

COMMISSION OF THE EUROPEAN COMMUNITIES

COM(86) 315 final

Brussels, 4 June 1986

Proposal for a
COUNCIL DIRECTIVE

amending Directive 85/611/EEC on the coordination of laws,
regulations and administrative provisions relating to
undertakings for collective investment in
transferable securities (UCITS) as far as
concerns the investment policy of
certain UCITS

(submitted to the Council by the Commission)

COM(86) 315 final

EXPLANATORY MEMORANDUM

The provisions relating to the investment policies of UCITS contained in Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)¹ considerably limit the discretionary powers of managers as regards the services which they may offer unit holders and the decisions which they may take as regards investment or borrowing on behalf of UCITS.

An examination of the situations in Denmark and the United Kingdom has shown that, because of those limitations, certain UCITS in those countries will be unable to continue to pursue particular investment policies (investment of more than 10% of their assets in mortgage credit bonds issued by the same institution or investment in units issued by UCITS managed by the same management company) if they wish to fall within the scope of the Directive and to benefit from its provisions, in particular from freedom to market their units within the Community. It does not seem appropriate to require those UCITS to terminate such practices or, if they fail to do so, to exclude them from the Directive's field of application and therefore from its benefits. This is why, during the Council's discussion of the proposed Directive on the coordination of the rules relating to UCITS, the Commission was invited to transmit to the Council proposals concerning those two situations as soon as possible.

However, instead of providing for derogation measures to enable Denmark and the United Kingdom to continue the practices referred to and at the same time to benefit from Directive 85/611/EEC, it seemed preferable to give each Member State the option of authorizing their UCITS to engage in such practices, provided that certain rules and conditions were observed in all authorized cases and investors were therefore guaranteed equivalent protection.

¹ OJ No L 375, 31.12.1985

Investment in bonds treated as public sector bonds

Article 22 of Directive 85/611/EEC distinguishes between two categories of transferable security, namely those which are issued or guaranteed by a State and those which are not.

In the case of the second category of transferable security, paragraphs 1 and 2 of that Article stipulate that a UCITS may invest no more than 5% of its assets in transferable securities issued by the same body. However, a Member State may authorize a UCITS to invest up to 10% of its assets in transferable securities issued by the same body, although that UCITS may not invest more than 40% of the said assets in transferable securities in respect of which authorization to exceed the 5% limit has been given.

Those limits are not designed to protect portfolios against the risk of monetary erosion, a general fall in stock market prices or changes in interest or exchange rates. They are designed instead to limit the impact on the UCITS's assets which a possible bankruptcy or cessation of payments on the part of an issuer whose securities are included in the portfolio may have.

This is why, given the fact that a State cannot normally become bankrupt, Article 22(3) permits Member States by way of derogation from paragraphs 1 and 2, to raise the limit on a fund's investment in transferable securities issued or guaranteed by the same State to a maximum of 35% of the fund's assets, while Article 23 even increases that limit to 100%, provided that certain conditions are observed.

It should be recognized, however, that transferable securities issued or guaranteed by a State are not the only securities which offer maximum guarantees as regards their servicing (payment of dividends and repayment of principal). Such may be true of other bonds such as mortgage credit bonds, and that is why mortgage credit bonds issued by Danish institutions specializing in mortgage lending are treated under Danish legislation as equivalent to bonds issued or guaranteed by the State. This equal treatment of mortgage and State bonds is enshrined in the rules relating to the investment of minors' assets, the reserves of pension funds and life insurance companies.

This equal treatment in Denmark is based on recognition of the fact that institutions specializing in mortgage lending and in the issue of mortgage credit bonds run only a minimal risk of becoming bankrupt because of the statutory reserves which they must build up and the fact that their assets and liabilities match in terms of interest rates and maturities. Furthermore, even if a bankruptcy were to take place, repayment of the bonds could still be made thanks to the joint liability of recipients of mortgage loans or through the sale of mortgaged property.

However, the guarantees offered by such bonds - which enable them to be treated as equivalent to State bonds - are not restricted solely to Danish mortgage credit bonds. There are mortgage credit and non-mortgage credit bonds in other Member States which offer equivalent guarantees, either in the sense that the risk of the issuer becoming bankrupt is equally minimal or that holders are guaranteed protection in the event of the issuer ceasing payment. Such is the case where the issuer is subject to special arrangements designed to preserve its liquidity and solvency, where the issue of bonds must be covered by loans with a secured right in rem or by loans to the public sector or where holders enjoy preferential rights guaranteeing that their bonds will be serviced even where the issuer ceases to make payments (for example, the "Kommunalobligationen" in the Federal Republic of Germany and the "obbligazioni opere pubbliche" in Italy). This proposal for a Directive (see Article 1(a)) takes account of such circumstances.

