European mutual funds

An introduction to UCITS for US asset managers

EY

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I. Introduction and a brief history of UCITS

Since the early days, when the European Steel and Coal Community was established in 1951 in order for commodities to be sold and transported freely within European borders, European policymakers have long sought to create a seamless market for goods and services throughout the continent. After the European Union (EU) was officially created and replaced the European Economic Community following the treaty of Maastricht in 1993, financial services, and asset management in particular, have moved to the very center of widespread sweeping legislative initiatives.

With the first implementation of the Undertakings for Collective Investment in Transferable Securities (UCITS) legislation, the entire European continent has been steadily moving toward a single market in terms of the manufacturing and distribution of asset management products. What this means for global asset management firms, especially those originally domiciled outside of Europe, is simple: the UCITS regime enables a firm to register an investment product one time in one EU domiciliation and then effectively distribute that product across the entire EU, which is now the world's second largest fund market outside of the United States. Given the relentless integration and globalization of the financial services industry and ongoing regulatory restructuring of the EU distribution landscape, growth-oriented firms can readily leverage the UCITS regime to increase assets under management and widen their investor base efficiently and effectively.

UCITS are regulated investment products established and authorized under a common EU legal and regulatory framework. Once a UCITS is established and authorized by the regulatory authority in its chosen country of domicile (an EU country only), it can then be marketed and distributed to all types of investors (both retail and institutional) throughout the European Economic Area (EEA)[1] via the UCITS European passport. UCITS can also be sold outside the EEA subject to each individual country's national regime. In fact, many UCITS are available for distribution in non-EU countries such as Switzerland, Hong Kong, Singapore, Taiwan, Chile, Peru, Bahrain, South Africa and Japan. In short, once an investment product is duly registered under UCITS, it can be distributed to a very large proportion of the global asset management market.

Unlike the Investment Company Act of 1940, which regulates mutual funds in the United States, the underlying UCITS regulations (known as the UCITS Directive) are constantly evolving. The original UCITS Directive was completed and published in 1985. UCITS IV was published in 2010, and UCITS V and VI are currently being discussed. Below is a timeline for the various iterations of UCITS as well as future amendments currently being considered.

UCITS I	UCITS II	UCITS III	UCITS IV	UCITS V	UCITS VI
1985 Original UCITS directive published.	**Abandoned** UCITS II was abandoned in 1998 after EU Member States failed to reach an agreement on its scope and purpose. Key provisions included much of the framework of UCITS III.	**2001** Firms were given until February 2007 to ensure their funds were UCITS III compliant. UCITS III was divided into two distintive directives: **Management directive:** Creation of the European Passport whereby a UCITS fund authorized in its home state could be sold anywhere within the EU. Also required the use of a simplified prospectus detailing the key features of a fund. **Product directive:** Allowed for investments in a wider range of asset classes with a corresponding distinction between non-sophisticated and sophisticated funds.	**2009** UCITS IV was effective 1 July 2011. Key provisions included the following: - Streamlined regulator-to-regulator notification procedures - Management company passport created - Key Investor Information (KII) document replaced the simplified prospectus - Master-feeder fund structures are introduced - Framework for domestic and cross-border fund mergers is created	**Spring 2016 (estimated)** UCITS V amendments were proposed by the EU Commission in July 2012 and approved by European Parliament in April 2014. Will align UCITS Directive with the AIFM Directive. Key provisions include the following: - Depositary regime updates, including their appointment and eligible entities, oversight duties, cash-monitoring duties, safe-keeping duties, delegation and overall liability - Establishment of remuneration policies and practices that promote sound and effective risk management and do not encourage risk-taking. Remuneration structures will need to include rules on variable and fixed compensation, including a requirement that at least 50% of variable remuneration be in the form of units - Creation of a sanctions regime and whistle-blowing procedures for reporting incidents to authorities	**To be determined** Potential areas covered include the following: - Eligible assets, use of derivatives and efficient portfolio management techniques - Liquidity management - Depositary passport - Money market funds - Long-term investment funds - Consistency with AIFM Directive

[1] The European Economic Area includes all EU countries (Austria, Belgium, Bulgaria, Croatia, Republic of Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom) as well as Iceland, Liechtenstein and Norway.

