UCITS at 30: A Look Back and the Path Forward

J.P. Morgan
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Since it was first introduced in Europe in 1985, the Undertakings for Collective Investment in Transferable Securities (UCITS) has evolved materially as a product and has become a successful international brand, with holdings in UCITS funds now at a record high of EUR 8 trillion at the end of 2014. UCITS funds have become a global standard, recognized for the high level of investor protection, transparency, and regulatory oversight that they provide. According to EFAMA Quarterly Statistical Release No. 62, net sales of UCITS for first half of 2015 are currently at EUR 397 billion, up from EUR 274 billion during the same period last year.¹

There is still plenty of potential for growth, however, even within Europe, which remains an under-tapped market in certain respects.

Denise Voss, Conducting Officer and Director at Franklin Templeton International Services, and John Donohoe, CEO of the Carne Group, recently sat down with J.P. Morgan Managing Directors Carin Bryans (Senior Country Officer in Ireland) and Amanda Cameron (Senior Country Officer in Luxembourg) to reflect on UCITS’ history and to discuss where the market is moving ahead of the UCITS V implementation in March 2016.

As Senior Country Officer for J.P. Morgan in Ireland, Carin Bryans oversees approximately 520 staff operating through five regulated entities. In Ireland, J.P. Morgan provides end-to-end services to Irish domiciled funds and also acts as the EMEA Operational Centre of Excellence for all AIFs. Through its bank subsidiary, J.P. Morgan also provides cash management services to institutional and corporate clients based in Ireland. In addition, Chase Paymentech Europe Ltd. was established in Ireland under the payment services directive, for all European payments and merchant acquiring business.

Carin received an undergraduate degree from The University of Texas at Austin, spent a year working in France for Zenith Data Systems and returned to Ireland in 1990 to take up a position at Chase Manhattan Bank. Since then, she has held a wide variety of roles at the firm, and also received an M.B.A. from The Michael Smurfit Business School.

Carin currently chairs the IFSC Funds Group on behalf of the Office of the Prime Minister, and was the Chairman of the Irish Funds Industry Association for 2010/2011.

Carin is a non executive director of the Irish Society for the Prevention of Cruelty to Animals (ISPCA), the largest animal welfare society in Ireland, and is also a founding member of Women in Business and Finance Ireland.
John Donohoe is the founder and CEO of Carne with over 25 years of experience in the financial services industry. He sits on and chairs the boards of some of the largest and most complex mutual and hedge funds. John also provides Carne clients with his considerable expertise on governance, product development, distribution and regulatory developments. He is considered a thought leader in the ongoing development of hedge fund governance and oversight.

John was a managing director at Deutsche Bank. He served as an executive/non-executive director on various Deutsche Bank boards, including Deutsche International (Ireland) Ltd. and subsidiaries, Morgan Grenfell & Co Ltd., Deutsche Trustees (UK) Ltd. and the WM Company Ltd. John spent 12 years with Deutsche Bank, where he rose to become CEO of Europe, Asia and Offshore, Deutsche Global Fund Services. Prior to establishing Carne, John was a senior vice president at State Street. He qualified as a Chartered Accountant with KPMG in Dublin and is a Fellow of the Institute of Chartered Accountants. He holds a First Class Honors degree in Accounting and Finance from Dublin City University.

Amanda Cameron is the Senior Country Officer for Luxembourg as well as the General Manager of J.P. Morgan Luxembourg Bank (JPMLB). She chairs the local management committee and is accountable to the Board of Directors for JPMLB.

Amanda joined J.P. Morgan (Chase Manhattan Bank) in Luxembourg in 1993, where she managed client services and operations for a number of years. In 2000, she moved to London as a relationship manager, before moving back to Luxembourg in 2003 as the head of EMEA Client Service for franchise clients. Amanda then moved into business management and was the Chief Administrative Officer (CAO) for the Luxembourg location for three years. In 2007, she relocated to Hong Kong to establish a sales support function, and later became the CAO for the APAC region, the CFO and, latterly, the CRO.

Amanda is a global co-chair for the Women’s Interactive Network (WIN), J.P. Morgan’s Business Resource Group focused on the development and retention of women at all levels of the organization.
Denise Voss has worked in the financial industry in Luxembourg since 1990.

Denise joined Franklin Templeton Investments in 1995. She is currently Conducting Officer and board member of Franklin Templeton International Services S.à r.l., a Luxembourg-based management company, managing both UCITS and AIFs, in and outside the EU.

