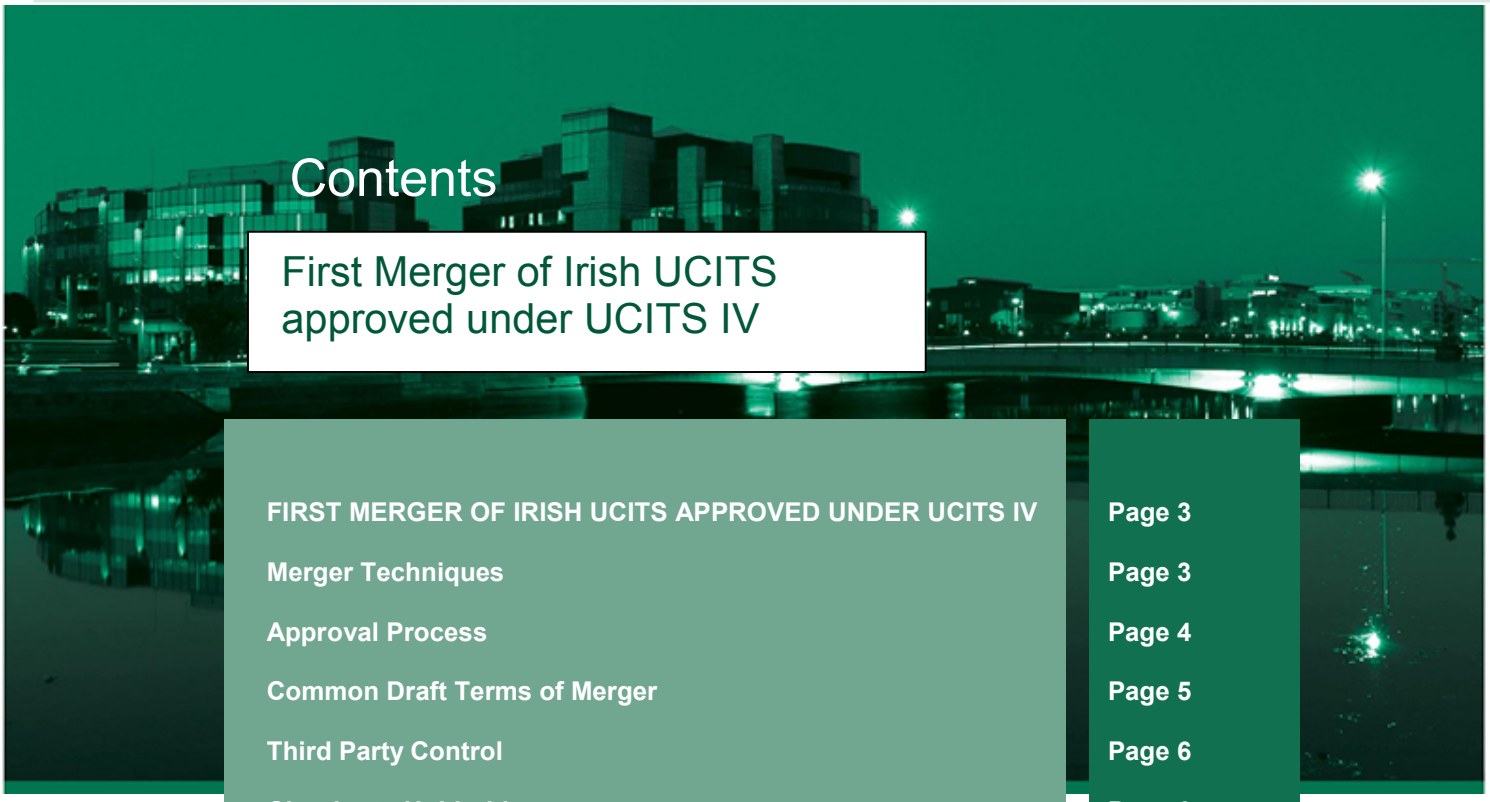
First Merger of Irish UCITS approved under UCITS IV

