



Cross-Border Pooling: The Impact of New EU Directives

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The market in Europe for tax-transparent, cross-border pooling strategies has reached a key developmental stage: European Union (EU) Directives aim to achieve more efficiency across borders and facilitate enhancement of product structuring.

Investment managers and multinational companies seeking solutions for the EU institutional market view tax-transparent, cross-border pooling strategies as a versatile product solution.

A significant milestone in this evolution should arrive in 2012, as the United Kingdom moves to establish a tax-transparent contractual fund regime. The new regime will join the Irish Common Contractual Fund (CCF), the Luxembourg Fonds Commun de Placement (FCP) and the Dutch Fonds voor Gemene Rekening (FGR) in the tax-transparent fund space.

These vehicles are designed to help institutional investors achieve the same withholding tax benefits as if they were investing directly in the underlying assets of a fund.

The concept of pooling, of course, is not new. Cost and risk management are obvious benefits; however, entity establishment and fund identity have historically presented distribution challenges and adverse tax consequences.

What is rising in trend is the contractual nature of the unit-issuing pooling vehicles that recognize the beneficial owner in a fund structure. This allows treaty-eligible EU institutions to shoulder less impact from a withholding tax perspective vs. investing in an opaque, or “look at,” vehicle.

Now, two regulatory changes in Europe have added to the debate over tax-efficient funds. The Undertaking

for Collective Investment in Transferable Securities IV Directive (UCITS IV) will give investment managers the ability to “passport” funds from country to country through a single pan-European management company. The second, the Activities and Supervision of Institu-

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tions for Occupational Retirement Provision (IORPs) directive, creates additional opportunity for multinationals to reduce cost and enhance governance.

Under the new framework, a UCITS-authorized management company in one EU member state will be able to manage a UCITS fund located in another. This allows a single portfolio of assets to be offered for different types of investors based in multiple jurisdictions.

While legally possible, the tax considerations of this type of arrangement are complex for the operators of the fund and its investors. One solution, given the right set of investors and investments, is a tax-efficient, commingled product that will not have adverse effects on the investor tax treaties.

The new directive also permits the use of a master-feeder fund to pool investor assets, which carries its own set of considerations around local legislation. When set up correctly, this approach presents an opportunity to achieve efficiencies under the UCITS regime.

The IORPs directive provides a framework to centralize investment and scheme administration arrangements, to provide a single point of pension management excellence. This directive provides the regulatory mechanisms to support the operation of cross-border occupational pension vehicles established in any European Economic Area country. As an example, Northern Trust anticipates the use of an Irish master trust IORP with DB and DC sections, investing through the tax-transparent Irish CCF. The master trust could operate alongside direct investment in the pooled fund by plans that do not want to use the IORP to pool assets and processes.

Meanwhile, the new legislation also introduces additional obligations. The landscape for compliance is changing in the wake of the global financial crisis, and there is demand for tighter asset management, operational oversight and risk management, with an emphasis on transparency. Centralized pools of assets make managing these obligations easier, and promoters looking to consolidate funds are considering their benefits.

Service providers are offering a range of services to accommodate these changes. Two examples are the outsourcing of the Key Investor Information Document required under UCITS IV, and bundled services like Northern Trust’s CCF Fund Hosting platform, which helps U.S. managers operate under the new UCITS directive.

Fund operators exploring new fund arrangements ought to carefully consider a tax-transparent delivery vehicle in their product suite. The EU Directives provide the framework for increased efficiency, creating a new set of considerations for fund structuring. 