

ALFI RESPONSE

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

19.08.08

Executive Summary

UCITS product-centred regulation achieves a high level of investor protection. As a result, UCITS funds are the most successful cross-border financial product across the EU and around the world.

Introducing a Management Company Passport could deliver advantages to the UCITS regime such as process improvements or the release of capital for selected industry players. However, these benefits must be viewed in the context of significant potential costs and risks.

Permitting a management company and a UCITS to be located in two different Member States would give rise to legal uncertainty, notably as to the fund's domicile, to the fund's nationality, to its place of submission to tax and finally, to its regulatory regime. Supervision of the fund by regulators and oversight by the depositary bank and auditors would necessarily become more cumbersome and complex, increasing direct costs and weakening investor protection. The global credibility of the UCITS "brand" would suffer.

It is ALFI's view that potential advantages from a "management company passport" could be outweighed by added legal, fiscal and regulatory uncertainty and risk. Moving away from a "product-centred" regulatory approach is not a simple exercise and necessarily alters and potentially weakens oversight integrity.

At a minimum, the spectre of additional costs and risks must be thoroughly analyzed and corrective measures must be designed in an exhaustive, deliberate exercise, not in a precipitant manner.

The current UCITS draft directive will provide significant operating and cost improvements to the UCITS regime, without weakening investor protection. Provisions in the draft directive are independent of the Management Company Passport question. ALFI believes that it is of vital importance to all parties associated with UCITS, including investors, that these measures are passed into law as soon as possible. A thorough, thoughtful and complete analysis must then be undertaken on examining the complex issues of the Management Company Passport.

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1. Introduction

1. ALFI represents the Luxembourg investment management and fund industry. It counts among its membership over 1 100 funds and asset management groups from around the world and a large range of service providers. According to the latest CSSF figures, on 30 June 2008, total net assets of undertakings for collective investment were 1.9 trillion euros.

2. There are 3 153 undertakings for collective investment in Luxembourg, of which 1 874 are multiple compartment structures containing 10 518 compartments. With the 1 279 single-compartment UCIs, there are a total of 11 797 active compartments or sub-funds based in Luxembourg.

3. According to 2007 EFAMA figures, Luxembourg's fund industry holds a market share of 25.7% of the European Union fund industry, and according to 2008 PWC/Lipper data, 75.4% of UCITS that are engaged in cross-border business are domiciled in Luxembourg. As one of the main gateways to the European Union and global markets, Luxembourg is the largest cross-border fund centre in the European Union and, indeed, in the world.

4. ALFI would like to thank CESR for the opportunity to participate in this call for evidence and ALFI welcomes CESR's intervention in this matter.

5. ALFI strongly supports the legislative proposal published by the European Commission on 16 July 2008 on UCITS IV and is in favour of all of the proposal's efficiency measures. Measures contained in the legislative proposal will contribute to improving UCITS efficiency and to strengthening the UCITS global brand. These stand-alone measures are independent of a management company passport and their implementation into EU law should not be conditional upon such a passport. ALFI is aware of the short time period left for the current European Union legislator to pass the proposed efficiency measures contained in the draft directive. For ALFI, it is of the utmost importance that the five topics currently included in the legislative proposal be adopted prior to June 2009. The management company passport entails complex questions and issues which need to be addressed with

great care and attention. This should not be an obstacle to the adoption of the other measures where there is a broad consensus among the industry, regulators and governments.

6. Since the publication of the EU Commission Green Paper in 2005, ALFI has carefully examined issues surrounding the management company passport. Indeed, as the EU's largest cross-border fund centre, Luxembourg has the most experience in issues of regulatory cooperation within the UCITS framework. ALFI's position over time has remained unchanged: while we are not in principle opposed to a management company passport, we believe that the potential advantages could be outweighed by added legal and regulatory costs and risks.

Before responding to the specific regulatory questions that have been posed in the call for evidence, ALFI would like to share with CESR a number of comments and points of concern which we have identified and analysed over the past years.

2. The UCITS global brand

7. Since the advent of the UCITS directive in 1985, UCITS have developed into the European Union's most successful cross-border financial product. Increasingly, outside the European Union, it has become a global brand.