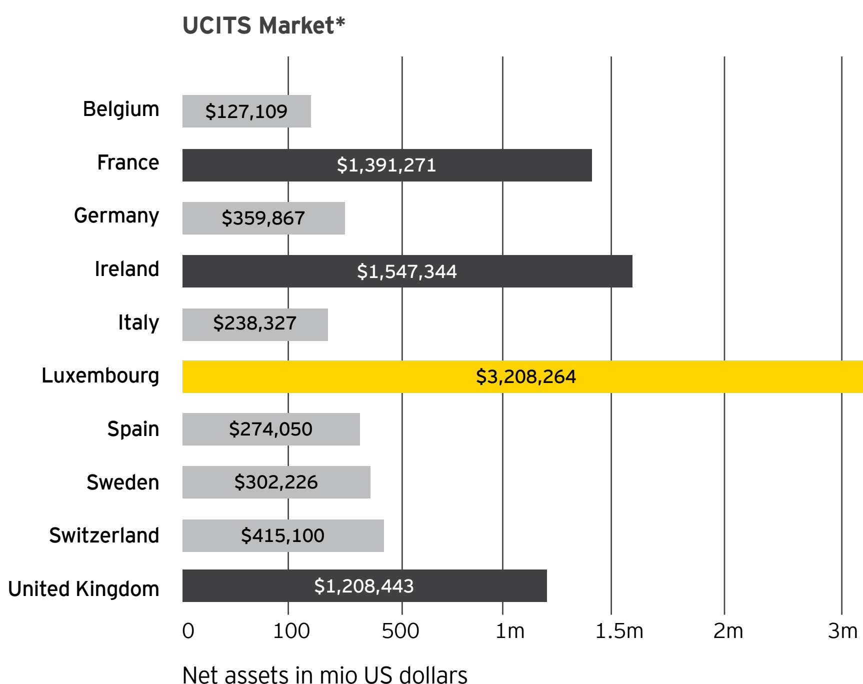
II. Domiciliation

UCITS Directive updates are proposed by the European Parliament in a somewhat similar process by which US legislation is proposed; debated; and then, eventually, approved by the U.S. Congress. In the case of EU directives, however, after authorization by the European Parliament, each new directive must then be translated and transposed into the local law of each EU country individually. This can create minor differences in terms of both implementation and interpretation. As mentioned, the key benefit obtained from UCITS registration is that once your fund has been approved by the regulatory authority in the country of domiciliation, distribution to all other countries in the EEA is relatively simplified and streamlined, and takes the form of a standardized notification procedure with the regulatory authorities for each of the countries of distribution. The level of interaction with the host country regulator and each EU country's own interpretation of the UCITS directive, as well as the factors noted below, make the decision on where to domicile your UCITS often one of the first and most important determinations. Other key factors that may influence a promoter's decision as to where to domicile their UCITS include the following:

- Preexisting relationship with and reputation of the regulator in the domicile
- Reputation of domicile or brand in the investment fund industry and outside the EEA
- Distribution strategy and location of investors
- Service provider considerations, including the ability to leverage relationships with current service providers to US domestic products
- Native language(s) spoken in domicile and those of investors as well as cultural alignment
- Political, economic and social environment stability
- Legal environment and taxation regime

Authorization of a promoter's fund as a UCITS involves the submission of an application, prospectus and Key Investor Information (KII) document, as well as other key agreements, documents and information with the regulatory authority in the chosen country of domicile. Once approved, the prospectus obtains a VISA stamp confirming that the regulator of the country of domicile has authorized the UCITS. Distribution throughout the EEA is then subject to notification procedures. The notification procedures, which were simplified under UCITS IV, involve the submission of a notification letter and required documents to the regulatory authority in the country of domicile (home country). The home country regulator then communicates and coordinates directly with the regulatory authority in the country of desired distribution (host country) for approval.

