



STATE STREET.

The Committee of European Securities Regulators
11-13 Avenue de Friedland
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August 22, 2008

**RESPONSE TO THE CALL FOR EVIDENCE ON THE REQUEST
FOR ADVICE ON THE UCITS ASSET MANAGEMENT COMPANY
PASSPORT**

State Street Corporation, headquartered in Boston, U.S.A., specializes in providing institutional investors with investment servicing, investment management and investment research and trading. With \$15.3 trillion in assets under custody and \$1.9 trillion in assets under management, State Street operates in 26 countries and more than 100 markets worldwide. Our European-based workforce of over 6,200 employees provides institutional investors with local support and service from our offices in Austria, Belgium, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Poland, Switzerland and the United Kingdom.

Dear Sirs, dear Madams

State Street Corporation would like to thank CESR for the opportunity to comment on the call for evidence on the UCITS asset management company passport.

We would be happy to discuss with you, in further detail, any comments you may have. Please do not hesitate to contact Gabriele Holstein at 0041 44 560 5101.

Sincerely,

Stefan Gavell
Executive Vice President
Regulatory and Industry Affairs

Dr. Gabriele Holstein
Director of European Regulatory and
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State Street Corporation's Response to the Call for Evidence on the Request for Advice to CESR on the UCITS Asset Management Company Passport

INTRODUCTION

This memorandum contains State Street's response to the Committee of European Securities Regulators' (CESR) call for evidence on the request for advice on the UCITS asset management company passport. We appreciate the opportunity to share our views on this important matter. We would like to offer both general observations for CESR's consideration, as well as responses to the specific questions raised in the consultation.

State Street supports the concept of a management company passport. For a management company passport to operate effectively, we believe that a number of prerequisites need to be met.

First, the responsibilities and roles of the different parties involved in the operation of a fund (i.e. management company, depositary, fund accountant, transfer agency, and custodian) should be more closely aligned across EU Member States. This could involve among other measures, clarifying how depositaries discharge their responsibilities as set out in Article 7 and 14 of the UCITS Directive and agreeing on rules of conduct for management companies on a pan-European basis instead of requiring each Member State to draw up its own rules of conduct which for management companies authorized in that Member State (Article 5h). It should also involve expanding existing prudential rules that management companies must observe (Article 5f) to ensure a common set of standards across all Member States.

Second, supervisory responsibilities should be allocated in a manner that (i) ensures a clear decision-making process and (ii) ensures the enforceability of regulatory actions. Both criteria are key to ensuring the protection of fund investors by avoiding situations of paralysis where a depositary is unable to react due to a lack of or untimely supervisory guidance and / or remedial action caused by an untimely or

imprecise decision making process. Specifically, State Street believes that the UCITS home Competent Authority should act as the single point of contact for all matters concerning the fund. The management company should be obliged to directly report any material breach of regulations, restrictions imposed by financial regulators or provisions of the prospectus. The UCITS home Competent Authority should also decide on relevant actions to be taken with regards to such breaches, including remedial actions which would need to be communicated to the home Competent Authority of the management company. The UCITS home Competent Authority should furthermore be able to solicit the assistance of the management company home Competent Authority in enforcing a pre-defined set of actions to address regulatory breaches. These measures should be structured within a mutual recognition framework among all Member State regulatory authorities.

Third, there should be a process to allow for validation that the management company possesses sufficient expertise to manage a specific UCITS product domiciled in another Member State. We advocate in this regard a *general authorization process for the management company* conducted by the home Competent Authority, as well as a *fund specific authorization process* conducted by the UCITS home Competent Authority. The UCITS home Competent Authority would be responsible for validating the qualifications of the management company in regards to its local expertise on a *fund by fund basis*. The current requirements of Article 21 could be used as the basis for a risk management process (RMP) review undertaken by the UCITS home Competent Authority.

As a general note, we emphasize that while we are supportive of the management company passport, we are concerned that the depositary, as the only institution left in the jurisdiction of the UCITS, may face additional oversight obligations for which it is not properly equipped. UCITS home regulators might be tempted to do so in order to have greater recourse to the UCITS via the sole entity it directly regulates. This would be an unfavorable and unjust development with significant commercial and operational consequences. This would potentially be compounded to the extent that practical issues emerge relative to supervisory cooperation.

State Street's detailed responses to the specific questions posed in the Paper follow below.

CHAPTER 3 – CONTENT OF THE ADVICE

3.1 Definition of domicile

CESR is asked to advise on the elements that could be used to distinguish the home Member State of the management company, that of the UCITS fund and that of the depositary in situations where use is made of the management company passport. Particular consideration should be given to the case of UCITS funds established under contractual or trust law.