8. The success of the UCITS global brand would never have been achieved in a purely local or national market. The harmonisation process of the UCITS framework in Europe has evolved significantly over time, and fund promoters now benefit from a highly regulated product that is increasingly accepted by regulators from all over the world who have allowed the UCITS product to be sold in their market. The UCITS global brand is well known and accepted outside of Europe, particularly in Latin America, South-East Asia and the Middle East.

9. According to a recent EFAMA survey (source: industry survey by EFAMA of 4th July 2008: UCITS as a global brand"), 90% of net sales of international UCITS promoted by the participating companies in the survey originated from Asia in 2007, with the rest coming from Latin America. This trend has continued in 2008, with positive flows from Asia and Latin America in the period January to May 2008. Investors in the Middle East show growing interest in UCITS.

10. The majority of the participants in the survey (82%) believe that the proportion of their UCITS held by investors in these regions will continue to grow over the next three to five years.

11. Building the UCITS global brand has been a long process and has provided significant benefits to the EU fund industry and to investors. However, this strong reputation could be lost quickly if the integrity of the UCITS product suffered through the introduction of an imperfectly thought-through passport regime.

12. Even the mere likelihood of uncertainty, of a legal or fiscal nature, for example, may have dramatic negative impacts on the UCITS global brand.

13. ALFI believes that a management company passport is a complicated question

that should be thoroughly analysed in a careful and deliberate manner.

3. The pivotal role of UCITS product-centred regulation

14. ALFI maintains that the UCITS product itself must unambiguously remain at the centre of the UCITS regime as a whole.

15. The integrity of UCITS regulation has, since inception, been conceived and built up as "product-centred" regulation. This approach has protected investors' interests and is based on the unique feature that the product itself (i.e. the UCITS) is subject to regulation. Such an approach justifies the granting of the passport that the product enjoys throughout the European Union. The introduction in 2001 of a harmonized regime for UCITS management companies has not changed this approach where the UCITS product remains at the centre of regulation.

16. Granting a passport to the management company as a service provider to UCITS should not lead to a situation where the quality and reputation of the "product" would be endangered.

17. A passport whereby a management company may set up and/or manage UCITS on a cross-border, hence remote basis, is only conceivable if the following consequences may be avoided:

- Duplication or gaps in the supervision and oversight of the UCITS (by the regulators, auditors, depositaries);
- Uncertainties as to the nationality of the UCITS and the application of local laws on it;
- Uncertainties as to the tax status of the UCITS;
- Uncertainties as to the actual costs and benefits for the UCITS and its investors of the implementation of a management company passport on a cross-border basis.

The mere likelihood of any of the above could seriously weaken the UCITS global brand, both within and beyond the European Union.

18. The European Commission itself has already observed in its white paper and supporting impact assessment that a (full) passport "could undermine the capacity of the fund supervisor and depositary to assume certain responsibilities with respect to the administration and operation of the fund. It could lead to tax authorities of the management company domiciles claiming jurisdiction over the revenue and income of the fund, in addition to taxation in the fund's domicile itself."⁽¹⁾

¹ Commission staff working document accompanying the Proposal for a directive of the European Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) – Impact assessment of the legislative proposal amending the UCITS directive {COM(2008) 458} {SEC(2008) 2264} page 56

19. A careful analysis of these issues is mandatory. This inevitably needs time and careful reflection and research. ALFI is committed to participating constructively and diligently to such an exercise.

4. Analysis of identified risks and uncertainties

4.1. Supervision and oversight

4.1.1. Regulatory supervision

20. ALFI has identified 3 main sources of risks and uncertainties in relation to the prudential supervision of the UCITS product.

21. (i) The provision of management company services on a cross-border basis should not deprive UCITS of the local substance necessary for the product regulator (i.e. the UCITS home Member State authorities) to properly carry out their supervisory functions.

22. There can realistically be no effective supervision by the regulatory authority of the UCITS domicile if there is no administrative and other head office substance in this jurisdiction. Substance requirements for management companies and self-managed UCITS were inserted precisely for this reason in the UCITS Directive by Directive 2001/107/EC.

