ALFI contribution to the CESR consultation paper on UCITS management company passport (Ref: CESR/08-748)

Introduction

1. ALFI represents the Luxembourg investment management and fund industry. It counts among its membership over 1 200 funds and asset management groups from around the world and a large range of service providers. According to the latest CSSF figures, on 31 August 2008, total net assets of undertakings for collective investment were 1.9 trillion euros.

2. There are 3 284 undertakings for collective investment in Luxembourg, of which 1 939 are multiple compartment structures containing 10 765 compartments. With the 1 345 single-compartment UCIs, there are a total of 12 110 active compartments or sub-funds based in Luxembourg.

3. According to June 2008 EFAMA figures, Luxembourg's fund industry holds a market share of 26.1% 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 consultation and ALFI welcomes CESR's intervention in this matter that facilitates examination of the main issues of concern with regard to the proposal for a management company passport (the 'management company passport/MC passport').

Preliminary remarks

5. Since the publication of the EU Commission Green Paper in 2005, ALFI has carefully examined issues surrounding the management company passport. ALFI's position over time has remained unchanged: while ALFI is not opposed in principle to a management company passport, ALFI believes that the potential advantages can under no circumstances be outweighed by additional legal, operational and regulatory risks and costs.

6. A management company passport entails complex issues which need to be addressed with utmost care. At a minimum, additional costs and risks must be thoroughly analysed.

In addition, in enacting any further proposed amendment to the UCITS framework, the appropriate legislative process must be fully observed. In this respect, ALFI considers that more time is needed to examine thoroughly and in an exhaustive manner the legal, regulatory and fiscal issues raised by a management company passport. Without the necessary assurances that such risks can be mitigated, it would be 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."[1]

7. In its *Request for assistance on the UCITS Management Company Passport* addressed to the President of CESR on 16 July 2008, the European Commission recalls why new provisions in relation to the management company passport have not been introduced in the proposal for a UCITS directive revision. The EU Commission had "given careful consideration" to this issue.

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

The Impact Assessment attached to the proposal for a revision of the UCITS directive, carried out in accordance with the 2003 inter-institutional agreement, concludes in that regard that:

"The IA [Impact Assessment] therefore concludes that the type of provisions needed to provide a management company passport would entail extensive bureaucracy and administrative costs. They would not fully dispel the supervisory concerns and investor protection risks associated with cross-border fund management. They would provide neither a cost-effective basis to introduce the passport. Potential drawbacks are considered to outweigh the expected benefits. The Commission therefore proposes not to change at this stage the provisions of the Directive in this regard but to maintain the status quo whereby fund managers undertake cross-border management through delegation-based solutions"[2].

ALFI largely shares the Commission's concerns.

8. Changes to the regulatory framework can only be considered if the benefits of such changes clearly outweigh related costs.

A more thorough analysis needs to concentrate not only on benefits but also on added costs including the "cost" of the additional risks taken. Attention must be paid to the interests of all stakeholders (investors, depositaries, auditors and supervisory authorities in Europe and beyond) and, most importantly, the possible negative impact of a loss of trust and, crucially, potential damage to the established global reputation of UCITS products in general. ALFI has in that respect repeatably stressed the global reach of the UCITS brand beyond Europe and the care every legislative revision requires from the perspective of cross-border sales in – and outside of the EU. The UCITS global brand is well known, perceived and accepted, particularly in Latin America, the Middle East and Asia.

9. It goes without saying that the current turmoil in the global financial markets also calls for particular care and makes it a precarious time to loosen the regulatory cohesion.

The current situation on the markets is not only about investor protection but is equally about (keeping and regaining) investor confidence and confidence more generally. In such an environment, weakening the UCITS supervisory regime and rendering it more complex could become fatal for the UCITS brand.

10. In the light of the comments made above, ALFI wishes to stress that an approach requiring further consultation and analysis is very much in line with the application of the principle of prudence, a general principle of European law to which secondary legislation such as a directive is also subject.

11. Moreover, ALFI questions whether the proposal for a management company passport may not breach the European law principle of proportionality. It would appear to do so, having regard to (i) exposure to additional costs on the part of national regulators and the depositary; (ii) increased exposure to risk for investors; (iii) the potential for substantially damaging the reputation of UCITS and (iv) the fact that an extended passport is not crucial to achieve gains in efficiency. In this context it is appropriate to refer to the conclusions reached in the Impact Assessment which can be recalled here:

"Finally, it appears necessary to assess the impact of this recommendation on the other proposed measures. In particular, whether this risks unbalancing the effectiveness of the

[2] Impact Assessment of the legislative proposal amending the UCITS Directive (COM(2008)458 SEC(2008)2264), page 29.

resulting legislative package. The answer is negative. Part of the rationalisation efforts aimed at by the MCP could be achieved by other means. First of all, a streamlined notification procedure will increase markets' openness and thus reduce the need to launch parallel fund ranges in different MS. A single fund range based in a single country (and therefore with a single MC) will be able to easily access investors in all MS. (This would particularly benefit smaller asset management groups.) Secondly, the possibility to merger funds across borders will reinforce this MC rationalisation process. By allowing the merger (and liquidation) of a fund established in country A into a fund in country B, industry players will be able to concentrate their fund ranges in the most efficient fund domiciles thus allowing the dismantling of MC in the less efficient ones".

