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UCITS Mergers – A Reminder

Practical Considerations

The UCITS merger regime came into effect pursuant to Directive 2009/65/EC (the "**UCITS Directive**"). In the years since Dillon Eustace advised on the first Irish merger under the UCITS merger regime in 2011, we have continued to regularly advise on domestic and cross-border UCITS mergers. In the intervening period, we have managed and dealt with a wide variety of legal and regulatory issues encountered by clients on the different aspects of the UCITS merger regime. While a brief summary of the UCITS merger process is set out in the Appendix to this note, a more detailed summary of the mechanics of the merger process can be found here. In this briefing, we have sought to outline some of the common queries and practical considerations that clients have encountered in our experience.

What are the effects of each merger technique?

There are three types of merger techniques detailed under Article 2(p) of the UCITS Directive. The effects of each merger technique are set out under Article 48 of the UCITS Directive and Regulation 66 of the Irish UCITS Regulations where the merging UCITS is domiciled in Ireland. Of particular interest to clients over the years has been the effect of the merger on the legal and regulatory status of the merging UCITS after the merger.

A merger effected in accordance with Article 2(p)(i) or (ii) of the UCITS Directive means that the merging UCITS ceases to exist on the entry into effect of the merger. Where the merging UCITS is Irish domiciled, an application for withdrawal of Central Bank of Ireland (the "**Central Bank**") approval does not need to be made. This is on the basis that the representatives of the merging UCITS will notify the Central Bank that the merger has been approved by way of providing the Central Bank with a certified copy of the resolution of the shareholders approving the merger and notifying the Central

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Bank that the merger has taken effect. Once this information has been provided to the Central Bank, it will remove reference to the merging UCITS from its register.

A merger effected in accordance with Article 2(p)(iii) of the UCITS Directive means that the merging UCITS continues to exist after the merger until the liabilities of the merging UCITS have been discharged. As a result, when the stakeholders of the merging UCITS are considering the costs of the merger they will need to factor in how the liabilities of the merging UCITS are to be discharged, for example will the liabilities be accrued in the net asset value of the merging UCITS prior to the merger or will the investment manager or management company or promoter cover the costs of the remaining liabilities? For completeness, the liabilities referred to above are costs outside of the legal, advisory or administrative fees and expenses associated with the preparation and the completion of a merger.

After the liabilities have been discharged then a formal application for withdrawal of approval of the merged UCITS sub-fund will need to be made to the Central Bank, where the merged UCITS is domiciled in Ireland.

It is worth bearing in mind that if the last sub-fund in the merging UCITS is intended to merge with another sub-fund, then, pursuant to the Central Bank's requirements, the only UCITS merger that is currently permitted by the Central Bank for the last sub-fund is a merger effected in accordance with Article 2(p)(iii) of the UCITS Directive. This is on the basis that a formal application to the Central Bank in respect of the revocation of authorisation of a UCITS umbrella requires at least one sub-fund to remain in existence when this application is made. If the last sub-fund of the merging UCITS merged under Article 2(p)(i) or (ii) of the UCITS Directive, the sub-fund would no longer exist on the entry into effect of the merger, which, would impact the application for revocation of the UCITS umbrella as at least one sub-fund would not be in existence. Since the effect of a merger carried out in accordance with Article 2(p)(iii) of the UCITS Directive is that the merging UCITS continues to exist after the merger until the liabilities of the merging UCITS have been discharged, this allows for the Central Bank's requirements of the application for revocation of the UCITS umbrella to be complied with.

Who bears the Costs?

Article 46 of the UCITS Directive and Regulation 64 of the Irish UCITS Regulations provide that the legal, advisory or administrative costs associated with the preparation and the completion of a merger must not be charged to either the merging UCITS or the receiving UCITS, or to any of their shareholders, except in cases "where the UCITS have not designated a management company".

This means that if a UCITS (merging and/or receiving UCITS) has appointed a management company, the funds themselves will not bear the costs of any merger. In such circumstances, the management company or companies (along with the respective investment managers managing the merging and receiving UCITS) will need to agree between themselves how and by whom the costs of the merger are going to borne.

Where a UCITS (merging and/or receiving UCITS) does not have a management company appointed, then, in the absence of any further regulatory guidance on these types of funds, the UCITS may bear the costs outlined above.

Can the Merging UCITS keep its track record?

ESMA sets out in its UCITS Q&A that where the receiving UCITS has past performance history, then this past performance history shall be maintained after the merger takes effect.

However, where the receiving UCITS does not have past performance history (i.e. it is unlaunched and has typically been established to accommodate the merger), then the past performance of the merging UCITS can be disclosed in the KIID(s) of the receiving UCITS. Such past performance is only permitted to be carried forward if the home Member State competent authority of the receiving UCITS reasonably assesses that the merger does not impact the UCITS' performance.