Assets of the top 10 domiciles — European investment fund industry, end December 2014



(*Source: EFAMA: In the sense of publicly offered open-ended investment funds (transferable securities and money market instruments), including funds-of-funds assets.)

III. Structuring

UCITS are structured as either stand-alone funds or multiple compartment funds. Multiple compartment funds (otherwise known as umbrella funds) are single entities that may comprise two or more compartments (known as subfunds)[2], with each subfund typically having a separate investment policy. The concept, in general, is similar to the creation of a multi-series trust (i.e., series funds) within a promoter's US mutual fund family, and is the most favored vehicle for the larger promoters of UCITS.

The legal structure that is chosen for a UCITS is one of the key decisions firms need to make, and typically there are multiple options. The structures available for a UCITS, like with many of the other crucial decisions, are domicile-driven. Each country in the EU has its own types of vehicles, structures and solutions available to promoters looking to open UCITS. However, there are often similarities between offerings of the primary fund domiciles and there is certainly an option for either a corporate or partnership structure.

There are also alternatives for firms looking to enter the European market without bearing the full costs and regulatory burden of opening a new structure. The most popular of these alternatives is the use of a UCITS platform (often known as "renting a compartment"). In this scenario, an unaffiliated platform provider will create a new subfund to an already existing umbrella structure and delegate the portfolio management function of that subfund to the respective investment management firm looking to gain entry into Europe. The manager typically controls the naming of its subfund, and although all subfunds on the platform may be marketed collectively by the platform provider, the asset manager can establish both a performance history brand and reputation within Europe. This structure is an ideal alternative for small firms that want to focus purely on portfolio management and return generation, while outsourcing the administration and day-to-day running of their fund to the platform provider. This can also be an attractive option for firms with no presence, brand or corresponding distribution network in Europe looking to bring their product to market quickly and with minimal start-up costs. The disadvantages include a loss of both flexibility and control, often including the ability to choose the service providers.

[2] Similar to funds established under a US multi-series trust (i.e., series funds), separate subfunds or compartments established under a UCITS registrant follow the protected cell concept, whereby the right of investors and creditors concerning one subfund or compartment are limited to the assets of that subfund or compartment (i.e., segregation of assets and liabilities on a compartment-by-compartment basis).

IV. Service providers

The key service providers to a UCITS are, in general, similar to those used by a US registered mutual fund and include the investment manager, administrator, transfer agent, distributor and auditor. However, there are some key differences:

UCITS management company

UCITS are required either to be self-managed or appoint a management company. Funds that are organized contractually (i.e., partnerships) are required to have a UCITS management company. The management company, through its board of directors, is ultimately responsible for the operations of the UCITS and most of its functions, but will generally delegate most tasks to more efficiently conduct business (portfolio management, administration, marketing and distribution, etc.). A management company, however, cannot delegate its tasks to the extent it becomes a "letter box" entity. There must be clear monitoring activities and management functions that take place at the management company level, and often requirements exist to have employees physically based and residing in the country of domicile of the management company. Self-managed funds are not required to appoint a management company, but can do so.

A self-managed UCITS does not have a UCITS management company and will instead, through a board of directors, appoint directly the investment manager, administrator, depositary bank, distributors and auditor. The specific requirements for the composition of a board of directors for UCITS differ by domicile. Although there is increasing pressure to have more of the directors of your UCITS to be independent from the asset manager, there currently are no requirements comparable to those for a US mutual fund. Typically only UCITS organized as companies can elect to be self-managed. An application to be self-managed, similar to the application for an entity to become a UCITS management company, must be submitted to the regulatory authority in the country of domicile and detailed requirements exist for a fund to be self-managed. In some domiciles, self-managed UCITS are becoming out of favor to the local regulatory authority given the lack of substance in Europe, particularly when the members of the board are non-Europeans.

One of the key provisions of UCITS IV was the introduction of a passport for UCITS management companies, which permits UCITS funds to be managed on a cross-border basis. Management companies located and approved in one domicile are now permitted not only to manage UCITS established in that same EU member state, but also UCITS domiciled in other EU member states. Approval of an entity for a management company passport requires both an application to the regulator in the country of domicile and corresponding notification procedures to each of the countries of domiciliation of the corresponding UCITS managed, similar to those employed for fund distribution.

