

UCITS mergers

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CONTENTS

1. INTRODUCTION	3
2. TYPES OF UCITS MERGER	3
3. APPROVAL PROCESS	4
4. COMMON TERMS OF MERGER	5
5. THIRD PARTY VERIFICATION	5
6. CIRCULAR	6
7. EFFECTS OF A MERGER	6
8. FURTHER CONSIDERATION	7
8.1 VOTING REQUIREMENTS	7
8.2 RIGHT OF REDEMPTION	7
8.3 TIMING	7
8.4 COSTS	7
8.5 PUBLICATION	8
8.6 Can the Merging UCITS keep its track record?	8
8.7 10% Cash Payment	8
8.8 Registration of the Receiving UCITS for Marketing	9
8.9 Translation of documents	9
9. CONCLUSION	9
CONTACT US	10

1. INTRODUCTION

Over the years, Dillon Eustace has been involved in a significant number of UCITS mergers, both domestic and on a cross-border basis. We continue to see strong demand for advice in respect of UCITS mergers, whether for building efficiency or seeking to achieve economies of scale. We set out below some information on the process involved in carrying out a UCITS merger, as well as some practical considerations.



2. TYPES OF UCITS MERGER

The UCITS Directive¹ (and its implementing legislation in Ireland, the UCITS Regulations²) provides for the following three types of merger contemplated under the UCITS Directive, which can be used when merging one or more UCITS with each other.

- 2.1 an operation whereby one or more UCITS or sub-funds thereof (the **Merging UCITS**), on being dissolved without going into liquidation, transfer all of their assets and liabilities to another existing UCITS or a sub-fund thereof (the **Receiving UCITS**), in exchange for the issue to their shareholders of shares of the Receiving UCITS and, if applicable, a cash payment not exceeding 10% of the net asset value of those shares;
- 2.2 an operation whereby two or more Merging UCITS, on being dissolved without going into liquidation, transfer all of their assets and liabilities to a Receiving UCITS, which they form, in exchange for the issue to their shareholders of shares of the Receiving UCITS and, if applicable, a cash payment not exceeding 10% of the net asset value of those shares; and
- 2.3 an operation whereby one or more Merging UCITS, which continue to exist until their liabilities have been discharged, transfer their net assets to a Receiving UCITS (i) in the same umbrella, (ii) to a Receiving UCITS which they form, or (iii) to an existing Receiving UCITS.

1 Directive 2009/65/EC - Undertakings for Collective Investment in Transferable Securities IV (recast), as amended

2 European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 [S.I. No. 352 of 2011], as amended

3. APPROVAL PROCESS

As part of the approval process under the UCITS Regulations, the Merging UCITS is required to provide the following information to the Central Bank of Ireland (the Central Bank):

1. the common terms of the proposed merger (the Common Terms of **Merger**) duly approved by the management of the Merging UCITS and the Receiving UCITS;
2. an up-to-date version of the prospectus and the UCITS KIID(s)/PRIIPs KID(s) (the KID) of the Receiving UCITS;
3. a statement by the depositaries of each of the Merging UCITS and the Receiving UCITS verifying compliance of certain particulars with the requirements of the UCITS Regulations and the respective UCITS' fund rules;
4. a verification from a depositary or an independent auditor (of either the Merging or Receiving UCITS) validating certain matters in accordance with the UCITS Regulations;
5. the information on the proposed merger that each of the Merging UCITS and the Receiving UCITS intend to provide to their respective shareholders (the **Circulars**, **each a Circular**);
6. a fully completed and executed (by legal counsel) version of the Central Bank's UCITS merger application form (**the Form**).

As indicated by point 4 above, it will be necessary to send a Circular to shareholders of both the Merging UCITS and the Receiving UCITS. If it is proposed to set up a new sub-fund as the Receiving UCITS, it may be worthwhile holding off on seeding the Receiving UCITS until after the merger has taken effect in order to avoid having to send a Circular to investors of the Receiving UCITS and to facilitate, where relevant, the use of the Merging UCITS' track record.