23. Such concern was already expressed in the original version of Directive 85/611. Article 3 has been inserted in the Directive in order to

- avoid UCITS becoming "empty boxes" and

- facilitate regulatory supervision by linking the location of a UCITS' head office to its registered office, where all the documents which allow an effective supervision must be kept (See "Vers un marché européen pour les organismes de placement collectif en valeurs mobilières", - Commentaires des dispositions de la directive 85/611/CEE du Conseil du 20 décembre 1985" OPOCE, 1988, pp. 6-7, n° 14).

24. (ii) The coexistence of two passports, one for a regulated and supervised product, the other for a regulated and supervised service provider, should not lead to regulatory duplications, supervisory gaps and/or conflicts of competences between authorities. Uncertainties as to which regulator is in charge of supervising the services provided to UCITS must be eliminated. In ALFI's view, because the UCITS regulation is and must remain a product regulation, the supervisory responsibility for all services provided to the UCITS must, as presently, remain entrusted to the UCITS home Member State authorities acting as "lead" regulator.

25. (iii) The coexistence of two passports also creates difficulties in relation to the enforcement of the regulation applicable to the UCITS product. Directive 85/611 is not a self-contained regulation. Member States keep therefore the residual competence of enacting national regulations regarding aspects not (fully) covered by the Directive. Situations where the authorities supervising the management company would be in charge of ensuring compliance with and enforcement of foreign regulations applying to the UCITS product should be avoided. For this

reason, ALFI recommends that the UCITS home Member State authorities keep this supervisory responsibility.

26. ALFI is, furthermore, of the opinion that (i) the respective roles and responsibilities of each regulatory authority, and (ii) the rules of a reinforced regulatory cooperation framework should be clearly defined at level 1, where the means to monitor and to enforce the rules under each authority's responsibility must be clarified.

4.1.2. Audit functions

27. Independent auditors play an important and integral part in the overall supervision and oversight of a UCITS. In addition to auditing the accounting information given in the annual report and financial statements of a UCITS, auditors are also required by many regulators in their respective jurisdictions to carry out additional work, such as compliance with anti-money laundering rules, codes of good conduct, service organisation reviews, IT security, etc. Auditors work very closely with regulators and have clear reporting duties in the event that serious weaknesses in internal controls or breaches of regulations are uncovered.

28. Auditors not only audit financial statements but, as long as it could have a material impact on year-end financial statements, also check that NAV calculations during the year are accurate. In some countries, when there has been a NAV calculation error, auditors must review the compensation process and ensure that it has been applied in accordance with the legislation applicable to the UCITS. The amount of compensation can itself have a significant impact on the financial statements.

29. The auditor of the UCITS has to perform its duties in relation to the UCITS separately from the auditing of the financial statements of the management company. If the audit of the management company were to be performed by a separate audit firm from the one responsible for the audit of the UCITS and acting under the regulations of a different country than the domicile of the UCITS, as would be more likely to happen in the case of the introduction of the management company passport, both auditors would necessarily have to cooperate, and additional risks may be inherent in a more complex audit process with additional potential conflict situations as conditions for auditing UCITS and Management companies do vary among member states. These risks may be numerous: there could be, for example, differing eligibility requirements.

It is important that the information pertaining to the fund and the people involved in the fund auditing process is based in the country of the fund in order to ensure a smooth audit.

30. If only a portion of the administrative functions (as described in Annex II of the UCITS Directive) were to be performed by the management company in its home country rather than in the UCITS' home country, the audit process would become less efficient necessarily increasing its costs as well as the risk of error.

31. Even periodical travelling to the management company's home country or delegation to a local auditor can by no means ensure an ongoing proper supervision as is presently performed by the auditor.

4.1.3. Role of the depositary

32. The depositary plays an important role due to the supervisory functions granted to it pursuant to the UCITS Directive. The depositary is in a similar situation to the UCITS' regulator and to the UCITS' auditor: effective oversight and supervision cannot be performed if no administrative substance (processes and records) is left in the home country of the UCITS.

Furthermore, the critical role of the depositary in safekeeping the UCITS' assets can be compromised if regulatory direction is ambiguous or not tightly co-ordinated with the fiduciary and administrative functions of the UCITS. For example, operations related to the realisation of collateral, recovery of assets, receipt or delivery of assets, can be hindered in the absence of absolute clarity in instructions, regulatory direction, and regulatory interpretation. This is especially the case in extraordinary situations of greatest risk, where high market volatility, lack of liquidity or counterparty failure can require speedy decisions and execution to protect a UCITS' position or assets.