Depositary bank

The functions performed by a custodian of a US mutual fund are performed by a depositary bank in Europe, and there are strict criteria in each domicile governing the types of entities that are eligible to act as a depositary. Most national laws mandate that only credit institutions located in the country of domiciliation or a branch of an EU credit institution may be appointed as depositary. Additionally, the duties and responsibilities of a UCITS depositary bank are much more extensive than those of a US mutual fund's custodian. In addition to the safekeeping of the UCITS' assets, the depositary bank also has additional oversight duties, including the following:

- Ensuring subscriptions and redemptions of shares or units[3] are carried out in accordance with the offering documents
- Ensuring all considerations, in relation to transactions involving any assets of the fund, are remitted within usual time limits
- Ensuring that the application of the fund's income is appropriate and in accordance with the offering documents

The next scheduled update to the UCITS directive, known as UCITS V, includes provisions requiring even more oversight and responsibilities for an entity serving as a depositary bank and additional liability for any loss of financial instruments held in custody either by the depositary itself or by a delegated entity. The provisions included within the UCITS V directive aim to harmonize the requirements of a UCITS depositary, including its liability, with those of a depositary of an alternative investment fund (AIF) whose manager is subject to the provisions of the Alternative Investment Fund Managers Directive (AIFMD).

[3] UCITS generally have a formal transfer agent and share registrar function, similar to that in the US. However, the depositary bank of a UCITS retains additional responsibility and oversight related to the subscription and redemption of fund shares.

Risk management

In general, the functions, guidelines, requirements and reporting for risk management are more formalized and robust for UCITS in comparison to US mutual funds. A UCITS' risk management function should be separated from the normal operating functions of the fund, including portfolio management, with safeguards in place to prevent conflicts of interest. A standard risk management function will include the following:

- A formal risk management policy, often including procedures that use a value-at-risk (VaR) model to calculate exposure
- Ensuring the risk profile disclosed to investors is consistent with the risk limits (including calculation of the synthetic risk and reward indicator (SRRI) in the KII document)
- Monitoring compliance with risk limits
- Providing regular and timely updates to senior management and those charged with governance on compliance with risk limits, current levels of risk and actual breaches of limits, as well as the overall adequacy and effectiveness of the risk management process

Administration

The fund administration, registrar and transfer agency, and domiciliation agency functions are often delegated, by the management company or board of directors, to the same organization. The existence of a domiciliation agent as a separate service provider differs from a US mutual fund. The domiciliation agent is responsible for providing the registered office of the UCITS and for keeping all correspondence of the fund, including all the key agreements and offering documents. The fund administration function of a UCITS is similar to that of a US mutual fund. One approach taken by promoters with both US mutual funds and UCITS, often with the same strategy, investment classes and valuation or accounting policies, is to leverage the same administration team for both product lines. There are provisions requiring that the named administrator for a UCITS fund, and certain of the administration activities, be located in the country of domiciliation. But unlike a US mutual fund, there are no specific provisions regarding the timing of the calculation of the net asset value per share/unit (NAV). As such, for many US promoters, many of the accounting and NAV calculation "preparatory tasks/procedures" may be performed by their US administrator for their UCITS product concurrently with their US products, which are then reviewed and ultimately issued by the administrator's European affiliate located in the domicile of the UCITS. The European affiliate remains ultimately responsible for the calculation and publication of the UCITS' NAV.

It should also be noted that the UCITS Directives do not require the calculation of a NAV and dealing to be performed on a daily basis, although many do. The directives require the calculation of NAV at least twice a month, and the frequency at which the NAV will be calculated must be expressly stated in the fund's prospectus and KII document.