In State Street's view, regardless of whether a UCITS is constituted as a unit trust / common fund or as an investment company, the UCITS home Member State should always be defined according to the law that is applicable to the UCITS. For *corporate funds*, this would mean that the domicile of the fund and depositary is determined by reference to the country under whose laws the fund is constituted and where the investment company has been established. In other words, an investment company's home Member State should be understood as having the same meaning as a UCITS home Member State. Where the management company function is performed by a separately appointed UCITS authorized management company established in a different jurisdiction from the fund, the home Member State of the management company should be the Member State in which the management company has been established and registered. For *contractual funds*, this would mean that the UCITS home Member State is the Member State where the law is applicable to the UCITS. The home Member State of the management company should be where the management company has been established and registered, regardless of whether the management company chooses to outsource certain administrative functions, such as valuation and pricing, to entities in other jurisdictions.

As such, we believe that the definition that should be considered is the one already contained in the DG Internal Market and Services Working Document ¹, removing, however, the reference to core administrative services: "A UCITS home Member State shall mean, whether the relevant UCITS is constituted as a unit trust / common fund or as an investment company, the Member State the law of which is applicable to the UCITS, as provided for in its instruments of incorporation / fund rules / trust deed."

State Street is aware of substance concerns raised by opponents of the management company passport who might question the removal of the reference to core administrative services. We would in this regard remind CESR that the UCITS III Directive includes additional requirements designed to ensure that the management company does not become a "letter box entity". As such, regulators should be satisfied that management companies established under the UCITS Directive, regardless of the Member State in which they are established, have significant substance to their activities.

3.2. Applicable law and allocation of supervisory responsibilities

a) CESR is asked to review the current specification of provisions of UCITS law that are binding at the level of the management company and at the level of the fund and depositary, and advise on whether the envisaged allocation of responsibilities are sufficiently complete and effective to cater for situations where the management company and UCITS fund are in different Member States.

State Street does not believe that the envisaged allocation of responsibilities is sufficiently complete to cater to situations where the management company is domiciled in a different jurisdiction than the fund.

¹ European Commission "Exposure Draft – Initial orientations for discussion on possible adjustments to the UCITS Directive".

Today, the responsibilities and roles of the parties involved in the operation of a fund (i.e. management company, depositary, auditor, fund accountant, transfer agency, and custodian) are different across EU Member States. Although *asset administration functions* (e.g. trade settlement and income collection) are similar, *fund administration functions* (e.g. fund valuation and bookkeeping) differ widely. For example, in some Member States the calculation of the NAV is considered to be the responsibility of the depositary, while in others it is the responsibility of the fund management company. For the management company passport to operate effectively, we believe that it is necessary to harmonize these differing roles and responsibilities.

In regards to current provisions of UCITS law that are binding at the level of the management company and at the level of the fund and depositary, we would offer the following comments:

Role of the Depositary – Article 7 and 14

These articles impose an oversight responsibility on the depositary. The UCITS and depositary will have the same home Member State, and as such are subject to the same regulatory regime.

In regards to aligning the roles and responsibilities of depositaries across EU Member States, it might be useful to have clarification, perhaps at level 2, as to how depositaries discharge their responsibilities as set out in Article 7 / 14.

It is, however, of concern to State Street that since the depositary will be the only institution left in the jurisdiction of the UCITS, additional oversight obligations could be imposed on depositaries for which the depositary is not properly equipped. UCITS home regulators might be tempted to do so in order to have greater recourse to the UCITS via the sole entity it regulates. As previously noted, this would be an unfavorable and unjust development with significant commercial and operational consequences. This would potentially be compounded to the extent that practical issues emerge relative to supervisory cooperation.

Rules of Conduct for Management Companies – Article 5h

Article 5h requires each Member State to draw up rules of conduct which management companies authorized, in that Member State, shall observe at all times. State Street notes that it would be important for these rules of conduct to be agreed to on a pan-European basis so that Member States are satisfied that all management companies comply with a common code of conduct.

Prudential Rules which Management Companies must observe – Article 5f

Existing prudential rules could be expanded, either within Article 5f, or through Level 2, to ensure a common set of more detailed prudential rules within all Member States.

b) In particular, CESR is asked to identify and propose solutions to any identified gaps in supervision or overlapping responsibilities that might arise if the management company and fund/depositary are located in different Member States.

In our view, the current allocation of supervisory responsibilities is not sufficiently complete to cater to situations where the management company is domiciled in a different jurisdiction than the fund.

