

## Financial Services

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### Fund Mergers Coming into Focus

#### Helping you to be prepared

Following the turbulence in world markets in recent months there has been increasing discussion around, and announcements of, fund merger/rationalisation proposals (which we will refer to from now on as mergers).

Therefore, we thought it might be timely to provide a few reminders for you on regulated fund mergers in case any of your colleagues might wish to explore the potential for these and seek your input on the legal and regulatory parameters.

#### Strategy

We would usually see merger projects breaking-down into three phases (albeit inter-related and with some elements of overlap):

These are:

1. Planning
2. Structuring
3. Preparation & implementation

An outline of the key elements of each of these phases is covered below.

#### Planning

With any project, planning is obviously a crucial step.

A key component of that planning, in the funds merger context, will be obtaining a complete understanding of all the key features of the funds (and any related wrappers) which are to be involved in the mergers and any issues that may flow from any mis-matches in those features. In particular the effect of any changes which may need to be made as a result when taken together with the other essential features of the merger proposals will affect the overall timing of the merger process. The sooner you are in a position to understand these different elements the sooner it will be possible to work out key timings and

deadlines that will need to be involved and plan for meeting all these and reflect them in a timetable.

Ensuring that all of these components are in place will enable the project team to focus properly on the time and resources that will be required for each phase of the project.

To support the creation of the project plan, it is usually necessary to carry out a diligence exercise. This typically analyses the relevant features and constitution of each fund to be involved in the merger. It would normally identify any issues that will typically result from differences in charges or other factors which may require special treatment before, or as part of, the merger proposals.

Another key benefit of that diligence exercise (particularly in complex mergers) can also be to gather, in one place accessible by all members of the project team, a database of key information in relation to those features which can then be used by the team going forward for the project including for the preparation of key documentation. It can also be useful in presenting aspects of the project to the FSA.

The output from this diligence exercise (which we can carry out for you) would normally be a report highlighting any issues or potential issues which may impact on how the mergers would need to be implemented.

The report can therefore be used to help you decide how best to meet your future needs in translating the existing funds concerned that will terminate (the **terminating funds**) into the funds with which they are to be merged and which will continue (the **continuing funds**) whether these are in existing or new vehicles.

If you want to use it in that way the diligence report can be used ultimately to define your implementation strategy as well as the basis for obtaining the necessary authorised fund manager (**AFM**) board approval(s) for the final merger proposals (and negotiating these with the depositary/ trustee and the FSA).

## Structuring

After the implementation strategy has been determined, the structure can be put in place. There are usually a number of aspects to this depending on the complexity of the mergers and whether the terminating and continuing funds originate from the same range managed by the same AFM. If the merger involves only a small number of funds within the same range then some of the structural steps referred to below will not be required.

If any new vehicles (AUTs/ OEICs) are required the process of establishing and authorising these for the purposes of the merger will usually require to commence first. The key documentation for this would be:-

- trust deed/ instrument of incorporation;
- prospectus;
- FSA Form 12/242 and 3 year plan;
- necessary agreements (depending on vehicle) including with any other third parties (such as administrators, investment advisers or registrars).

We can take a lead role in the preparation and negotiation of these documents for you.

We can also deal with the FSA authorisation process on your behalf.

The FSA have in theory up to six months to authorise a new AUT/ OEIC (although in practice we have managed to achieve much shorter timescales such as 6-8 weeks) and in our experience the FSA's turnaround timescale for new OEIC authorisations is currently around 8 weeks.

It is also worth noting that sub-funds can be added to an OEIC after its initial establishment if certain decisions as to the composition of the OEIC cannot be made at the point of establishment. We can also deal with this process (which involves amending the documentation and obtaining FSA approval) on your behalf. The FSA have up to one month to approve a new sub-fund.

If there are any changes required to existing vehicles to facilitate the merger process then these need to be effected (again with FSA approval where appropriate). For example, if ranges of funds are being brought together post-acquisition then it will expedite the merger process if, in advance, the AFM and depositary/trustee of all funds involved are harmonised into those persons who will be the AFM/depositary of the ongoing vehicle. If changes are required, we can deal with the

requisite application for FSA approval on your behalf.