DILLON EUSTACE

DUBLIN HONG KONG NEW YORK TOKYO



Contents

First Merger of Irish UCITS approved under UCITS IV

FIRST MERGER OF IRISH UCITS APPROVED UNDER UCITS IV

The first merger of an Irish authorised UCITS has been approved under the new merger regime for UCITS, as set out in Directive 2009/65/EC ("UCITS IV"). The transaction involved the merger of a sub-fund of an Irish UCITS unit trust (the "Merging Fund") with a sub-fund of a UCITS SICAV authorised under Luxembourg law (the "Receiving Fund"). The merger was approved by the Central Bank of Ireland (the "Central Bank") on 1st September, 2011 and implemented on 21st October, 2011. Dillon Eustace acted for the Merging Fund.

The purpose of this Article is to examine the merger requirements under UCITS IV and the practical application of such requirements.

Merger Techniques

There are three types of merger techniques contemplated under UCITS IV as follows:

(i) 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 unitholders of units of the receiving UCITS and, if applicable, a cash payment not exceeding 10% of the net asset value of those units;

(ii) an operation whereby two 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 a UCITS which they form or a sub-fund thereof, the "receiving UCITS", in exchange for the issue to their unitholders of units of the receiving UCITS and, if applicable, a cash payment not exceeding 10% of the net asset value of those units;

(iii) an operation whereby one or more UCITS or sub-funds thereof, the "merging UCITS", which continue to exist until the liabilities have been discharged, transfer their net assets to another sub-fund of the same UCITS, to a UCITS which they form or to another existing UCITS or a sub-fund thereof, the "receiving UCITS". This is the most commonly used merger technique for Irish authorised UCITS.

The merger of the Merging Fund with the Receiving Fund was carried out under the technique outlined at (iii) above. It is expected that this technique will be the most attractive for fund

promoters given that, in practise, the liabilities of merging funds are generally not transferred as part of the merger arrangements.

Approval Process

As part of the approval process under UCITS IV, the merging UCITS is required to provide the following information to the Central Bank:

(a) the common draft terms of the proposed merger duly approved by the merging UCITS and the receiving UCITS;
(b) an up-to-date version of the prospectus and the key investor information (or simplified prospectus) of the receiving UCITS;
(c) a statement by each of the trustee / custodian of the merging and the receiving UCITS verifying compliance of certain particulars with the requirements of the UCITS Regulations and the respective UCITS' fund rules; and
(d) the information on the proposed merger (the "Circular") that each of the merging and the receiving UCITS intend to provide to their respective unitholders.

Fund promoters should be aware of the requirement referred to at (d) above and the fact that it will be necessary to send a Circular to both investors of the merging UCITS and the receiving UCITS. If it is proposed to set up a new fund for the purpose of housing the merged assets, fund promoters should consider holding off seeding the new fund until such time as the merged assets have been transferred to the new fund in order to avoid having to send a Circular to investors of the receiving UCITS.

The documents set out at (a) - (d) above must be provided in such a manner as to enable the Central Bank to read them in one of the State's languages or in a language acceptable to the Central Bank. It is, therefore, important to factor in time for the translation of the Prospectus and key investor information (or simplified prospectus) of the receiving UCITS into the English language. While the Central Bank may be prepared to accept a non-English version of the Prospectus of the receiving UCITS, a translation of the key investor information (or simplified prospectus) into English will be required (as an English version of this document will be required to be appended to the Circular to investors of the merging UCITS).

The Central Bank is required to transmit copies of the documents referred to above to the competent authorities of the receiving UCITS home Member State. In the case of the merger of the Merging Fund with the Receiving Fund, notwithstanding that there were no investors in the Receiving Fund, a cross border notification was still required to be made to the Luxembourg CSSF in order to allow it to consider the merger proposals.