ESMA expects the performance of the UCITS to be impacted if there is, inter alia, a change to the investment policy or to the entities involved in the investment management. It should also be made clear in the KIID(s) of the receiving UCITS that the performance is that of the merging UCITS.

Where the receiving UCITS is domiciled in Ireland and the merging UCITS is domiciled in another Member State, the Central Bank's UCITS Q&A permits past performance to be disclosed where the receiving UCITS or its management company provides a confirmation to the Central Bank that:

- the investment policy, strategy and portfolio composition have not been substantially altered as a consequence of the transfer to the UCITS regime;
- there is no change to the entities involved in the investment management of the UCITS;
- it is satisfied that the past performance data is accurate; and
- appropriate disclosure will be included with the past performance in the KIID stating that the data relates to a period when the UCITS was domiciled outside of Ireland prior to the merger.

What is a 10% Cash Payment?

Under the merger techniques in Article 2(p)(i) and (ii) of the UCITS Directive, if applicable, a cash payment not exceeding 10% of the net asset value of the shares issued by the receiving UCITS, may be made to the shareholders in the merging UCITS. There is no regulatory requirement to make the cash payment, only where it is applicable. However, over the years we have received queries in respect of the relevance of this cash payment and when it applies. Neither the UCITS Directive nor the Irish UCITS Regulations provide further detail on when the 10% cash payment may apply.

However, when the merger techniques were being considered by the European Commission, the cash payments appear to have been envisioned for circumstances where, shareholders in the merging UCITS would not be entitled to a round number or fraction of shares, taking into account the fractioning of shares in the receiving UCITS. Then in such a circumstance, a cash payment, as outlined above, for the difference in the number of shares, would be paid to the shareholders of the merging UCITS. It also appears that the European Commission considered that the cash payment, as outlined above, could alternatively be invested in the receiving UCITS on the behalf of the shareholders in the merging UCITS in order to obtain a round number or a fraction of shares issued by the receiving UCITS to the shareholders in the merging UCITS.

Neither the UCITS Directive nor the Irish UCITS Regulations suggest who should make this cash payment. However, Article 46 of the UCITS Directive and Regulation 64 of the Irish UCITS Regulations regarding merger costs should be borne in mind.

In order to ascertain if a cash payment, as outlined above, is applicable, investment managers, management companies or promoters of the merging and receiving UCITS will need to consider how shares are issued in the respective UCITS and whether there will be any differences once the merger takes effect. This point should be considered from the outset so that the relevant parties can ensure that they have the appropriate reserves to cover the cash payment.

What are the Voting and Quorum Requirements?

75% of the votes actually cast by shareholders present or represented by proxy at the general meeting of shareholders of the merging UCITS will be required in order for a merger to take effect.

From the outset, a review of the voting and quorum provisions for the UCITS should be considered, which will be set out in the relevant UCITS' constitutional documents. From a practical perspective, consideration will also need to be given to any patterns or history regarding previous attendance and/or voting of shareholders for general meetings, as this will help ascertain early if the management company needs to engage with shareholders in order to encourage their attendance and participation at the general meeting in order to ensure there is a quorum. If a quorum is not reached, then subject to the provisions of the constitutional documents of the UCITS, the general meeting will likely be adjourned to a specified time. An adjournment(s) will have an impact on the timing of the merger and so this should be factored into the merger timeline and any adjournment should promptly be brought to the attention of the UCITS' service providers.

In relation to the voting particulars, consideration will need to be given to the provisions in the constitutional documents regarding voting by a show of hands by shareholders in person or by proxy or if voting is, or can, be carried out on a poll at general meetings. This point is of relevance because the provisions of the constitutional documents may, for example, set out that voting by a show of hands means that regardless of the shareholding of each shareholder, each shareholder present in person or by proxy, has one vote. While voting carried out by a poll may, for example, result in a shareholder, present in person or by proxy, being entitled to one vote in respect of each share held by them.

In light of the voting and quorum particulars outlined above, engagement with shareholders by the relevant stakeholders will need to be considered early on.

Registration of the Merging UCITS for Marketing?

In order for the competent authority(ies) to approve the merger, the receiving UCITS will need to be registered for marketing in the same jurisdictions that the merging UCITS has been registered. Although marketing notifications made to the competent authorities of the home Member State of a UCITS are relatively straight forward and should only take up to 10 working days to be transferred to a host Member State, if the merging UCITS is registered for marketing in a number of jurisdictions, then early co-ordination will be required by the management company of the receiving UCITS to ensure that any necessary registrations are put in place. This is particularly the case where the relevant jurisdictions require the appointment of local agents as agreements may need to be negotiated which could impact timing.