4. 2. Tax uncertainties

4.2.1. Direct taxes

33. The tax impact and risk related to a management company passport need to be highlighted. Thus, by way of example, if a UCITS domiciled in Member State B is managed by a management company based in Member State A, the tax authorities of Member State A could consider that "mind and management" of the UCITS has been transferred to Member State A. The UCITS would then be taxed twice: in its own domicile and in the Member State of the domicile of its management company.

34. With regard to direct taxes, two situations have to be considered:

- i) A corporate-type UCITS, e.g. a SICAV, designates a foreign management company.

There is a risk that the place of the effective management and control of a SICAV domiciled in Member State B is deemed to be transferred to the jurisdiction where the head office of the management company is situated (Member State A). As a consequence, the SICAV could be considered as a tax resident of Member State A although it has not been incorporated there. Alternatively, it could be deemed to have created a permanent establishment in Member State A and be taxed on the profits allocated to the permanent establishment, while remaining subject to tax in Member State B.

- ii) A contractual-type UCITS, e.g. an FCP, is set up in Member State B by a management company having its registered and head office in Member State A.

There is a risk that the FCP is considered to be an "opaque" pool of assets ("*patrimoine d'affectation*" – "*Zweckvermögen*" – "*trust*") assimilated for the

purpose of taxation to a corporate entity and additionally subject to tax in Member State A, even if the UCITS has no legal personality. The application of the laws of two different countries to the management company and the contractual-type fund could lead to serious fiscal problems and should thus be avoided.

35. From an international tax law standpoint, there is a growing concern raised by foreign tax administrations regarding the substance of entities enjoying a particular tax treatment or claiming benefits in general. If the management company based outside of the domicile of the UCITS may exercise control over it, it is likely that the UCITS would be subject to foreign tax on its profits.

36. Foreign tax authorities have challenged substance issues in several recent cases. One example is the Indofood case (see the UK Revenue guidance paper (Draft Guidance on HMRC's interpretation of the Indofood decision (<http://www.hmrc.gov.uk/>))⁽²⁾). A second example is the new German rules on anti-treaty shopping (Section 50d (3) EStG (Income Tax Act) and the "Jahressteuergesetz" 2007 (Annual Act 2007)).

37. The substance requirements vary from one country to another but have nevertheless certain common features. Apart from regular board meetings held in the country where these entities are supposed to be resident, these entities must be provided with sufficient "business substance".

38. Even the mere likelihood of an additional tax charged in Member State A on the assets of the UCITS domiciled in Member State B would have a significant negative impact on investor confidence in the UCITS product. It is not inconceivable that the auditor, in some cases, will need to qualify its conclusions even in the event of the mere likelihood of uncertainty on the tax aspects of a UCITS.

39. In addition, diverging views from the tax authorities in the various Member States are likely to create more distortions and arbitrage situations which will ultimately be detrimental to investors.

4.2.2. VAT

40. From a VAT perspective, even if progress has been made through the European Court of Justice case law, the VAT exemption that applies to the services rendered

² Indofood International Finance Limited v JPMorgan Chase Bank, London Branch, case n. HC05C00335 decided by the English High Court of Justice on 7 October 2005 and by the English Court of Appeal on 2 March 2006. In this case the UK courts were called to decide whether the interposal of a Dutch BV as an intermediate vehicle between Mauritius and Indonesia (so that Indofood would benefit from the application of the Dutch Double Tax Treaties with Indonesia and Mauritius) precluded the application of the referred Tax Treaties. In the referred case law the English Court took on an international construction of the meaning of "beneficial owner" under the context of double tax treaties and further clarified the meaning of conduit companies with a view to denying the benefit of double taxation relief to an applicant that can be characterized as "treaty shopping" using a conduit company (the Dutch vehicle).

by the management company is still applied very differently from one Member State to the other. Those differences can be observed along two dimensions: (1) the qualifying entities (UCITS) and (2) the qualifying management services. These two dimensions are still interpreted differently in the different Member States. Those differences might significantly distort the competition between UCITS established and managed in different jurisdictions, to the prejudice of the investors.