For a cross-border merger, it may be necessary to arrange for documents to be translated. Therefore, it is important to factor in time for the translation of the Prospectus and the KID(s) of the Receiving UCITS into English. This is considered further below under "Translation of Documents".

Once a full application has been received by the Central Bank, it will review all of the documentation that has been provided and may issue comments seeking further clarification of certain matters. These must be addressed to the satisfaction of the Central Bank before the merger can proceed.

For a cross-border merger, the Central Bank is required to transmit copies of the documents referred to above to the competent authority of the Receiving UCITS' home Member State.

The Central Bank will only authorise the proposed merger if the following conditions are met:

1. the proposed merger complies with the relevant provisions of the UCITS Regulations (namely, the documents at 1 to 6 above are complete, the Common Terms of Merger complies with the requirements set out under "Common Terms of Merger" below, verification by the depositaries of both the Merging UCITS and the Receiving UCITS have been provided and certain matters have been validated, as set out under "Third Party Verification" below;
2. the Receiving UCITS has been approved to market its shares in Ireland and in all Member States where the Merging UCITS has been approved to market its shares; and
3. the Central Bank and the competent authority of the Receiving UCITS' home Member State are satisfied with the proposed information to be provided to shareholders (or no indication of dissatisfaction from the competent authorities of the Receiving UCITS' home Member State has been received).

It is important to note that the requirement set out at point 2 above that the Receiving UCITS (even where it is domiciled outside of Ireland) be approved to market its shares in Ireland will apply even in circumstances where (i) there will be no Irish shareholders in the Receiving UCITS following the merger; and (ii) there is no intention to market the shares of the Receiving UCITS in Ireland (this point is considered further below under "Registration of the Merging UCITS for Marketing").

4. COMMON TERMS OF MERGER

The Merging UCITS and the Receiving UCITS are required to draw up Common Terms of Merger, which must contain the following particulars:

1. an identification of the type of merger and of the UCITS involved;
2. the background to and rationale for the proposed merger;
3. the expected impact of the proposed merger on the shareholders of both the Merging UCITS and the Receiving UCITS;
4. the criteria adopted for the valuation of the assets and, where applicable, the liabilities on the date for calculating the exchange ratio of shares of the Merging UCITS into shares of the Receiving UCITS (the **"exchange ratio"**);
5. the calculation method of the exchange ratio;
6. the planned effective date of the merger;
7. the rules applicable, respectively, to the transfer of assets and the exchange of shares; and
8. in the case of mergers carried out under either points 2 or 3 under the heading "Types of UCITS Merger" above, the fund rules or instrument of incorporation of the newly constituted Receiving UCITS.

With regard to point 8 above, it will be necessary to file the fund rules or instrument of incorporation of the Receiving UCITS with the Central Bank if the Receiving UCITS has been established for the purpose of the merger. In this regard, the Central Bank will not require the fund rules or instrument of incorporation of the Receiving UCITS if it is a new sub-fund of an already existing UCITS.

5. THIRD PARTY VERIFICATION

The depositaries of each of the Merging UCITS and of the Receiving UCITS are required to verify the conformity of the particulars set out in points 1, 4 and 7 under the heading "Common Terms of Merger" above with the requirements of the UCITS Regulations and the fund rules of their respective UCITS.

Further, either the depositary or an independent auditor (which can be the statutory auditors) of each of the Merging UCITS and the Receiving UCITS is required to validate the following:

1. the criteria adopted for the valuation of the assets and, where applicable, the liabilities on the date for calculating the exchange ratio;
2. where applicable, the cash payment per share; and
3. the calculation method of the exchange ratio as well as the actual exchange ratio determined at the date for calculating that ratio.