However, it did not seem appropriate to incorporate into the proposal for a Directive all the Member States' criteria for treating certain bonds as equivalent to bonds issued or guaranteed by the State, since those criteria may vary from one Member State to another and in time. That is why it was considered preferable simply to incorporate into the proposal the principle of treating certain bonds as equivalent to State bonds where they offer the same guarantees as the latter, while at the same time leaving it to Member States to draw up the lists themselves and providing for a procedure for notifying the other Member States similar to that provided for in Article 20 of Directive 85/611/EEC where debt instruments are treated as equivalent to transferable securities (transmission of the lists of such debt instruments to all Member States together with the reasons for treating them as equivalent and, where appropriate, discussions on those lists within the Contact Committee).

To sum up, it is proposed, in view of the above, to supplement Directive 85/611/EEC by the addition of a paragraph 4 to Article 22, which would permit Member States to raise the limit laid down in paragraph 1 of that Article to a maximum of 35% where a UCITS assets are invested in bonds treated as equivalent to bonds issued or guaranteed by the State, and to make reference to Article 20 of the Directive for the purpose of providing for a procedure for informing Member States. A paragraph 5 also stipulates that investments made on the basis of the various provisions of Article 22 may under no circumstances exceed 35 % of the assets of a UCITS.

Parallel UCITS

There are funds which invest savings raised from the public only in units issued by other UCITS managed or controlled by the same management company or by the same group of companies as that which manages or controls the fund.

That type of fund (henceforth referred to as "parallel UCITS") offers those purchasing its units a service which enables them to derive more comprehensive benefits from the professional management of their savings. In the absence of a parallel UCITS, unit holders, when faced with a range of UCITS specializing on the basis of geographical and/or sectoral criteria, must choose the specialist UCITS in which they wish to invest their savings. Where there is a parallel UCITS, however, the manager himself makes that choice for the unit holder and that choice is constantly reviewed in the light of the prospects of the various UCITS concerned.

Parallel UCITS already operate in the United Kingdom where they are known as "managed funds". However, that type of UCITS is not covered by Directive 85/611/EEC as currently worded, since it fails to observe the investment rules laid down in Articles 19 to 26 of the Directive. In order to enable them to benefit from Directive 85/611/EEC, it would therefore be necessary to exempt them from application of those rules, while at the same time making them subject to special investment rules.

This is the objective of Article 26a which it is proposed to incorporate into the Directive. However, the possibility of securing exemption from Articles 19 to 26 should not prejudice holders of units issued by a parallel UCITS, since the aim of those provisions (e.g. with respect to the quality of

the transferable securities in which UCITS must invest or the obligation to diversify risks) is not undermined because parallel UCITS may invest their assets only in units issued by UCITS which must themselves comply fully with those provisions.

Points (a), (b) and (c) of the proposed Article 26a set out the investment rules which must be observed by parallel UCITS.

Observance of those rules will have the following effects :

- (a) Parallel UCITS will be able to invest their assets only in units issued by UCITS which are themselves subject to the Directive but which are not parallel UCITS. This precludes the setting up of parallel UCITS which make cross or multi-stage investments between themselves and the establishment of mixed UCITS, that is those which invest partly in shares and bonds and partly in other UCITS (except as permitted under Article 24 of Directive 85/611/EEC).
- (b) Parallel UCITS will be able to invest their assets only in units issued by UCITS managed or controlled by the same company or group.
- (c) Companies which do not manage or control a sufficient number of UCITS which pursue different investment objectives or policies will not be able to set up parallel UCITS within the meaning of Directive 85/611/EEC.

As to point (d) of Article 26a, its aim is not to limit the amount or nature of the costs, commissions and charges which may be payable by those subscribing for units issued by a parallel UCITS but to make it necessary for any such charges to be clearly shown so that a potential unit holder may himself decide whether the additional service offered by a parallel UCITS justifies the possible additional costs included.