41. For instance, in some circumstances, a management company and a fund established in two different Member States could avoid all VAT costs (the management company established in Member State A could recover in full its input VAT paid to its suppliers and the Fund as recipient established in Member State B could benefit from a VAT exemption on the services received from the management company).

42. On the contrary, in other circumstances, a management company and a fund established in two different Member states may be obliged to pay VAT twice. Once where the management company is established (as no right of deduction of the input VAT would be recognized to the management company in Member State B) and once where the Fund, as recipient, is established (as the services received from the management company could not benefit from any VAT exemption in Member State A).

43. Direct and VAT tax issues need to be carefully examined and clarified in order to minimise additional risks and cost to be born by investors. ALFI believes that more time is needed to consider the full tax implications of a management company passport and to eliminate any uncertainties that might negatively impact investment volumes in UCITS and the reputation of the UCITS global brand.

44. Finally, ALFI respectfully disagrees with the statement of the EU Commission in its impact assessment saying that the danger of overlapping tax jurisdictions would be limited in scope, and where a residual risk remains it would be up to the national tax authorities to align their taxation policy with the regulatory approach (presented in the exposure draft). Such risk is not to be perceived as minimal, as for the time being it remains to be seen how the tax authorities of the 27 Member States ⁽³⁾ would respond to such considerations. This alone would create tax risk, which could constitute a major risk for the UCITS product and brand.

4.3. Legal uncertainties

45. The scope of the management company passport differs depending on the legal form of the UCITS concerned. If a management company located in Member State A is "designated" by a corporate-type UCITS (e.g. a SICAV) domiciled in Member State B, this appointment occurs by way of delegation. The SICAV still maintains its Board of Directors and other governing bodies, as the case may be, which will have a direct responsibility as regards the functioning of the SICAV, over and above the responsibilities entrusted to the management company.

³ Mathematically speaking, there are 351 separate bilateral pairs of tax authorities among the 27 EU Member States ($N \times (N-1)/2$). Therefore, tax issues surrounding the management company passport are necessarily complicated by the sheer magnitude of potential bilateral relationships.

46. In the example given above, designation of a foreign management company entails the transfer of actual day-to-day management functions out of the domicile of the SICAV into the domicile of the management company, whereby the Board of Directors of the SICAV is left with a mere supervisory role. In a similar manner to the situation described above regarding the tax uncertainties, there is a risk, pursuant to the national laws of the Member States in which the SICAV has been established, that the SICAV loses its nationality. In a worst-case scenario, the SICAV could be left with no nationality or with a double nationality. This can only be avoided if the legal system of the SICAV's home Member State is left the discretion to decide on establishing minimum rules of substance and governance to eliminate this uncertainty.

47. A contractual-type UCITS (like an FCP) has no legal personality. It is a pool of assets invested on behalf of the unit-holders. The management company is the legal representative empowered to set up the pool, to manage its assets and to take any other decision on behalf of the unit-holders. With the exception of the depositary appointed by the management company, no other body shares responsibilities such as those entrusted to the management company, as is the case in a corporate-type UCITS.

48. If a management company located in Member State A sets up an FCP to be domiciled in Member State B, under the proposed new system, the nationality of the FCP would be established only with reference to the governing laws applicable to the FCP (those of Member State B) as stipulated in the management regulations. This deviates from the current rules where the nationality of the FCP is determined by the registered office of its management company.

49. ALFI is of the view that in a contractual-type UCITS, the laws of the home Member State of the UCITS should also govern the relationship between the UCITS, its investors and its management company to further reinforce the nationality of the UCITS.

More generally, whatever the legal form of the UCITS may be, the contractual relationship between the UCITS, the depositary and the service providers entrusted with the "extended" core administrative functions should also be subject to the laws of the home Member State of the UCITS.

50. ALFI is however concerned that the link to a specific jurisdiction consisting solely of stipulating that the laws of this jurisdiction govern the respective contractual relationship, may, in the absence of any other substance in that jurisdiction, not be sufficient to legally establish the nationality of the UCITS, in particular for contractual-type UCITS.

51. In any event, whatever the additional proposed safeguards may be, complex conflict of law issues - where private international law rules are not harmonised - may arise.

52. The nationality of the UCITS must not be challenged through a passport regime. Without additional safeguards, conflict of law issues may be virtually unmanageable and will not only seriously impair investor confidence, but also undermine the UCITS global brand.