Prior to joining Franklin Templeton Investments, Denise worked in the audit division of Coopers & Lybrand in Boston and Luxembourg for over nine years. Denise holds a Massachusetts C.P.A. license and obtained an undergraduate degree from Tufts University, as well as a Masters degree in Accountancy from Bentley College. She was recently appointed Chairman of the Association of the Luxembourg Fund industry (ALFI) and has been a member of the ALFI board of directors since 2007. She is also Chairman of the European Fund and Asset Management Association (EFAMA) Investor Education working group.
What are your reflections on those early years?

Carin Bryans, J.P. Morgan (CB): The Directive was first published in 1985 with an implementation deadline of 1988. Funds were authorized in Luxembourg in April 1988, and then in Dublin in July 1989. Throughout the 1990s, growth in UCITS certainly gathered momentum, as more funds were authorized in those jurisdictions that had implemented the Directive. By 2002, there were almost 2,000 sub-funds authorized in Dublin alone. Looking back at those early years, I think it is fair to say that at first, non-European managers viewed UCITS as more of an opportunity than did European managers. Our first UCITS client in Dublin 25 years ago was a U.S. manager that saw the potential of the UCITS passport and wanted to take advantage of it, even though, in those early days, the passport benefits were largely aspirational, as the functioning of the passport was untested.

Source: Central Bank of Ireland

Denise Voss, Franklin Templeton (DV): I think that only a few countries saw UCITS as an opportunity—primarily Luxembourg and Ireland, which, due to their size, needed to look outward for business. The big European countries, like Germany and France, were more focused on their domestic markets. It also took time for UCITS to gain critical mass because people were getting used to the rules and learning how it would and could work in terms of global distribution. Infrastructure and administration had to be set up. At an early stage, quite a number of U.S. managers recognized UCITS as an interesting opportunity for growth, largely due to their experience with the U.S. funds that were established under the Investment Company Act of 1940 and looked very similar from an investor protection perspective.

Irish domiciled UCITS funds total net assets & No. of funds

John Donohoe, Carne Group (JD): It took time to develop because Europe was a very different place in the late 1980s and early 1990s. We did not have an integrated Europe by any means in terms of a single market for funds. In the beginning, there were no global managers; there were only domestic managers focused locally. Distribution channels were also very segmented. In Italy, for example, banks generally distributed their own funds. In Germany, banks and insurance companies owned distribution. And, in the U.K., distribution was predominantly through authorized independent financial advisers. This legacy is still here today, but it has opened up considerably in certain markets and channels.

What were the drivers for the growth of UCITS in those early days?

JD: There were a number of drivers, but, primarily, the development of managers’ models and the evolution of distribution channels aided that initial growth. Managers looked for acquisition opportunities in other countries and developed objectives to become global or pan-European. They looked outside their domestic markets for growth opportunities, whether in Europe or in Asia, and identified efficiencies in selling products cross-border as traditional distribution channels evolved and opened up.

CB: In addition to the importance of global managers, we saw the emergence of global service providers and the offerings they provided for UCITS, such as the calculation of a daily NAV, thus enabling distribution capability on a global basis. These services have continued to develop and evolve with the use of technology and global operating models. Additionally, assets in UCITS have grown as the European Union and its institutions have evolved and matured from those early days when Europe was still rather fragmented.

DV: Of course, the evolution of the passport through the years has increased growth. Another driver of growth was the development of the UCITS product itself, from the early days of the first Directive when one could only invest in listed equities and bonds and certain collective investment schemes, to UCITS III and investment in derivatives. Investing in various parts of the world was attractive to institutional investors, which drove growth as well.
What was the appeal for investors?

**JD:** Compared to other investment products at the time, UCITS was a product that was a lot more transparent, a lot simpler to understand, and offered more protection to investors.

**DV:** That was one of the main reasons why UCITS expanded outside of the EU. A Hong Kong regulator, for example, wouldn’t have approved a fund for distribution to Hong Kong investors that didn’t have strong investor protection rules. Our fund was registered in Hong Kong in 1994, pretty early in the history of UCITS, and demonstrated the universal appeal of UCITS.

**Amanda Cameron, J.P. Morgan (AC):** At the start, the UCITS product was simple and straightforward, which was attractive to those early investors. As the UCITS product has developed and grown in terms of sophistication, so have its investors. Their knowledge and understanding of markets and products have evolved in tandem with the UCITS product.
Opportunities and obstacles to growth

Where's the next big opportunity for growth?