We view the following two criteria as key for determining supervisory responsibilities:

- (i) Clear decision-making mechanism:** For the management company passport to work, we believe it is paramount for the UCITS home Member State regulator (“UCITS home Competent Authority”) to act as the single point of contact for the depositary and for all matters concerning the fund. The management company should be obliged to report any material breach of regulations, restrictions imposed by the regulators or provisions of the prospectus, directly to the UCITS home Competent Authority as well as to its home Member State regulator (“Management Company home Competent Authority”). The UCITS home Competent Authority would also need to be

promptly informed by the regulator of the management company of any material developments affecting the management company. It should be the obligation of the UCITS home Competent Authority to decide on relevant actions to be taken with regards to breaches by the management company, including remedial actions which would need to be communicated to the Management Company's home Competent Authority. The sharing of information between the respective regulators could be defined in a manner similar to the CESR protocol on the supervision of branches under MiFID Article 4, "Unsolicited exchange of information".

- (ii) **Enforceability of actions:** State Street believes that the UCITS home Competent Authority should be able to solicit the assistance of the management company home Competent Authority via a Standing Request for Assistance comparable to Article 6 of CESR's protocol on the supervision of branches under MiFID, without, however, section b). If a management company Competent Authority receives a Standing Request for Assistance from a UCITS Competent Authority (e.g. verification of information and investigation on the territory of another Member State), it should agree to provide assistance in accordance with that request without a right of refusal. Furthermore, there should be a pre-defined catalogue of actions a UCITS home Competent Authority can undertake to address breaches by the management company. A framework should be developed for the mutual recognition of supervisory enforcement actions in this area among regulatory authorities of Member States.

In our view, both criteria (i) and (ii) are key to ensure the protection of fund investors while avoiding situations of paralysis where a depositary is unable to react due to a lack of or untimely supervisory guidance and / or remedial action caused by an unclear decision making process.

c) CESR is asked to advise on whether formal structures (e.g. colleges of supervisors or MoUs) are needed to underpin cooperation between competent authorities responsible for and the UCITS fund.

Generally, we believe that CESR is best placed to answer this question. While we believe formal structures are likely to be beneficial in underpinning supervisory cooperation, we question the colleges of supervisors concept. As outlined above, a clear and timely decision making process and enforceability of actions are key, criteria which are unlikely to benefit from a college of supervisors framework which does not normally involve day-to-day decision making.

3.3. Authorization procedure for UCITS fund whose management company is established in another Member State

a) CESR is requested to advise on the need for and design of mechanism or process which will allow for checking that qualifications of the management company (authorized in another Member State) are commensurate with the demands/risks embedded in the investment policy of the UCITS fund.

In our view, the authorization and review process under the management company passport should include both a *general authorization* process for the management company undertaken by the management company home Competent Authority and a *fund specific authorization process* undertaken by the UCITS home Competent Authority.

General authorization of the management company: The authorization of a management company should be set-up as a two stage process. Stage one would provide the management company with authorization to operate a UCITS in its home state, while Stage two would extend this authorization to allow the management company to operate a UCITS in another Member State. The “bar” for achieving a stage two authorization would be higher than the first, including demonstration by the

management company that is has the requisite skills, expertise and systems to operate funds in other jurisdictions.

Furthermore, the requirements for achieving a stage two authorization would need to be clear and concise, as well as defined on a pan-European basis. This is to ensure that the inefficiencies which have arisen in regards to the notification procedures for the UCITS product passport do not arise in the case of the management company passport. Without a common set of rules across all Members States, there is a danger that the benefits of a management company passport would be largely negated.

Authorization of a specific UCITS: The UCITS home Competent Authority should be responsible for checking the qualifications of the management company in regards to its local expertise for managing a given UCITS on a *fund by fund basis*. As previously noted, the current requirements of Article 21² could be used as the basis for a risk management process (RMP) review undertaken by the UCITS home Competent Authority. More specifically, the RMP could be expanded to include details of the management company's expertise to manage a particular UCITS product in another Member State. The UCITS home Competent Authority would be entitled to receive comprehensive documentation on the RMP to enable it to assess the expertise of the management company. This assessment should, however, be limited to determining: (i) expertise to manage the instrument type and product structure of the proposed UCITS and (ii) expertise relative to the fund requirements of the UCITS home Competent Authority. If the above two areas are not addressed or are not adequately addressed via the RMP, the UCITS home Competent Authority should be entitled to engage with the management company to satisfy itself that there is sufficient expertise and request the enhancement of the RMP where necessary. This would include a refusal to grant authorization until such time as the noted deficiencies have been remedied. The UCITS home Competent Authority should also be entitled to receive an annual RMP statement and be advised of any material amendments.