53. In addition, several items listed under administration of Annex II b) are considered to be owned by the UCITS, and not by the management company and as such may simply not be located or carried out in another jurisdiction than that of the home country of the UCITS. In particular, complexities could arise concerning the maintenance of the unit-holder register, where conflicts may exist among laws in multiple jurisdictions (e.g. laws on data protection issues).

5. Complexities and potential inefficiencies resulting from a management company passport

54. The location of the management company in another Member State adds legal and regulatory complexity to the supervision of the UCITS' set-up and its ongoing operations. The dynamics of operating the management company passport have to be carefully analysed. Having a management company managing a UCITS established in another Member State is likely to create uncertainties and increase inefficiency and costs.

55. If the UCITS and the management company are based in the same jurisdiction and therefore subject to supervision by a single supervisory authority, the latter can consider, in any cases where its authorisation is required, both the situation of the UCITS and the management company at the same time.

56. The UCITS Directive comprises many provisions where the authorisation process requires the supervisory authority to consider the situation of the management company and the situation of the UCITS at the same time. In the event that two supervisory authorities are involved, a consultation process will be required which will impact negatively the approval process and its efficiency.

57. Based on the detailed examples hereafter, one can easily conclude that dual supervision will have a significant impact on the efficiency of the approval process. Any impact of this type is clearly in contradiction with the aim of the UCITS IV efficiency package to facilitate the processes (notably through the revised notification procedure for cross-border registration).

58. Consider the following examples:

- Article 5 (a) b) of the Directive requires that the persons who effectively conduct the business of the management company must be of sufficiently good repute and must be sufficiently experienced with regard to the type of UCITS managed by the management company.

Assuming that the assessment of whether such persons are adequately experienced with regard to a specific type of UCITS to be authorised by its home regulator can only be made by the latter in light of the specific characteristics of the UCITS concerned, it will not be sufficient for such persons to have been previously authorised by the home regulator of the management company at the time of the latter's authorisation. The procedure enabling the supervisory authority in the home country of the UCITS to ascertain that the relevant persons have adequate experience will

take time and imply a duplication of the assessment initially made by the home regulator of the management company.

- A similar situation arises with regard to the authorisation of a risk-management process employed by the management company for the UCITS which it manages. It is not sufficient for the home regulator of the management company to approve this risk-management process at the time of authorisation of the management company. The home regulator of the UCITS will need to make its own assessment of whether the risk-management process is appropriate in light of the characteristics of the specific UCITS for which it has to grant authorisation.

59. The possibility of the management company delegating its investment-management functions also raises complicated prudential supervisory issues. This can be illustrated by the following example:

A management company set up in Member State A manages a corporate-type UCITS domiciled in Member State B. The management company has, as permitted by Article 5g of the UCITS Directive, delegated the investment management functions to another company in Member State C. The UCITS is distributed in certain EU Member States, and say, in Hong Kong and Japan.

- The delegation by the management company based in Member State A to the asset manager in Member State C will need to be approved by the regulator of either Member State A or B or both. The relationship between the management company and the asset manager may be governed by the laws and regulations of either of their respective countries, unless the UCITS' rules clearly indicate that the rules of the UCITS' domicile, i.e. Member State B, are applicable. In this example neither company is based in Member State B.
- The situation will be even more complicated if the asset manager is domiciled in a non-EU country, and it is accepted by the regulator in Member State A (management company regulator) and not by the regulator in Member State B (UCITS regulator). This conflicting situation could arise if, as required by Article 5g(d) of the UCITS Directive, there is cooperation between the regulator of Member State A and the regulator of country C but not between the regulator of Member State B and the regulator of country C. The resolution of such an issue will cause delay, add cost to the process and may create a conflict situation between regulators.
- Continuing the example, the foreign regulators, the Hong Kong Securities and Futures Commission (SFC) and the Japanese Ministry of finance (MOF) would need to deal with regulators of two different countries with, potentially, different languages and rules. Their main concern is clarity over the rules that prevail. This will add inefficiency and cost to the process and, more importantly, may create incomprehension and uncertainty in the minds of the foreign regulators in the UCITS' importing countries.
- The foregoing example highlights the need for the UCITS' rules to clearly define the roles and responsibilities of each regulator.

