

Barry O'Rourke of SEI presents his case for regulated products in the current economic climate, listing the advantages of UCITS for investors in particular

Capitalising on the current climate

At a time when the market downturn has created an escalating number of fund casualties, investors are taking a closer look at regulated products. UCITS (Undertakings for Collective Investment in Transferable Securities) funds fit this profile and have been growing in popularity.

The UCITS structure offers investors a regulated product while giving investment managers access to global markets. UCITS has been honed through a number of restructurings and, in its present form, is well placed to serve the uncertain environment in which it resides.

The EU UCITS Directive was implemented by 10 EU states in 1989 with an objective of standardising regulation in the different member states across Europe. Ireland, along with Luxembourg, has been at the forefront as a preferred venue for UCITS fund establishment, but it is very much a pan-European product.

A UCITS fund, once established and approved in one EU member state, can utilise the 'EU Passport' that enables the investment manager to register their fund with another EU member state regulator in order to sell the fund without further authorisation being required. The EU has continued to develop the UCITS directives to ensure greater harmonisation throughout the EU and to allow for more sophisticated investment techniques to be used by the UCITS funds. Further developments at the EU level resulted in the UCITS III directives, which have proven very successful.

Upgrading to UCITS III

Ireland was at the forefront of implementing the UCITS III regime in Europe.

Firstly, the types of securities that a UCITS III fund can invest in have been expanded from what was originally permitted in UCITS I funds; it moved

away from allowing only standard long-only equity and bond funds to allowing managers to invest in a broader array of financial instruments. As a result, UCITS III now gives investors a lot more scope in terms of investment strategies.

The Management Directive portion of the UCITS III directives dealt with the development of corporate governance for the UCITS funds using more sophisticated investment techniques. The Irish regulatory body has given guidance highlighting the types of functions for which the management company of Irish UCITS fund must be responsible for, such as:

- | Decision taking
- | Monitoring compliance
- | Risk management
- | Monitoring of investment performance
- | Financial control
- | Monitoring of capital
- | Internal audit
- | Supervision of delegates of the board

Another key benefit from the UCITS III upgrade was the ability to vary the products that fund managers were selling. As a result, products can be established within the UCITS fund structure with investment techniques that were traditionally considered to be limited only to alternative products, and attract markets that were previously untapped, such as retail investors who were keen to invest in alternative investments.

Popularity in the current environment

As a result of these modifications, UCITS have proved extremely popular. The industry data issued by the Irish Funds Industry Association (IFIA) in October 2008 confirmed the popularity of UCITS structure in Ireland: 80% of Irish registered funds



Barry O'Rourke is a member of the Institute of Chartered Accountants in Ireland and has worked in the financial services industry for 18 years. He has been the managing director for SEI's Dublin office since 2005.



are set up as UCITS funds. This translates into asset levels of approximately €540bn (US\$700bn) and there is certainly continuing and increasing interest from fund managers and investors in the product for the reasons outlined.

Ireland has long been considered an ideal venue to establish UCITS funds. It has firmly established itself as a premier fund-servicing centre, well suited to servicing a range of fund types. The expertise that Ireland has in terms of trustee and custody, fund accounting, fund administration, but also in transfer agency, makes the country a very attractive market in general, and well positioned to service UCITS. In addition, a proactive and pragmatic regulatory environment is appealing to fund managers and investors alike.

The volatility of the current market environment has meant, of course, that no structure is completely immune, and while UCITS have managed to stay out of the negative headlines, their performance is very much dependent on the investment objective of the fund. So, for example, the performance of a UCITS fund that was fully invested in fixed income may have been less impacted by the recent economic downturn than a UCITS invested in emerging markets.

The future of UCITS

There is industry-wide nervousness at the moment about which direction the markets are going to take in 2009. However, for those investors that do want market exposure, and this number will increase as

confidence levels increase, products like UCITS III will be seen as a more appealing investment product.

Going forward, there are other proposals in progress in the EU to further enhance the product (UCITS IV). One modification being discussed is to allow for a management company in one EU member state to have a fund in a separate member state, but for the regulation of that management company and the fund to remain in their respective member state's regulator. The proposal would prevent managers from having to set up two separate management companies.

We will have to wait and see what the impact of further UCITS modifications will mean to the market. As good as it is, the UCITS brand is still evolving and a number of other improvements can still be made.

Given the current market conditions and the reduction of asset allocations, UCITS funds provide managers with the ability to broaden their distribution potential, while offering a product that is more attractive to cautious investors. While UCITS may not save the day, they are poised to capitalise on the current environment and thrive over the long term.

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