² Article 21 currently states the management or investment company must employ a risk-management process which enables it to monitor and measure at any time the risk of the positions and their contribution to the overall risk profile of the portfolio and it must communicate to the competent authorities regularly and in accordance with the detailed rules they shall define, the types of derivative instruments, the underlying risks, the quantitative limits and the methods which are chosen in order to estimate the risks associated with transactions in derivative instruments regarding each managed UCITS.

Strict timelines should be defined for the authorization of the management company in a manner similar to what has been proposed for the UCITS product passport.

We note that considerable differences exist in accounting practices for cross-border funds compared to domestic funds. Fund markets which are primarily local have limited practitioner experience in regards to the complexities of cross-border funds such as accounting requirements in multi-class funds, highly complex taxation and other reporting requirements imposed by other Member States. Where the management company is unable to adequately address via the RMP that it possesses sufficient expertise in regards to such requirements, we recommend that the UCITS home Competent Authority grant authorization under the condition that accounting and fund administration remain in the UCITS home market until the risks involved in such complexities are more fully understood by the management company.

b) CESR is asked to advise on any duly motivated circumstances under which a management company could be refused permission to manage/set up a fund in another Member State.

Referring to our comments above, the UCITS home Competent Authority should be entitled to request the enhancement of the RMP where necessary and refuse authorization relative to the specific UCITS product until such time as the deficiencies have been remedied. Furthermore, if the management company fails to fulfill its obligations in relation to a UCITS for which it is responsible, the UCITS home Competent Authority should have the competence to revoke the permission granted. This could also be the case where the RMP requirements need to be strengthened due to a change in the inherent risk of the underlying instrument or product structure of the fund or due to a change in the fund requirements of the UCITS home Competent Authority.

Effective information sharing agreements between regulators, as well as open disclosure, should be in place in order to ensure that regulators of other Member States in which the management company is seeking to operate are aware of instances where authorization was refused or permission revoked. This would also have the

benefit of helping to prevent regulatory arbitrage. This could involve among other measures, setting up a central database of EU authorized UCITS along with details of their respective management companies.

3.4. On-going supervision of the management of the fund

a) CESR is asked to advise on the conditions (e.g. in terms of direct or indirect access to or control of certain functions or processes) needed to ensure that the supervisor of the UCITS and the supervisor of its management company have sufficient means and information to discharge their duties effectively.

In order to effectively discharge their duties, the capacity (i.e. maximum number of management companies supervised by a given supervisory employee) could be limited as is currently the case in Luxembourg. Supervisory staff should furthermore possess sufficient knowledge in regards to the instrument type and product structure of a UCITS for which they are responsible.

b) CESR is asked to advise on the obligations of information and conduct of business that the management company owes to the UCITS fund and depositary (and vice versa).

There should be clear obligations imposed on management companies to deliver adequate information to supervisory authorities and depositaries. This includes the responsibility to promptly report any material breach of regulations, restrictions imposed by financial regulators or provisions of the prospectus.

c) CESR is asked to advise on the mechanisms or procedures that should be envisaged to ensure the timely and effective exchange of information between a UCITS supervisor and a supervisor of a management company (or vice versa).

The sharing of information between supervisory authorities could be defined in a manner similar to the CESR protocol on the supervision of branches under MiFID Article 4 “Unsolicited exchange of information”.

3.5. Dealing with breaches of rules governing the management of the fund

a) CESR is asked to advise on any mechanisms or information flows that are needed to ensure that the respective competent authorities are duly and quickly informed of any breach of the rules governing the management of the fund; and the conditions under which effective enforcement action can be undertaken.

Referring to our comments in 3.4.b) it should be the responsibility of the management company to promptly report any material breach of regulations, restrictions imposed by financial regulators or provisions of the prospectus to the UCITS home Competent Authority, as well as the management company home Competent Authority. We would in this context reiterate our view that the management company passport should not result in the imposition of additional oversight obligations on the depositary. More specifically, any measure extending the role of the depositary in supervising the management company and its activities is likely to inappropriately shift fiduciary responsibility and therefore risks, to the depositary. This would be an unfavorable and unjust development with significant commercial and operational consequences.

For conditions required under which effective enforcement actions can be taken please see our comments in section 3.2. b), where we outline our views in regards to a clear and timely decision-making process and well as the enforceability of actions decided by the UCITS home Competent Authority.

b) CESR is invited to advise on the need for and form of any additional measures to facilitate effective enforcement action by authorities responsible for a contractual form UCITS fund when the management company is established in another Member State.

We note that the absence of a corporate board of directors increases the importance of adequate management company supervision and effective regulatory mechanisms. For practical reasons, however, we believe that processes for ensuring effective

enforcement actions by authorities should be the same whether the UCITS is constituted as a unit trust / common fund or as an investment company.