60. The following are a few more of the additional complications that arise with regard to regulatory oversight when the management company passport is used:

- In its lifecycle, the UCITS' operations will be subject to regulatory supervision such as auditing, production of other regulatory reports, indemnification rules for NAV errors or investment restriction breaches, disclosure (transparency) requirements, anti-money laundering rules, etc. The UCITS' rules should stipulate that the applicable rules are those of the Member State of the UCITS' domicile, however, this will imply that a management company will need to have staff trained and knowledgeable in the rules of the Member State of the UCITS domicile. The management company will also need to institute controls and processes to comply with the rules of the Member State where the UCITS is domiciled.
- The regulators of both the UCITS and management company, the auditors of the UCITS and the management company may need to communicate regularly and will need to have access to documents, analyses and reports produced by those involved, including the service providers. The exchange of and request for further information and additional work will only add to inefficiency and costs due to language issues, differences of interpretation of rules and standards of working.

6. Cost/benefit analysis of the management company passport

61. Changes to the regulatory framework should only be considered if the benefits of such changes clearly outweigh costs. ALFI believes that the management company passport will undoubtedly increase costs and risks to the UCITS regime.

62. A thorough analysis needs to look not only at financial benefits but also at financial costs and the "costs" of additional risks. It should include the interests of all stakeholders (such as investors, depositories, auditors and supervisory authorities in Europe and beyond) and, most importantly, should include non-financial elements such as the negative impact of a loss of trust and reputation.

63. ALFI is convinced that a management company passport will lead to a more complicated system with increased risks of error. In order to perform their duties, depositories and auditors will need to work cross-border, which will lead to increased travel costs, translation costs and communication difficulties. Such complexity will be reflected in the service providers' fees and therefore be borne by the UCITS and its final investors. An increase in exchange of information between regulators, in solving, for example, interpretation divergences in relation to investment policies and risk management, in addition to translation costs and communication difficulties, will at least result in the need to hire additional staff, require double filing and storage of certain documents, as well as delaying approval processes and time-to-market.

64. Today's sub-prime crisis shows how quickly a loss of confidence can disrupt a financial system. ALFI believes that the management company passport could introduce the spectre of regulatory, legal or fiscal risk into the successful UCITS

product. Such a question should be thoroughly examined from a cost/benefit perspective, taking into account the interests of all stakeholders.

7. Specific answers to the points raised in the call for evidence

65. Sub. 3.1. 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 ALFI's view, the elements that could be used to distinguish the home Member State of the management company and that of the UCITS fund are those that mean that the substance of the UCITS is located in its own domicile. More specifically, these elements are those necessary for ensuring that, from a tax and legal perspective, the UCITS is considered as having one single domicile, which must be located in its home Member State (please see N° 33 to N° 53 above). As those elements may differ between the various Member States, the most stringent approach should prevail so as to ensure that Member States recognise the tax and legal domicile of the UCITS. There should also be enough substance in the home Member State of the UCITS to permit effective supervision and oversight of the UCITS product (see N° 20 to N° 32 above).

66. Sub. 3.2. 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.

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.

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 management company and the UCITS fund.

Because the UCITS regulation is and must remain a product regulation, the supervisory responsibility for all services provided to the UCITS must remain entrusted to the UCITS' home Member State authorities acting as "lead" regulator.

It is therefore the UCITS' home Member State authorities who must be responsible for approving the UCITS' features and ensuring its proper and efficient permanent supervision.

More specifically, it is the authorities in the UCITS' home Member State which must be responsible for, inter alia, approving (i) the fund rules/instruments of incorporation and any changes thereto, (ii) the choice of the depositary, the management company (also in light of the experience of the management

companies, conducting persons as regards the investment policy of the UCITS) and the auditor, (iii) the risk management process employed by/for the UCITS and (iv) the organisation of the administration infrastructure of the UCITS.

Similarly, it is the authorities in the UCITS' home Member State which must be responsible, inter alia, for (i) dealing with any net asset value calculation errors, (ii) dealing with any investment policy and restriction issues and related interpretation of UCITS investment rules, (iii) dealing with any non-compliance with other UCITS rules and (iv) dealing with investor complaints.

