of the receiving UCITS must also be provided to unit-holders of the merging UCITS.
- Unit-holders of both the merging UCITS and the receiving UCITS will have the right to request the repurchase or redemption of their units upon being informed of the proposed merger. Alternatively, unit-holders will have the right to convert their units into units in other UCITS with similar investment policies managed by the same management company.

Once the regulator of the merging UCITS (the “**home regulator**”) has received a complete file, it must immediately transmit copies of the information referred to above to the regulator of the receiving UCITS (the “**host regulator**”). The competent authorities will then consider the potential impact of the proposed merger on unit-holders of the merging and the receiving UCITS respectively, to assess whether appropriate information is being provided to unit-holders. The home regulator shall inform the merging UCITS, within 20 working days of submission of the complete information whether or not the merger has been authorised. The home regulator shall also inform the host regulator of their decision. If the competent authorities consider that the file is not complete, they can request additional information within 10 working days of receiving the information referred to above.

## **Key Points in relation to UCITS Master / Feeder Structures**

The establishment of master-feeder structures, including cross border master-feeder structures, for UCITS was introduced by UCITS IV. The master-feeder structure offers a solution to asset managers seeking to achieve economies of scale across their existing fund structures. The purpose of the structure is to enable the establishment of local feeders in a specific member state (for the purpose of availing of local tax or marketing incentives), combined with the flexibility of basing the master UCITS in the European domicile of choice for the asset manager. The pooled structure will be able to achieve greater economies of scale and consequent cost efficiencies as well as other general advantages of the domicile chosen for the master vehicle, all to the advantage of investors.

The UCITS Directive provides for an exemption from the generally applicable UCITS investment restrictions in order to permit the creation of master-feeder UCITS structures. The relevant provisions provide that:

- The feeder UCITS must invest at least 85% of its assets in the master UCITS. It may hold up to 15% of its assets in one or more of the following:
  - ancillary liquid assets; and
  - financial derivative instruments (“**FDI**”), which may be used only for hedging purposes.
- The investment policy of the feeder UCITS will need to expressly provide for the investment of a minimum of 85% of its assets in the master UCITS and provide a description of the master UCITS.
- A feeder UCITS is only allowed to invest in one master UCITS.
- The master UCITS must have:
  - at least one feeder UCITS;
  - cannot be a feeder itself; and
  - cannot hold units of a feeder UCITS.

- Where the depositaries of the master and feeder UCITS are different entities, they must enter into a depositary information sharing agreement in order to ensure the fulfilment of their respective duties. A similar requirement to enter into an information sharing agreement between auditors applies where the auditors of the master and the feeder UCITS are different.
- The feeder and the master UCITS must enter into an agreement whereby the master agrees to provide the feeder with all information necessary to permit the feeder to meet its requirements under the UCITS Directive (the “**Information Sharing Agreement**”). This requirement for a written agreement may be replaced by internal conduct of business rules (the “**Internal Conduct of Business Rules**”) where both funds are managed by the same UCITS management company.
- The valuation points between the master and feeder need to be co-ordinated. The Information Sharing Agreement or Internal Conduct of Business Rules must include, for example amongst other information, the following in relation to dealing arrangements:
  - co-ordination of the frequency and timing of the net asset value calculation process and publication of prices of units;
  - co-ordination of transmission of dealing orders by the feeder, including, where applicable, the role of transfer agents or any other third party;
  - where the units of the feeder and the master are denominated in different currencies, the basis for conversion of dealing orders; and
  - settlement cycles and payment details for subscriptions and redemptions of units of the master including, where agreed between the parties, the terms on which the master may settle redemptions by a transfer of assets in kind to the feeder.
- The master UCITS cannot charge subscription or redemption fees for the investment of the feeder into its units or the divestment thereof.
- A master UCITS authorised by the Central Bank must immediately inform the Central Bank of the identity of each feeder which invests in its units. In the case where the feeder will not be authorised by the Central Bank, the Central Bank will be obliged to immediately inform the competent authority of the feeder home Member State of such investment.
- When the UCITS master-feeder framework was introduced, it was anticipated that this could offer advantages to promoters in distributing their funds in the EU through local feeder funds. However, the success of enhanced notification procedures introduced under UCITS IV has meant there has been less demand for master / feeder structures as a distribution model.

Full details of the Asset Management and Investment Funds Group, together with further updates, articles and briefing notes written by members of the Asset Management and Investment Funds team can be accessed at [www.matheson.com](http://www.matheson.com).

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