V. Key prospective fund documents

The two key prospective documents required under the UCITS Directives are the prospectus (often referred to as the full prospectus as a carryover from earlier days when a simplified prospectus was also required) and the KII document. The prospectus is prepared in one of the official languages of the country of domicile and the exact contents required are governed by the regulatory authority in that domicile, but in general it must include all information necessary for investors to be able to make an informed judgment of the investment proposed to them and the associated risks. The prospectus may be translated into a host country language, but is not required to be. Typical required information is consistent with that of a US mutual fund and includes the following:

- Name of the fund and names of compartments (umbrella funds)
- Legal form and dates of establishment and/or incorporation
- The investment objectives for each compartment, including the investment policies, limits, techniques, asset classes used and borrowing practices
- Types and characteristics of shares or units, including the procedures for issuance, redemption and circumstances that would lead to suspension of dealing (i.e., the ability of investors to subscribe or redeem from the fund)
- Periodicity of the NAV calculation and dealing frequency
- Accounting, expense information and valuation policies
- Service providers, including auditor and depositary bank

The KII document was established as part of the UCITS IV Directive and replaced the simplified prospectus. The KII document constitutes pre-contractual information and must be consistent with corresponding sections of the prospectus. It is mandatory that the KII document, corresponding to the specific fund and each share or unit class and in a language approved by the host country of the prospective investor, be provided to all investors prior to purchase.

The form, presentation and content of the sections of the KII document have been detailed in an implementing directive from the European Parliament (Commission Regulation (EU) No 583/2010 of 1 July 2010 implementing Directive 2009/65/EC) and state that the following must be included:

- Title, explanatory statement, name and identification of UCITS code number
- Objectives, investment policies (categories of eligible instruments, industry, geographical area(s), market sector(s), etc.), benchmark, dealing frequency or liquidity and income distribution or reinvestment policy
- An SRRI, which is an integral number between 1 and 7 based on increasing level of volatility of weekly past returns over the last five years of the fund, taking into account distributions (guidelines on the methodology for calculation of the SRRI are published by the Committee of European Securities Regulators (CESR)[4])
- Charges borne by the funds (calculated and presented in accordance with guidance from the CESR)
- Past performance for the last 10 years, with blanks shown for years not available
- Practical information, including name of depositary bank, where and how to get financial information (prospectus and annual reports), statement on the tax impact, authorization details and the date of publication

For those firms with a full UCITS product line, registered for sale in numerous countries, and with multiple share classes, the production of updated annual KII documents represents a significant cost and undertaking.

[4] On 1 January 2011, CESR was replaced by the European Securities and Markets Authority (ESMA), which is part of the European System of Financial Supervision.

VI. Investment management

UCITS are subject to detailed investment and borrowing rules with a general focus similar to that of US mutual funds on both liquidity and diversification. UCITS must invest in only eligible assets. Core eligible assets include the following:

a. Transferable securities admitted to or dealt in on a regulated market

b. Money market instruments

c. Deposits with credit institutions

d. Closed-ended funds

e. Open-ended funds

f. Financial derivative instruments of which the underlying consists of eligible assets or interest rates, foreign exchange rates or currencies and financial indices

No more than 10% of net assets (sometimes referred to as the "trash ratio") may be invested, as non-core investments, in transferable securities and money market instruments that are not listed on an exchange or dealt in another regulated market (somewhat similar to the requirement for US open-ended mutual funds that at least 85% of their investments be in liquid securities). Detailed regulations and requirements also exist for diversification, including rules, by issuer, counterparty and investments in other funds with certain exceptions for funds investing in government issues and those replicating indexes.

In general, UCITS are restricted from borrowing with the exception of borrowing on a temporary basis with a limit of up to 10% of the net asset value of the fund. In comparison, US mutual funds are permitted to borrow, but are subject to a 300% asset coverage requirement (i.e., open-ended US mutual funds may borrow amounts from a bank that do not exceed 50% of its assets, excluding the amounts of the borrowing). A UCITS may also obtain foreign currency by means of back-to-back loans, which are not considered to be borrowing under the Directive. Short selling of securities is not permitted; however, it may be possible to use derivative instruments to create synthetic short positions and the use of all types of derivatives for both hedging and investment purposes is common among UCITS, providing certain restrictions are adhered to.