The responsibility of the authorities in the management company's home Member State must be limited to authorising the management company.

More specifically, this entails (i) checking/ensuring compliance of the management company with requirements as to initial capital and own funds, (ii) ascertaining the good reputation and experience of the persons who conduct the business of the management company, (iii) approving the programme of activity setting out the organisational structure of the management company, (iv) ascertaining whether any existing close links between the management company and other persons justify a refusal of authorisation, (v) taking the necessary action required by the UCITS Directive in relation to the identity of the management company's shareholders, (vi) ensuring that any other operating conditions imposed by the UCITS Directive on the management company are met, (vii) withdrawing the management company's authorisation if the conditions imposed by the UCITS Directive on the management company are no longer met and (viii) taking all the necessary actions and measures provided for by the UCITS Directive in the event that a management company wishes to establish a branch or wishes to provide services in other Member States.

In relation to any overlap in responsibilities of the authorities in the UCITS' home Member State and those in the management company's home Member State which may result from the foregoing (certain cases have been highlighted above, please see N° 58 and N° 59 above), it must be ensured that these issues are resolved to the full satisfaction of the authorities in the UCITS' home Member State, acting as "lead" regulator and having the overall responsibility for ensuring investor protection.

67. Sub. 3.3. 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 (authorised in another Member State) are commensurate with the demands/risks embedded in the investment policy of the UCITS fund.

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.

Because the UCITS as a product must remain at the centre of any regulation and supervision, ALFI recommends that the supervisor of the UCITS checks that qualifications of the management company (authorised in another Member State)

are commensurate with the demand/risks embedded in the investment policy of the UCITS fund.

A management company could be refused permission to manage/set up a UCITS fund in another Member State, notably if the management company did not comply with any law or regulation applicable in the Member State of the UCITS' domicile and governing the provision of its services to the UCITS. These laws and regulations should include the provisions governing oversight of the management company by the supervisor of the UCITS when providing services to the UCITS.

68. Sub. 3.4. 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.

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).

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).

Ensuring that the supervisor of the UCITS has sufficient *means* to carry out its supervisory duties effectively, entails first of all clarifying explicitly, as per the UCITS Directive, that the supervisor of the UCITS is competent for granting the authorisations, performing the permanent supervision and ensuring investor protection as specified in N° 66 above. This also entails clarifying, as per the UCITS Directive, that the supervisor of the management company has only residual competence on issues concerning the management company which do not specifically refer to the UCITS which the management company governs.

With respect to the *information* which must be at the disposal of the supervisor of the UCITS in order for it to carry out its duties of prudential supervision, appropriate administrative substance must exist in the UCITS home Member State (please see, inter alia, N° 20 to N° 23 above).

The management company of a corporate-type UCITS, being a service provider in respect thereof, must provide the UCITS, its Board of Directors and its other appointed service providers (including the depositary) with all necessary information so as to enable the UCITS to (i) comply with the UCITS rules, (ii) demonstrate such compliance to the supervisor of the UCITS and (iii), more generally, ensure efficient investor protection.

69. Sub. 3.5. 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.

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.

Any breach of the rules governing the management of the UCITS must be clearly reported, in a first instance, to the authorities in the UCITS' home Member State, acting as "lead" regulator and responsible for the permanent supervision of the UCITS. Just as the authorities in the UCITS' home Member State are competent to approve the choice of the management company, they should also be responsible for deciding upon the withdrawal of a management company of a UCITS subject to their supervision if it does not comply with the relevant UCITS rules.

Such a structure will result in complex legal and regulatory issues.

8. Conclusion

Questions surrounding the viability of the management company passport are complex and the stakes are enormous. ALFI believes that more time is needed to examine thoroughly, deliberately and exhaustively the legal, fiscal and regulatory issues raised by CESR's call for evidence on the management company passport. Without such assurances that these risks can be mitigated, it is impossible to conclude that the "... current high level of investor protection provided by the UCITS framework can be maintained in the context of such cross-border management arrangements."⁽⁴⁾

⁴ CESR Cover Sheet : "CALL FOR EVIDENCE ON THE REQUEST FOR ADVICE TO CESR ON THE UCITS ASSET MANAGEMENT COMPANY PASSPORT " 17 July 2008