In light of the above third party verification provisions, it is important to involve the depositary (and, if necessary, the auditors) of both the Merging UCITS and the Receiving UCITS at the early stages of the merger proposals in order that any potential issues can be identified and addressed at the outset.

6. CIRCULAR

The Circular to be provided to shareholders of the Merging UCITS (and, if necessary, the Receiving UCITS), must include appropriate and accurate information on the proposed merger such as to enable them to take an informed decision as to the possible impact thereof on their investment and to exercise their rights to vote and/or redeem their shares prior to the merger becoming effective. The Circular is required to include the following details:

1. the background to and the rationale for the proposed merger;
2. the possible impact of the proposed merger on shareholders, including any material differences in respect of investment policy and strategy, costs, expected outcome, periodic reporting, possible dilution in performance, and, where relevant, a prominent warning to investors that their tax treatment may be changed following the merger;
3. any specific rights shareholders have in relation to the proposed merger, including the right to obtain additional information, the right to obtain a copy of the report of the independent auditor/depositary on request (i.e. the report regarding points 1-3 under the heading "Third Party Verification"), and the right to request the repurchase or redemption or, where applicable, the conversion of their shares without charge and the last date for exercising that right;
4. the relevant procedural aspects and the planned effective date of the merger; and
5. a copy of the KID(s) of the Receiving UCITS.

If either the Merging UCITS or the Receiving UCITS has been registered for distribution in another Member State, the Circular to the shareholders in the Merging UCITS/Receiving UCITS must be translated into the official language of the relevant UCITS' host Member State or into a language approved by its competent authority. In planning for the merger, it is necessary to factor in both the timing and costs associated with the foregoing translation requirements. This is considered further below under "Translation of Documents".

7. EFFECTS OF A MERGER

A merger effected in accordance with either 1 or 2 under the heading "Types of UCITS Merger" above, 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 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 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 3 under the heading "Types of UCITS Merger" above, 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 Merging UCITS will need to be made to the Central Bank, where the Merging UCITS is domiciled in Ireland.

It is worth bearing in mind that if the Merging UCITS is the last sub-fund in a UCITS umbrella, 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 3 under the heading "Types of UCITS Merger" above. 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 Merging UCITS was the last sub-fund in a UCITS umbrella merged via either 1 or 2 under the heading "Types of UCITS Merger" above, 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 3 under the heading “Types of UCITS Merger” above 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.

8. FURTHER CONSIDERATION

8.1 Voting requirements

The threshold for approval of a merger is that it must be approved by at least 75% of the votes cast by shareholders present or represented by proxy at the general meeting of shareholders of the Merging UCITS in order for a merger to take effect.

From the outset, a review of the voting and quorum provisions for the Merging UCITS should be considered, which will be set out in the Merging 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 Merging 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.

Accordingly, engagement with shareholders by the relevant stakeholders will need to be considered early on in the merger process.

8.2 Right of Redemption

Shareholders of both the Merging UCITS and the Receiving UCITS have the right to request, without any charge other than those retained by the UCITS to meet disinvestment costs, the redemption of their shares (or, where possible, to convert them into shares in another UCITS with similar investment policies and managed by the same management company or by any other company linked to the management company). This right of redemption is effective from the moment that the shareholders of the Merging UCITS and those of the Receiving UCITS have been informed of the proposed merger and ceases five (5) working days before the date for calculating the exchange ratio.

The Central Bank may require or allow the temporary suspension of the subscription, repurchase or redemption of shares provided that such suspension is justified for the protection of the shareholders.

8.3 Timing

The Central Bank will carefully review the merger timetable to ensure compliance with the timing requirements set out in the UCITS Regulations. In this regard, subject to Central Bank approval and completion of relevant translations (if required), the Circular to investors must be provided at least thirty (30) days before the last date for exercising the investor’s right of redemption (as set out under “Right of Redemption” above). In practice, this means that the effective date of the merger cannot be earlier than thirty-five (35) days following the date of the Circular.