Even if the merger is less complex there may still be changes to the continuing fund that are required in order for it to receive the portfolio of the terminating fund.

There may also be other related adjustments required, such as to ISA wrappers or Regular Savings Schemes terms and conditions or to internal insurance unit linked fund structures and documentation (to reflect the revised continuing fund structure). Changes may also be required to WRAP platform documentation if you have one in place.

If you were undertaking a major merger programme that required the various mergers to be staggered over a period of time the structure for the merger programme could be established in phases, with the different elements being built to correspond with the timing of each round of mergers.

## Preparation & Implementation

### Preparation

Although certain aspects of preparation for the merger process can be started before the structure is finalised, it is only once the structure is in place that the merger process can proceed with certainty.

The crucial documents in this phase are the circulars explaining to holders the proposals that affect the relevant fund and containing the scheme of arrangement which is the legal document which sets out the terms of the merger. The circular will also serve as the notice for the holders meeting to obtain approval for the proposals. As a practical point managers must take care to ensure that the message given to investors is sufficiently compelling to ensure that the necessary approvals are forthcoming from holders at the required meetings.

While any merger will require approval from holders in the terminating fund which will be transferring its assets and terminating as part of the merger, it may be possible to avoid the need for approvals from holders in the continuing fund which will receive the assets and continue. This will be the case if the merger is not likely to result in any material prejudice to those holders, is consistent with the objectives of the fund; and will not breach any of the investment and borrowing restrictions in the FSA's Collective Investment Schemes Sourcebook (**COLL**).

We can take a lead role in preparing circulars and in negotiating these with depositaries/ trustees as well as your auditors.

In large scale rationalisations we recommend that, where possible (depending on the similarity and complexity of the proposals in relation to the funds involved), an "omnibus" circular is used rather than multiple circulars which each cover only one set of proposals. This approach has the advantage of substantially reducing the amount of documentation for review and approval by the AFMs, depositories/ trustees and auditors involved as well as by the FSA and HMRC and as a result achieves significant time and cost savings for you.

Tax clearances must be applied for and we have the expertise to deal with these on your behalf. In practice, the draft circular(s) will be supplied as part of the process for obtaining these clearances.

Any merger of regulated funds in the UK must be carried out in accordance with COLL and will require to be approved by the FSA. We can deal with the FSA approval processes on your behalf. The FSA have up to 1 month within which to give their approval.

Thereafter, the circular(s) would be sent to holders convening the necessary meeting(s) at which the proposals must be approved. We can also guide you on the procedure for obtaining holder approvals (including the formal requirements and arrangements for the meetings).

### Implementation

Provided the proposals are approved at the necessary meeting(s), implementation can then commence. Any necessary practical steps preliminary to implementation can be taken. Thereafter, each merger can be implemented according to the pre-agreed timescales reflected in the circular(s).

We can also liaise with the AFMs, depositories, auditors and FSA to wind-up the terminating funds at the appropriate time. As part of any application to the FSA to wind up those funds, a solvency statement from the AFM (confirmed by the auditors) and a statement from the depository will require to be sent to the FSA.

### Fees & Control of your Costs

We appreciate that in relation to any merger proposals you will want to operate within a strict budget for external legal costs.

We can provide the necessary legal, regulatory and tax input which you require cost effectively. The larger the proposed rationalisation then the greater the economies of scale that can be realised. We are happy to quote for this type of work on a capped basis subject to agreeing with you the scope of work (including, most importantly, the structure of the merger process) and timetable. This type of pricing mechanism gives you the necessary assurance that the external legal aspects of any merger process would be delivered within your budget.

### Further Information

Our regulatory team has long and proven experience of advising on fund mergers and can harness this experience to provide clients with merger solutions in an efficient and cost effective manner.

This Bulletin is correct to the best of our knowledge and belief at the time of going to press. It is however written as a general guide, so it is recommended that specific professional advice is sought before any action is taken. We are required by law to protect personal data.

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If you would like any further information on anything in this Bulletin, or any other Financial Services issues, please call the person at D&W with whom you normally liaise, or one of the following specialists:

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