Just like liquid alternative mutual funds in the US, many hedge fund and alternative fund managers are looking at UCITS funds as an opportunity to both broaden their investor base and increase assets under management. Investor demand to provide more liquidity and transparency coupled with UCITS brand recognition, investment diversification and risk management requirements and the increased level of regulation and governance oversight have led to significant growth in the alternative UCITS market. Many hedge fund managers have amended traditional hedge fund strategies to be replicated within a UCITS wrapper. Such managers have put in place bimonthly dealing, and taken on very short redemption notice periods to meet UCITS requirements.

The same factors and associated costs that asset managers contemplate when opening a US mutual fund, such as increased governance and oversight, regulation and compliance, people, infrastructure and data management, also need to be considered when deciding whether a UCITS is the optimal structure for both the firm and its clients.

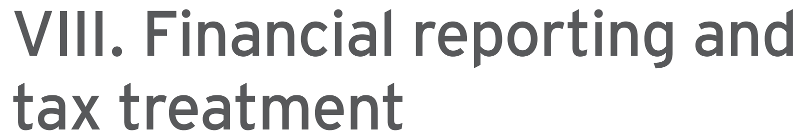
VII. Distribution

US mutual funds are designed, structured and intended to be sold to US-based retail and institutional investors. In general, the market and distribution networks for US mutual funds are mature, established and advanced. Promoters have multiple, well-established channels available to them, including direct sale, professional advisors (including financial advisors, private bankers, full-service brokers, independent financial planners, investment service representatives of banks and savings institutions, insurance agents, and accountants), retirement plans (primarily 401(k) plans) and fund supermarkets (offered through primarily online discount brokers), as well as institutional sales to corporations, insurance companies, endowments, private family offices, defined benefit plans, foundations and universities.

By comparison, the distribution of UCITS is still evolving. Distribution within continental Europe remains dominated by large EU regional and local banks. Retail banking clients often purchase shares or units in UCITS through bank representatives. While the bank-centric fund distribution model is expected to continue to dominate the European landscape, there is already movement toward platform-based distribution, particularly in the UK, where there are already over 30 active online electronic distribution portals.

Another key distinction between US mutual funds, as mentioned, is that UCITS can be sold cross-border, both within the EU or EEA and beyond. An increasing number of UCITS are being registered for distribution outside the EU in Africa, Asia, the Middle East and Latin America. While asset managers may use mutual funds as their product of choice for US distribution, UCITS can be used to market to investors globally, both in Europe and beyond.

New European regulations have also been key to driving change in fund distribution. The Retail Distribution Review (RDR) in the UK, the ban on inducements in the Netherlands and the recently implemented Article 24 of the Markets Infrastructure Financial Instruments Directive 2 (MIFID-2) prohibit distributors from receiving any payments from asset managers for selling their products and are challenging the long-standing revenue-sharing doctrine of the industry. In the US, intermediary fees and "distribution in-guise" have also been a long-standing focus area of regulators and an examination priority of the Securities and Exchange Commission (SEC) as well as the U.S. Department of Labor in terms of distribution of pension and retirement products. The same wider industry trends are affecting both UCITS and US mutual funds: the convergence between traditional and alternative asset managers and products, the continued rise and growth of exchange-traded products, and the impact of social media and digital distribution as Millennials come of age and alter the industry demographic.



VIII. Financial reporting and tax treatment

The allowable reporting GAAP(s) as well as the language(s) permitted for the financial statements of a UCITS are determined by the regulatory authority or local laws and regulations in the country of domiciliation as well as specific requirements of what must be included in both the annual and semiannual reports. The reporting GAAP chosen will often be selected based on the location and preference of the underlying investors as well as influenced by the comfort and competence of both management and the administrator. The general UCITS requirements for financial reporting include the following:

- Audited Annual Report — must be filed with regulatory authority (and published) within four months of the fund's year-end and available to investors in the manner specified in the prospectus as well as the KII document. A paper copy must be delivered on request and free of charge.
- Unaudited Semi-Annual Report — filed (and published) within two months of period-end.