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

I. the proposed merger complies with the relevant provisions of the UCITS Regulations (namely, the documents at (a) – (d) above are complete, the common draft terms of merger complies with the requirements set out under "Common Draft Terms of Merger" below, verification by the trustee / custodian of the merging and the receiving UCITS and validation of certain matters as set out under "Third Party Control" below);
II. the receiving UCITS has been approved to market its units in the State and in all Member States where the merging UCITS has been approved to market its units; and
III. the Central Bank and the competent authority of the receiving UCITS home Member State are satisfied with the proposed information to be provided to unitholders, 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 II. above that the receiving UCITS be approved to market its units in the State will apply notwithstanding that (i) there will be no Irish investors in the receiving UCITS following the merger and (ii) there is no intention to market the units of the receiving UCITS in Ireland. Fund promoters should, therefore, ensure that steps are taken at an early stage of the merger process to register the receiving UCITS for sale in Ireland (if such registration is not already in place) as this will be a pre-condition to authorisation of the merger by the Central Bank.

Common Draft Terms of Merger

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

(a) an identification of the type of merger and of the UCITS involved;
(b) the background to and rationale for the proposed merger;
(c) the expected impact of the proposed merger on the unitholders of both the merging and the receiving UCITS;
(d) the criteria adopted for the valuation of the assets and, where applicable, the liabilities on the date for calculating the exchange ratio of units of the merging UCITS into units of the receiving UCITS (the "exchange ratio");
(e) the calculation method of the exchange ratio;
(f) the planned effective date of the merger;
(g) the rules applicable, respectively, to the transfer of assets and the exchange of units;
(h) in the case of mergers carried out under either (ii) or (iii) under the heading "Merger Techniques" above, the fund rules or instruments of incorporation of the newly constituted receiving UCITS.

With regard to (h) above, it will be necessary to file the fund rules or instruments of incorporation of the receiving UCITS with the Central Bank (in English unless the Central Bank agree to another language) 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 instruments of incorporation of the receiving UCITS if it is a new sub-fund of an already existing UCITS. In the case of the Receiving Fund, while it was newly formed for the purpose of housing the assets of the Merging Fund, its fund rules were not required to be filed with the Central Bank as the umbrella fund of the Receiving Fund had already been established.

Third Party Control

The trustee / custodian of each of the merging and of the receiving UCITS is required to verify the conformity of the particulars set out in points (a), (f) and (g) under the heading "Common Draft Terms of Merger" above with the requirements of the UCITS Regulations and the fund rules of their respective UCITS.

Further, either the trustee / custodian or an independent auditor (which can be the statutory auditors of the merging or receiving UCITS) is required to validate the following:

(a) the criteria adopted for the valuation of the assets and, where applicable, the liabilities on the date for calculating the exchange ratio;
(b) where applicable, the cash payment per unit; and
(c) 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 control provisions, it is important to involve the trustee / custodian (and, if necessary, the statutory 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. In the case of the Merging Fund and the Receiving Fund, the trustees were entities within the same group, which facilitated the operational side of the merger process.

Circular to Unitholders

The Circular to be provided to unitholders of the merging and of the receiving UCITS, must include appropriate and accurate information on the proposed merger such as to enable them to take an informed decision on the possible impact thereof on their investment and to exercise their rights to vote and/or redeem their units prior to the merger becoming effective. The Circular to be provided to the unitholders of the merging UCITS should focus on the needs of investors who have no prior knowledge of the features of the receiving UCITS or of the manner of its operation while the Circular to the unitholders of the receiving UCITS should focus on the operation of the

merger and its potential impact on the receiving UCITS. The Circular is required to include the following details:

(a) the background to and the rationale for the proposed merger;

(b) the possible impact of the proposed merger on unitholders, including but not limited to 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;

(c) any specific rights unitholders have in relation to the proposed merger, including but not limited to the right to obtain additional information, the right to obtain a copy of the report of the independent auditor or the trustee on request, and the right to request the re-purchase or redemption or, where applicable, the conversion of their units without charge and the last date for exercising that right;

(d) the relevant procedural aspects and the planned effective date of the merger;

(e) a copy of the key investor information (or simplified prospectus) of the receiving UCITS.