8.4 Costs

It is not permitted to charge any legal, advisory or administrative costs associated with the preparation and the completion of the merger to the Merging UCITS or the Receiving UCITS, or to any of their shareholders (except in the limited case of a self-managed UCITS). Such costs

include the costs of convening the general meeting of shareholders, any costs associated with the transfer of the assets of the Merging UCITS to the Receiving UCITS and the costs of termination of the Merging UCITS (assuming it will terminate following the merger).

This means that if a UCITS (Merging and/or Receiving UCITS) has appointed a management company, the UCITS 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.

8.5 Publication

Once the merger is effective, fund promoters will need to make arrangements to ensure that the merger is made public and notified to the competent authorities of the home Member States of the Receiving UCITS and the Merging UCITS.

8.6 Can the Merging UCITS keep its track record?

ESMA sets out in its UCITS Q&A that, in the case of a merger where the Receiving UCITS is newly established with no performance history, the past performance of the Merging UCITS should be used in the KID of the Receiving UCITS if the competent authority of the Receiving UCITS reasonably assesses that the merger does not impact the UCITS' performance. ESMA has stated that it expects the performance 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 KID 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:

1. the investment policy, strategy and portfolio composition have not been substantially altered;

2. there is no change to the entities involved in the investment management of the UCITS;
3. it is satisfied that the past performance data is accurate; and
4. appropriate disclosure will be included with the past performance in the KID stating that the data relates to a period when the UCITS was domiciled outside of Ireland prior to the merger.

8.7 10% Cash Payment

Under the types of merger described at points 2 and 3 above under the heading "Types of Merger" above, 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; it is only payable 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 UCITS Regulations provide further detail on when the 10% cash payment may apply.

However, it appears (from when the European Commission was proposing the introduction of the UCITS merger regime) that it was envisaged that the cash payments would be intended for circumstances where shareholders in the Merging UCITS would not be entitled to a round number or fraction of shares in the Receiving UCITS, taking into account the fractioning of shares in the Receiving UCITS. In such a circumstance, a cash payment, as outlined above, for the difference in the number of shares, would be (i) paid to shareholders in the Merging Fund; or (ii) invested in the Receiving UCITS on the behalf of shareholders in the Merging Fund.

Neither the UCITS Directive nor the UCITS Regulations suggest who should make this cash payment. However, the considerations outlined under "Costs" above 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 UCITS and the 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, if required.

8.8 Registration of the Receiving 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, 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.

Where the Merging UCITS is registered for marketing in jurisdictions in which it is not proposed to market the Receiving UCITS following the merger, then it may be worth considering de-registering from certain jurisdictions in advance of the merger to reduce the amount of marketing notifications that the Receiving UCITS would have to make.

In the context of cross-border mergers, the Central Bank requires confirmation, via the Form outlined above under "Approval Process", that where the Merging UCITS is Irish domiciled, 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 this additional confirmation 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.

8.9 Translation of documents

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 UCITS/Receiving UCITS must be translated into the official language of the relevant UCITS host Member State or into a language approved by its competent authority(ies). In planning for the merger, stakeholders in each of the Merging UCITS and the Receiving UCITS should factor in both the timing and costs associated with these translation requirements. In particular, where a host Member State has multiple official languages, it may be worthwhile engaging with local counsel to ascertain if the Merging UCITS/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) into which the Circular (and ultimately the KID(s) appended to the Circular) is translated.

9. CONCLUSION

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

CONTACT POINTS



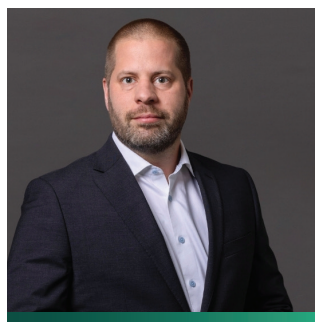
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