A fund can choose any month-end as its fiscal year-end as long as the first annual report issued is not for a period exceeding 18 months. For those UCITS advised by a US SEC-registered investment advisor, special consideration must also be given to the US SEC Custody Rules and whether the year-end financial statements will be used to satisfy the audit exemption. Further consideration also must be given for those funds marketing their shares or units in multiple jurisdictions, particularly those outside the EU or EEA, as certain countries have specific additional reporting that may have to be included in the annual report, an appendix thereto or a full separate supplemental report, and may potentially be required to be audited. Examples of countries in the EU or EEA and outside the EU that require additional reporting include Spain, Switzerland and Hong Kong.[5]

In the case of a multi-compartment UCITS, all information required for the annual and semiannual reports is required for each compartment. However, unlike a US multi-series trust (e.g., series fund), the financial statements for all the subfunds in a UCITS umbrella structure are required to be presented in one report and with an aggregated total on each of the financial statements for all compartments or subfunds within the structure (i.e., a combined total). Separate reports for each of a UCITS' compartments may also be prepared, but must include either the auditor's general report or a separate audit report for each compartment.

UCITS are generally exempt from taxation at the fund level, with the exception of some registration duties or other small or nominal taxes due in the country of domiciliation. Withholding taxes on income will depend heavily on the country of domiciliation and the fund's or investors' ability to benefit from double-tax treaties in existence. In general, there is no withholding on distributions made from a UCITS to its investors. However, tax planning and consultation with tax professionals is paramount when deciding on both the domiciliation and structuring of a UCITS based on the target and expected investors. This is especially true given that some countries require shareholder tax reporting to investors residing in those jurisdictions during a given tax year.

[5] For example, the Swiss Fund Association (SFA) requires that the financial statements of UCITS distributed in Switzerland include return and performance information for each subfund and the calculation of a Total Expense Ratio (TER) and Portfolio Turnover Ratio (PTR), as well as the name and address of the UCITS' Swiss representative and paying agent.

UCITS vs. US mutual fund key elements comparison

	UCITS	US open-ended mutual fund
Governing regulation	UCITS Directive	Investment Company Act of 1940
Key regulator(s)	Regulatory authority in country of domicile	SEC and IRS
Eligible investors	All	All
Key documents	Prospectus, Key Investor Information (KII) document, financial statements	Prospectus, statement of additional information, financial statements
Independent trustees/directors	No requirement	Independent board of directors required
NAV calculation and redemption frequency	Minimum twice a month	Minimum once a day (open-ended funds)
Investment management agreement	Updated as needed	Must be updated and approved annually by the board of directors/trustees
Investment liquidity	No more than 10% of assets in investments that are **not** listed on an exchange or dealt in another regulated market	85% of investments must be in liquid securities
Shareholder distribution requirements	None	A fund must distribute at least 90% of income annually[6]
Tax treatment	No tax, except for nominal registration duties	No tax, subject to RIC qualification tests
Multiple compartments	Yes – Subfunds	Yes – Multi-series trust
Multiple share classes	Yes	Yes
Structures available:		
Corporations/trusts	Yes	Yes
Partnerships	Yes	Yes
Closed-ended	No	Yes
Master-feeders	Yes	Yes
Exchange-traded	Yes	Yes
Diversification requirements	Yes	Yes
Service providers	UCITS management company (required for contractual funds only), depositary bank, administrator, registrar and transfer agent, domiciliation agent, paying agents, auditor	Investment manager, distributor, custodian bank, transfer and shareholder servicing agent, fund administrator, independent registered public accounting firm
Risk management	Detailed requirements	General requirements
Performance fees	Permitted	Permitted only if all investors are "qualified clients" under the '40 Act or through a "fulcrum fee"
Borrowing/leverage restrictions	Limited to 10% of net assets on a temporary basis	Bank borrowing permitted, subject to 300% asset coverage requirement

[6] This is only one of the requirements of Subchapter M of the U.S. Internal Revenue Code for a US investment company to qualify as a regulated investment company and require no provision for US federal income taxes.