II

(Preparatory Acts)

COMMISSION

Proposal for a Council Directive amending Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as far as concerns the investment policy of certain UCITS

*COM(86) 315 final**(Submitted by the Commission to the Council on 11 June 1986**(86/C 155/04)*

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 57 (2) thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas Article 22 (1) and (2) of Council Directive 85/611/EEC (1) as amended by, limits the investment of UCITS assets in transférable securities issued by the same body to 5 %, a limit which may, if required, be increased to 10 %;

Whereas that limit poses special problems for UCITS established in Denmark in cases where they wish to invest an appreciable proportion of their assets on the domestic bond market, since that market is dominated by mortgage credit bonds and the number of institutions issuing such bonds is very small;

Whereas those mortgage credit bonds are subject in Denmark to special rules and supervision designed to protect holders and are treated under Danish legislation as equivalent to bonds issued or guaranteed by the State;

Whereas Article 22 (3) of Directive 85/611/EEC derogates from paragraphs 1 and 2 of that Article in the case of bonds issued or guaranteed by a State and authorizes UCITS to invest up to 35 % of their assets in such bonds;

Whereas, for the reasons given, a similar derogation is justified in the case of Danish mortgage credit bonds; whereas, however, there are in other Member States bonds which offer the investor equivalent guarantees by virtue of the special rules and regulations which are applicable to them; whereas it is therefore necessary to extend the derogation to all those bonds, while at the same time leaving it to Member States to draw up themselves the list of bonds which they may wish to treat as equivalent to State bonds and providing for a procedure for informing the other Member States similar to that provided for in Article 20 of Directive 85/611/EEC;

Whereas certain unit trust management companies have recently set up in the United Kingdom parallel unit trusts (managed funds) which invest their assets exclusively in units issued by other UCITS which they manage;

Whereas those parallel unit trusts may prove useful to investors who, while wishing to diversify their investments, are not themselves in a position to choose between a whole range of specialist and general funds managed by the same management company;

Whereas arrangements should be made for those parallel funds to benefit from the advantages provided for in Directive 85/611/EEC, and particularly from the freedom to market their units within the Community; whereas, to that end, it is necessary to exempt those funds from application of the investment rules laid down in Section V of Directive 85/611/EEC, which are inappropriate in their case, while at the same time making them subject to special investment rules and to the other obligations laid down in that Directive;

Whereas it is necessary to extend those arrangements to parallel funds which may be set up in other Member States and to render them also applicable to investment companies investing their assets in the units of other UCITS to which they are linked, .

(1) OJ No L 375, 31. 12. 1985, p. 3.

HAS ADOPTED THIS DIRECTIVE:

Article 1

Directive 85/611/EEC is hereby amended as follows:

1. The following paragraphs are added to Article 22:

4. Member States may raise the limit laid down in paragraph 1 to a maximum of 35 % where the transferable securities of an issuer are bonds which in view of the guarantees they offer investors by virtue of the special rules and regulations governing them in the Member State of issue, are equivalent to the securities referred to in paragraph 3.

Member States shall send to the Commission lists of the categories of bonds which they plan to treat as equivalent to the securities referred to in paragraph 3 and any amendments which they contemplate making to those lists in accordance with the procedure and arrangements laid down in Article 20 (1). The Commission shall forward that information to the other Member States in accordance with the procedure laid down in Article 20 (2).

5. Investments in transferable securities issued by the same body carried out in accordance with paragraphs 1, 2, 3 and 4 shall under no circumstances exceed in total 35 % of the assets of a UCITS.

The transferable securities referred to in paragraphs 3 and 4 shall not be taken into account for the purpose of applying paragraph 2.

2. The following Article 26a is inserted.

Article 26a

Member States may authorize a UCITS (hereinafter referred to as a "parallel UCITS") to invest its assets, notwithstanding Articles 19 to 26, in units issued by other UCITS provided that the following conditions are met:

- (a) The parallel UCITS must invest its assets — subject to the necessary conditions concerning liquidity — exclusively in units issued by UCITS subject to the provisions of this Directive, including Articles 19 to 26 thereof;
- (b) The parallel UCITS and the UCITS in the units of which it invests must:
 - be managed by the same management company, or
 - be managed or controlled by companies which are separate but linked by common management or control or by a substantial direct or indirect holding.
- (c) The parallel UCITS must have the opportunity of investing its assets in the units of at least 10 UCITS which meet the criteria set out at (a) and (b) and which can be distinguished from each other by their investment policies and/or objectives.
- (d) The parallel UCITS must describe in its instruments of incorporation or fund rules and in its prospectus or any promotional literature the characteristics of the UCITS in the units of which it is authorized to invest. Those documents must clearly show in figures the charges, taxes, commissions and other costs directly or indirectly borne by the parallel UCITS' unit-holders, so that the latter are able to assess the cost of investment in the parallel UCITS in relation to the cost of direct investment in the units of the underlying UCITS.

Article 2

The Member States shall bring into force the measures necessary to comply with this Directive by the same dates as those provided for in Directive 85/611/EEC. They shall forthwith inform the Commission thereof.

Article 3

This Directive is addressed to the Member States.