If either the merging UCITS or receiving UCITS has been notified for distribution in another Member State, the Circular to the unitholders 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, fund promoters should factor in both the timing and costs associated with the foregoing translation requirements.

Voting requirements

Previously, the merger of an Irish UCITS with another UCITS was only effective if (i) it was approved by 75% of the votes actually cast by unitholders of the merging UCITS (ii) the votes in favour represented more than half of the total number of units in issue of the merging UCITS and (iii) provision was made to the effect that all non-voting unitholders of the merging UCITS be redeemed.

Under UCITS IV, the voting requirements for UCITS have been relaxed as the requirements at (ii) and (iii) above no longer apply. The only requirement now is that the merger of the Irish UCITS be approved by 75% of the votes actually cast by unitholders present or represented at the general meeting of unitholders of the Irish merging UCITS.

Member States must not impose more stringent presence quora for cross-border than for domestic mergers or more stringent presence quora for UCITS mergers than for mergers of corporate entities.

Right of Redemption

Unitholders of both the merging 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 units or, where possible, to convert them into units in another UCITS with similar investment policies and managed by the same management company or by any other company linked to the management company. The right of redemption is effective from the moment that the unitholders 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.

Timings

The Central Bank will carefully review the merger timetable to ensure compliance with the timing requirements under UCITS IV. In this regard, subject to Central Bank approval and completion of relevant translations, 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 practise, this means that the effective date of the merger can not be earlier than thirty five (35) days following the date of the Circular. Fund promoters will need to work closely with all relevant parties, including the administrator and trustee / custodian of the merging and receiving UCITS, to ensure that the proposed effective date of the merger satisfies the relevant UCITS IV timing requirements.

Costs

Except in cases where UCITS have not designated a management company, any legal, advisory or administrative costs associated with the preparation and the completion of the merger are not permitted to be charged to the merging or the receiving UCITS, or to any of their unitholders.

It will be necessary to examine the individual structure of each party to the merger to ascertain if there is scope for either the merging UCITS or the receiving UCITS to bear any of their respective merger costs, on the basis that it is self-managed. In the case of the merger of the Merging Fund with the Receiving Fund, since the Merging Fund was a unit trust with a designated management company, the merger costs of the Merging Fund could not be borne by the Merging Fund or any of its unitholders.

Fund promoters should be aware, therefore, that unless both the merging and receiving UCITS are self-managed, they will need to bear all costs associated with the implementation of the merger. Such costs will include the costs of convening the general meeting of unitholders, 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).

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 and the merging UCITS.

CONTACT US

Our Offices

Dublin
33 Sir John Rogerson's Quay,
Dublin 2,
Ireland.
Tel: +353 1 667 0022
Fax: +353 1 667 0042

Hong Kong
62/F, The Center
99 Queens Road, Central
Hong Kong
Tel: + 852 3965-3126
Fax: + 852 3965-3222

New York
245 Park Avenue
39th Floor
New York, NY 10167
United States
Tel: +1 212 792 4166
Fax: +1 212 792 4167

Tokyo
12th Floor,
Yurakucho Itocia Building
2-7-1 Yurakucho, Chiyoda-ku
Tokyo 100-0006, Japan
Tel: +813 6860 4885
Fax: +813 6860 4501

e-mail: enquiries@dilloneustace.ie
website: www.dilloneustace.ie

Contact Points

If you have any queries or would like further information relating to the above matters, please contact us at any of our offices listed above or through your usual contact in Dillon Eustace

DILLON EUSTACE

DUBLIN HONG KONG NEW YORK TOKYO

33 Sir John Rogerson's Quay, Dublin 2, Ireland.
www.dilloneustace.ie

In alliance with Arendt & Medernach