AC: Asia continues to be a key market for UCITS. There is huge recognition of the UCITS brand by both investors and regulators, and, in 2014, Singapore emerged as a top market in terms of UCITS registrations, particularly Luxembourg UCITS. The Middle East and South America also saw record numbers of UCITS registrations last year. All of the statistics show that UCITS is a globally recognized brand, and promoters are taking advantage of this recognition by registering in a greater number of global markets and gathering assets. A PwC distribution report I read recently noted that the top five fund promoters have registered their UCITS for sale in 35 or more markets around the world.

DV: There are opportunities everywhere—Switzerland, South America, Taiwan, Korea, Japan. Importantly though, there are still plenty of opportunities in Europe. Given demographic changes, Europeans are going to have to save more for their retirement. Although we have a growing middle class outside of Europe, penetration is low in terms of households that invest in funds, including UCITS. There are huge opportunities, but we need to help people understand the importance of saving now for the future.

CB: I agree. Europe still offers massive opportunities; we have an aging population of people who need to save for their future. This is a great opportunity for UCITS. Investor education is a key component to that growth potential. This is something that our entire industry—asset managers, service providers, national governments and European institutions—should consider and address.

DV: There exists a natural chain of information flowing from policymakers to industry associations to industry participants, such as service providers and asset managers, to distributors and to the end investors. It is important that those who have a direct dialogue with end investors understand the products they are selling. A number of asset managers do focus on education for their distributors, and we are finding more and more financial advisors are asking for educational materials for the end investor.

JD: Identifying the right investment product for a particular investor is key to future growth. Investor ‘type’ is evolving and changing. Furthermore, the landscape is evolving as the pensions space is transitioning from defined benefit to defined contribution; demographics are shifting, in terms of wealth, which means more distribution via wealth managers; and retail platforms are emerging. UCITS has the ability to offer all of these investor ‘types’ a variety of products, from very passive, to enhanced, to very active strategies. UCITS also offers transparency and value of return, although value of return is not, of course, guaranteed. For managers, UCITS products offer scale and cost efficiencies, which essentially meet both the needs of investors and mangers.

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Opportunities and obstacles to growth

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<tr>
<th>Region</th>
<th>Total UCITS registrations at Dec 14</th>
<th>During 2014</th>
<th>% growth 2013-2014</th>
<th>Trend over 5 years</th>
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<tbody>
<tr>
<td>ASIA PACIFIC</td>
<td>6132</td>
<td>409</td>
<td>7.15%</td>
<td></td>
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<tr>
<td>MIDDLE EAST</td>
<td>965</td>
<td>404</td>
<td>72.01%</td>
<td></td>
</tr>
<tr>
<td>AMERICAS</td>
<td>2378</td>
<td>31</td>
<td>1.32%</td>
<td></td>
</tr>
<tr>
<td>AFRICA</td>
<td>329</td>
<td>56</td>
<td>20.51%</td>
<td></td>
</tr>
<tr>
<td>EUROPE</td>
<td>73701</td>
<td>6111</td>
<td>9.04%</td>
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Source: Benchmark your Global Fund Distribution 2015, March 2015, PwC Luxembourg

Do the different initiatives in Asia, such as the ASEAN fund passport, the Hong Kong-China Mutual Recognition Scheme, and the Asia Regions Fund passport, threaten UCITS growth in that region?

DV: The devil is in the detail. Europe was challenging enough, and we had the European Union in place at the time. For example, the ASEAN’s fund passport is a cross-border passporting framework that includes Singapore, Malaysia, and Thailand. This allows fund managers operating in the three nations to distribute fund products across borders to retail investors via a streamlined process. The challenge, though, is that while it is relatively easy for one country to expect another to accept its fully approved and established process, it is more difficult for that country to accept another’s process on faith, especially in the absence of common prudential regulation, supervision, or legal systems.

CB: The European legislative process is complex, but there is an established pan-European legal and regulatory framework here. Even with that in place, it still took time for UCITS to really gain global brand recognition. So, on that basis, it may take time in Asia for these initiatives to develop and gain traction.

AC: Interest in UCITS from Asia does not appear to be waning, and we see it in the increased UCITS registrations in the region mentioned previously and the continuing queries we receive from Asian asset managers. We should not be complacent by any means, but the success of these initiatives is to a large extent out of our control. What is within our control is ensuring that UCITS continue to be recognized as a brand that investors can trust, can understand and can invest in regardless of their location.

