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**TITLE: COMMENTS AND RECOMMENDATIONS REGARDING
INVESTMENT FUND REGULATIONS**

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Comments and recommendations regarding investment fund regulations

These comments and recommendations are derived mostly from considerations of the Transposition Table for the domestic Law on Investment Funds and Level I EU Directive 2009/65/EC.

Comments

- **UCITS (undertakings for collective investment in transferable securities)** are subject of Directive 2009/65/EC regulation. The undertakings may be constituted in accordance with contract law (as common funds managed by management companies), trust law (as unit trusts), or statute (as investment companies). Management companies, and three types of funds (open-ended fund, closed-ended fund and private fund) that can be managed by management companies, are subject of Law on investment funds. The legal form of investment funds is not completely unified abroad; consequently the legal form of domestic funds established by Law is not fit for monolithic comparisons with UCITS types established by EU Directives. However domestic UCITS may be treated according to Directive 2009/65/EC, as indicated in the Transposition Table.
- Considering the purpose of EU Directives, there is a large difference between EU member States and States which are harmonizing their national Laws with EU Directives. By their very nature, some chapters of EU Directives are in their entirety not governed by domestic Law, while others are partially so. Certain chapters or articles of EU Directives that are not governed by domestic Law could be implemented, while some could not. In some cases the question is one of personal point of view, especially because it is more suitable to regulate some aspects by enacting bylaws.
- The Law on Investment Funds mostly complies with EU Directives. However, many aspects of the Directives are not regulated by the Law, especially those relating to international activities of UCITS. Some discrepancy exists with respect to the regulated level of debt and own capital, and, to a lesser extent, relative to the protection and information of investors.

Recommendations

- The major recommendation is to separately regulate UCITS and UCI within the Law on Investment Funds or to exclude UCI from the scope of the Law on Investment Funds. A third possibility could be to enact separate Laws on UCITS and UCI, respectively. **UCITS and UCI are regulated under separate EU Directives.**
- **The definition of “investment fund” (with regard to UCITS) should be expanded and modified; investment funds must be statutorily required to invest no less than 90% of their assets in transferable securities and money market instruments according to Directive 2009/65/EC (Article 50 (2)).**

Bylaws, specified as part of the Law on Investment Funds or a future Law on UCI, should regulate alternative investments, which are not subject to EU Directive 2009/65/EC with regard to UCITS. EU-level regulation on non-UCITS (which can mainly be invested in nontransferable securities) is in progress.

“On the 1st July 2011, the Alternative Investment Fund Managers Directive (AIFMD) 2011/61/EU was published in the Official Journal of the EU. The EU member states will have until July 22, 2013 to update their national laws, regulations and administrative provisions to give effect to the AIFMD. This new EU legislation will regulate managers of hedge, private equity and real estate funds and other alternative investment funds. It covers almost any investment fund except funds regulated under EU legislation on Undertakings for Collective Investment in Transferable Securities (UCITS).”

- UCITS should be under the obligation of **Risk Management** according to implementing Regulation 583/2010 (which is directly applicable to EU member states). The Law on Investments Funds should stipulate this only as a general obligation to be specifically governed by bylaws and charters of the funds themselves, with the implementation of this requirement to be supervised by the Serbian SEC.
- As for the discrepancy between transferable securities (not defined by the domestic Law) as governed by the EU Regulation, and financial instruments approved by Law, such as stakes in domestic Limited Liability Companies, (which are not regarded as securities under the Company Law, and, also, have questionable external liquidity to be considered transferable investment instrument according to criteria of regulated markets), Commission Directive 2010/43/EU implementing Directive 2009/65/EC should be incorporated into the Law insofar as it concerns risk management. The Serbian SEC should impose the regulation of bylaws and internal acts to management companies and investment fund specified by types and categories to implement Commission Directive 2010/43/EU.

- **Capital adjustments** should be stipulated in cases when the value of the portfolio of a management company exceeds EUR 250,000,000 according to Directive 2009/65/EC, although this cannot realistically be achieved in the near future.
- Directive 2009/65/EC (Article 83) established that Management Company can borrow no more than 10% of the value of a common fund and 15% of its assets in total. Under the domestic Law this figure is set at 20% for open-ended funds, while non-UCITS (closed-ended and private funds) can borrow unlimited amounts.
- The Law should be harmonized with Directive 2006/49/EC Article 21, which stipulates that investment firms are required to hold own funds equivalent to one quarter of their preceding year's fixed overheads. The competent authorities may adjust that requirement in the event of a material change in a firm's business since the preceding year.

Where a firm has not completed a year's business, starting from the day it starts up, the requirement shall be a quarter of the fixed overheads projected in its business plan, unless an adjustment to that plan is required by the competent authorities. Previous described limits should be established for management companies and investment funds which are legal persons, respectively.

- Law is almost completely harmonized with prospectus requirements as provided for under Directive 2009/65/EC. However, the Directive emphasizes a "**Key investor information**" document, is similar to a summarized prospectu, which is referred to, but not regulated by the Law on Investment Funds.

"Key investor information shall include appropriate information about the essential characteristics of the UCITS concerned. The words 'key investor information' shall be clearly stated in that document. Key investor information shall be written in a concise manner and in non-technical language. It shall be drawn up in a common format, allowing for comparison, and shall be presented in a way that is likely to be understood by retail investors".

Commission Regulation (EU) No 583/2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards key investor information. This Regulation established the form and presentation of key investor information and the content of individual sections of the key investors' document.

The Law on Investment Funds should impose regulation of bylaws by the Serbian SEC and internal acts to management companies and investment fund specified by types and categories to implement Commission Regulation (EU) No 583/2010.

- **Internal control mechanisms** are only mentioned in the Law; however this segment is mainly governed by the Company Law. The Serbian SEC should ensure, by virtue of its supervisory function, the efficient operation of internal control of management companies, as measured by all criteria established by Commission Directive 2010/43/EU. The *mutatis mutandis* principle should be emphasized in the Law and, especially, in the bylaws.
- **Conflict of interest** is not explicitly mentioned, but is described in the Law on Investment Funds with respect to Management Company boards. However, the Law on the Capital Market also both refers to and regulates conflict of interest. Internal control should be permanently supported by Law, and, especially, bylaws, following the definition of conflict of interest provided in Commission Directive 2010/43/EU.
- **Foreign management companies (including those based in EU member states)** and investment funds must register domestic management companies to be able to operate in the local market. The Law should provide that UCITS can be authorized by either a Member State management/investment companies operating directly, or a locally registered management company. However, the Law on Investment Funds stipulates that foreign companies can sell their units only if they act as domestic funds managed by domestic management companies. This is probably a matter related to Serbia's EU membership; consequently, the Transposition Table contains only a note with respect to this issue.