Glossary

AIF: Alternative investment fund
A collective investment undertaking, including investment compartments thereof, which (i) raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefits of those investments, and (ii) does not require authorization pursuant to Article 5 of Directive 2009/65/EC (the UCITS Directive).

AIFMD: Alternative Investment Fund Managers Directive
European Union legislation aimed at increasing investor protection and reducing systematic risk by creating a harmonized EU framework for managers of alternative investment funds in the EU.

CESR: Committee of European Securities Regulators
An independent committee of European securities regulators established by the European Commission in June 2011. In January 2011, the CESR was replaced by the European Securities and Markets Authority.

EEA: European Economic Area
The EEA includes all EU countries (Austria, Belgium, Bulgaria, Croatia, Republic of Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom), as well as Iceland, Liechtenstein and Norway.

EEC: European Economic Community
The EEC was an international organization created by the Treaty of Rome of 1957. Upon the formation of the European Union in 1993, the EEC was incorporated and renamed as the European Community. In 2009, the European Community's institutions were absorbed into the European Community's wider framework and the community ceased to exist.

ESMA: European Securities and Markets Authority
A European Union financial regulatory institution and European Supervisory Authority that works in the field of securities legislation and regulation to improve the functioning of financial markets in Europe, strengthening investor protection and cooperation between national competent authorities.

EU: European Union
The EU is a politico-economic union of 28 member states that are located primarily in Europe. The EU operates through a system of supranational institutions and intergovernmental-negotiated decisions by the member states. The institutions are the European Commission, the Council of the European Union, the European Council, the Court of Justice of the European Union, the European Central Bank, the Court of Auditors and the European Parliament. The European Parliament is elected every five years by EU citizens.

GAAP: Generally Accepted Accounting Principles
Standard framework of guidelines for financial accounting used in any given jurisdiction; generally known as accounting standards or standard accounting practice. These include the standards, conventions, and rules that accountants follow in recording and summarizing and in the preparation of financial statements. Key GAAPs include US GAAP, International Financial Reporting Standards (IFRS) and UK GAAP.

GAAS: Generally Accepted Auditing Standards
Sets of standards against which the quality of audits are performed and may be judged. Several organizations have developed such sets of principles, which vary by territory. Key standards are those promulgated by the American Institute of Certified Public Accountants (AICPA) and Public Company Accounting Oversight Board (PCAOB) and the International Standards on Auditing (ISA) issued by the International Auditing and Assurance Standards Board (IAASB).

KII: Key Investor Information
The KII document is a short document containing key investor information, the aim of which is to facilitate retail investors' understanding of the product being offered. It is intended to allow direct comparisons to be made more easily between UCITS funds.

MIFID: Markets in Financial Instruments Directive
MIFID is a European Union law that provides harmonized regulation for investment services across the 31 member states of the European Economic Area (the 28 EU member states plus Iceland, Norway and Liechtenstein). The directive's main objectives are to increase competition and consumer protection in investment services.

RDR: Retail Distribution Review
RDR is the name that has been given to a new set of rules that are enforced in the UK aimed at introducing more transparency and fairness in the investment industry. The most significant change is that financial advisors are no longer permitted to earn commissions from fund companies in return for selling or recommending their investment products. Instead, investors now have to agree fees with the adviser up front. In addition, financial advisors now have to offer either "independent" or "restricted" advice and explain the difference between the two — essentially making clear whether their recommendations are limited to certain products or product providers.

SRRI: Synthetic Risk and Reward Indicator
The SRRI is a key feature of the Key Investor Information document and a measure of the overall risk and reward profile of an investment fund. Funds are categorized on a scale from 1 to 7, with 1 being lowest risk and 7 being highest risk. Typically, the SRRI is derived from the volatility of past returns over a five-year period.

VaR: Value at Risk
The calculation and monitoring of risk exposures, including investment risk exposures, is a key requirement of the risk management function over a UCITS. The value-at-risk model is the most commonly used of the acceptable methodologies to assess risk exposure along with the commitment approach or internal models.

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