JD: As a manager, it depends where your distribution is focused. If you are a local asset manager in Asia and you only want to sell domestically, then you can set up a domestic Asian fund. That makes sense. But if you have ambitions beyond the Asian market, then you are dependent on numerous reciprocal arrangements not only within Asia, but also between Asian countries and the rest of the world. That will take time. Another reality is that expenses are absolutely key to growth; it is all about cost control. The reality is that UCITS growth and scale is at a size now that it has the potential to deliver on cost efficiency.
What impact will UCITS V have on investors?

DV: UCITS V is more than just a housekeeping exercise that aligns certain provisions to AIFMD (Alternative Investment Fund Managers Directive) and harmonizes other UCITS provisions throughout all member states. UCITS V will actually strengthen investor protection. There is a depositary element that defines the eligibility criteria for a depositary and clearly defines its tasks. There is a higher liability for loss of assets than what exists today in most EU-member states. There is also the depositary oversight element, which is a positive for UCITS investors. For managers, UCITS V changes remuneration policies, with the goal of ensuring that managers aren’t rewarded for taking unnecessary risks. UCITS V also establishes a greater harmonized approach to the imposition of sanctions if/when the UCITS legal framework is breached.

Does the UCITS product need more development/enhancement in the future?

JD: In my view, any regulatory change has to achieve the right balance between investor protection and investment choice. Investors, particularly retail investors, should be afforded proper protection, but not to the detriment of investment choice, which should come down to the risk appetite of that investor once he/she is properly and appropriately equipped with all information on that investment.

DV: I think Lord Hill, the new European Commissioner for Financial Services and Capital Markets Union, put it very well in his speech last November4 when he said: “I do think that it is only common sense to take a step back after five busy years of legislating in crisis conditions and ask ourselves this question: have we always struck the right balance between reducing risk and encouraging growth? If the evidence tells us that we haven’t always got the balance exactly right, we should be self-confident enough to make adjustments. There may be areas where we identify gaps; there may be areas where we need to fine tune to make investment flows easier…I am also conscious that businesses need regulatory stability and consistency to plan ahead and make decisions to invest. To grow, they need to focus on developing their product lines, expanding their customer base, getting an edge on competitors.”

CB: I agree that the industry as a whole needs a ‘settling in’ period to properly assess consequences of all of the recent regulations and understand where they intersect or overlap, so that together we can look at adapting what we have, if necessary.

AC: Ultimately, we must not damage the brand and undo all of the work and successes we have achieved together since 1988. I am not against further regulatory change, provided it is thoughtful, measured and proportionate, and has a chance of achieving a clear and stated aim. The reality is that regulations do add complexity and cost to fund managers and service providers.

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What does the future hold for UCITS?

**AC:** In my view, the future is bright. According to figures released recently by ALFI, the industry body in Luxembourg, net assets under management in Luxembourg UCITS funds at the end of March were almost EUR 3 billion, which is a 15% increase since the start of January 2015. Similar growth has been seen in Ireland for their UCITS funds over the same period.

**DV:** I am very optimistic about the future. There are still tremendous opportunities for UCITS. We need to be pragmatic about dealing with regulation. We also need to make sure that UCITS is relevant for the younger generation and generations to come, not just in terms of distribution and access of investment funds from the internet, but also in terms of communicating and interacting with this group of potential investors.

**CB:** Shopping for the younger generation these days is very dynamic and very dependent on views expressed on social media, which is different from the buying behaviour of UCITS investors today, who generally don’t change their investments that often. As service providers, we have to evolve to deal with new distribution mechanisms, new countries, and new investment strategies as efficiently and effectively as we can, so that we are here in another 30 years discussing continued UCITS growth and success.

Sources: CSSF

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Looking ahead

UCITS continue to grow and evolve. If you are considering launching a UCITS fund, questions to consider may include, but are not limited to, the following:

1. Who are your target investors and where are they located?
2. What is your investment strategy and can you operate such a strategy within the constraints of a UCITS product?
3. In order to reach your target investor base and manage your investment strategy, what products and fund features do you need to consider?
4. Are you familiar and up-to-date with regulatory obligations and requirements of UCITS and UCITS management companies?
5. Are you keeping in mind that cost is a driver for investors?
We wish to thank Franklin Templeton International Services and the Carne Group for participating with us in this conversation. The views expressed are those of the participants alone and do not necessarily reflect the official policy or position of J.P. Morgan.

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