If it is the case that, although the merging UCITS is registered for marketing in a number of jurisdictions, but there are no shareholders in the merging UCITS from those jurisdictions and the receiving UCITS doesn't intend for the receiving UCITS to be marketed in all of the same jurisdictions, then co-ordination between the merging and receiving UCITS could allow the merging UCITS to de-register from certain jurisdictions and reduce the amount of marketing notifications or local appointments that the receiving UCITS would have to make.

In our experience, UCITS are registered for marketing in their home Member State upon their authorisation by their home Member State competent authority and so where a domestic merger is taking place (i.e. the merging and the receiving UCITS are established and authorised in the same EU Member State), the receiving UCITS does not normally have to concern itself with ensuring that it is marketed in the same Member State that the receiving UCITS is established. However, where cross-border mergers are taking place, it is important to note that the receiving UCITS will need to be registered for marketing in the home Member State of the merging UCITS. This requirement applies notwithstanding that (i) there may be no investors who are from the Member State of the merging UCITS in the receiving UCITS following the merger and (ii) there is no intention to market the shares of the receiving UCITS in the Member State of the merging UCITS.

What languages must the documentation be in?

If either the merging UCITS or receiving UCITS have been registered for marketing in another Member State, the Circular to the shareholders in the merging/receiving UCITS must be translated into the official language of the relevant UCITS host Member State or into a language approved by its competent authorities. In planning for the merger, stakeholders in each of the UCITS should factor in both the timing and costs associated with the foregoing translation requirements. In particular, where a host Member State has multiple official languages, it is worthwhile engaging with local counsel to ascertain if the merging/receiving UCITS have previously informed the host Member State competent authority of the official language that they will use when communicating with the host Member State and/or shareholders in that jurisdiction. This will have an impact on the official language(s) that the Circular (and ultimately the KIID(s) appended to the Circular) are translated into.

Is there a Merger Application Form?

In recent years, the Central Bank has streamlined the merger application process by introducing a UCITS Merger Application Form (the "**Form**"). Where the merging UCITS is an Irish UCITS, the Central Bank requires the advisers to the merging UCITS to submit a duly completed and executed Form. The contents of the Form centres around ensuring compliance with the disclosure requirements set down in the Irish UCITS Regulations (reflecting those in the UCITS Directive) in respect of the Circular, common draft terms, confirmation letters from the depositaries and the independent auditor (where relevant). The Central Bank also requires confirmation, via the Form, in the context of cross-border mergers that that the merging UCITS (i) will terminate its marketing registrations once the merger has taken place, (ii) is aware of each host Member States' conditions for the termination of marketing of UCITS in that Member State, and (iii) will comply with these obligations. These are post-merger necessities that should be carried out. However, given the additional obligation imposed by the Central Bank via the Form, the stakeholders in the merging UCITS should, as part of their own internal merger steps and timeline, include these matters in their planning for completeness.

If you have any queries in respect of the issues raised in this article, please do not hesitate to contact us.

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APPENDIX

Summary of UCITS Mergers

- Select one of three merger techniques set out under Article 2(p) of the UCITS Directive;

- Obtain approval from the home Member State competent authority of the merging and receiving UCITS. Where the merging and receiving UCITS are both based in the same EU jurisdiction only one competent authority will be approving the merger. The documents required to be submitted to the home Member State competent authority of the merging UCITS are;

  - the common draft terms of the proposed merger duly approved by the merging UCITS and the receiving UCITS (which includes a merger timetable with the merger steps scheduled in accordance with the UCITS Directive);

  - an up-to-date version of the prospectus and the key investor information (or simplified prospectus) of the receiving UCITS;

  - a statement by each of the depositaries of the merging and the receiving UCITS verifying compliance of certain particulars with the requirements of the respective UCITS' funds rules and the Irish UCITS Regulations[1] (in the case of Irish merging UCITS) or the UCITS Directive or its implementing legislation where the merging UCITS is established in another EU jurisdiction;

  - the information on the proposed merger (the "**Circular**") that each of the merging and the receiving UCITS intend to provide to their respective shareholders. If the receiving UCITS does not have any shareholders, then the Circular is not required for the receiving UCITS;

  - validation by a depositary or an independent auditor (of either the merging or receiving UCITS) regarding the valuation of assets and where applicable liabilities, cash payments (where relevant) and the exchange ratio.

- Obtain 75% of the votes actually cast by shareholders present or represented at the general meeting of shareholders of the merging UCITS.

- Comply with the notification/publication requirements once the merger is effective.

[1] S.I. No. 352 of 2011 - European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (as amended) (the "Irish UCITS Regulations")