12. Assuming it is ultimately considered appropriate to extend the scope of the management company passport despite all the objections raised, ALFI is keen to address CESR's proposals in a constructive manner and to find viable solutions.

In the developments that follow, ALFI will attempt to elaborate workable solutions unlikely of affecting the acknowledged strength and reputation of the UCITS set up.

General Observations

13. A UCITS is a collection of movable assets, managed, kept and administered for the exclusive benefit of the investors. This collection of assets and the investors investing therein require multiple operations and services on the part of different actors participating in the life of the UCITS. A UCITS is a mass of intangible property the subject of systematic exploitation in the exclusive interests of investors.

14. The protection of investors is crucial given that UCITS are financial products, which materialise in the form of units or shares which are aimed at the public at large, providing a savings opportunity. The effectiveness of prudential supervision of UCITS is therefore crucial.

15.The functioning of a UCITS as much as its effective supervision will require substance in the Member State in which it is established. There is simply no way around this.

16. This fundamental fact must at all times be kept in mind in elaborating a legal regime and passport for the management company, which remains but one component of the entire UCITS set up and an actor, in the proper functioning of a UCITS, alongside others (depositary and the supervisory authority of the UCITS notably). A risk free approach cannot be centered only on the management company as a financial operator seeking to make use of the freedom of movement, ignoring the larger collective reality within which it must be placed.

The particularities of collective investment vehicles such as UCITS necessarily condition the modalities by which a management company can manage a UCITS remotely from another Member State. This very specific context is radically different from the context in which an investment firm, which is moreover generally a far more modest operator, operates. It gives rise to the need to examine with great care any proposed transposition to the area of collective management of the regime under the MiFID directive, which was conceived for operators and situations which are fundamentally different.

In this respect, uncertainties as to which regulator is in charge of supervising the services provided to a UCITS must be eliminated. In ALFI's view, because UCITS regulation is and must remain a product centred regulation, the supervisory responsibility for all services provided to the UCITS must, as is currently the case, remain entrusted to the UCITS home Member State authority acting as "lead" regulator. In order to allow the UCITS competent authority to assume its supervisory responsibilities, appropriate substance of the UCITS' must be available and remain in their jurisdiction of competence.

17. Fiscal issues have not been considered in the CESR consultation paper. Such issues can however not be ignored. They are intrinsically linked to the definition of the UCITS' domicile and nationality. Legal questions pertaining thereto are obvious. Hence they must be resolved before any management company passport solution can become operational. They cannot just be ignored.

Specific answers/comments to the questions raised for consultation in the various boxes

CHAPTER 1
Definition of domicile

Box 1: Management company

18. Questions for consultation:

Do you agree with CESR's proposals in Box 1?

- **point 1 of Box 1**

19. ALFI notes (and welcomes) that CESR resorts here to classical, workable and legally reliable criteria to identify the management company's home Member State (that is: registered office and head office). ALFI wonders why CESR departs from this generally accepted approach when it comes to dealing with common funds (see Box 2).

- **point 4 of Box 1**

20. ALFI is favourable to proposal 4 which aims at preventing risks of *forum shopping*.

ALFI wishes to recall in this context that the obligation to carry on a significant part of its activities in the Member State of origin[3] is a requirement for banking and financial operators benefiting from a European passport[4].

Having regard to the legitimate interests of the Member State of a UCITS managed by a management company set up in another Member State, ALFI considers that the former should be involved in ensuring that such a principle is respected.

- **point 5 of Box 1**

21. ALFI expresses reservations, which are developed in more detail hereafter, in respect of (i) the possibility given to the management company to provide services in other Member States by means of the free provision of services[5] and also regarding (ii) the right for the management company to choose to carry on its activities in other Member States either by means of a branch, or by means of a free provision of services[6].

ALFI is of the strong view that the nature of a UCITS does not allow for its remote management on the basis of the free provision of services[7].

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[3] Currently featuring in Recital 8 in the preamble to Directive 2001/107/EC.
[4] See art. 11(2) of Directive 2006/48/EC relating to credit institutions.
[5] See point 5 of Box 1.
[6] See point 5 of Box 1.
[7] See comments made above in relation to Box 3.

The substance required for the proper management and appropriate prudential supervision of a UCITS in the UCITS' Member State is incompatible with the free provision of services. The same goes for the proper and risk free determination of a UCITS domicile and nationality. A permanent presence of the foreign management company in the UCITS Member State cannot be avoided.

In any event, the UCITS competent authority must be able to assess the adequacy of available means in its territory having regard to the characteristics (i.e. size; complexity; type of investors….) of the UCITS.

- **Explanatory text point 7**

22. ALFI wishes to draw CESR's attention to the fact that in the event that, unlike the current situation, a management company manages a UCITS on a cross border basis, delegation of tasks must continue to be monitored by the UCITS home Member State authority. See below under Box 5, point 7.

- **Explanatory text point 10**

23. CESR itself considers that "in order to ensure an harmonious functioning of the system and to avoid excessive complexity", the free provision of services by a management company must be excluded where directed towards a third Member State by use of a branch established in a Member State other than that of the management company[8]. This proposed limitation is exemplary of the intrinsic incompatibility of a free provision of services in the context of the management of a UCITS on a cross border basis. In fact, the exercise of the free provision of services by means of a branch amounts to the simple exercising of this freedom by the management company itself[9]. If there is a good reason to disallow a cross border provision of services to a management company branch, there should be, and there are, equally good reasons to authorize a cross border provision of services by a management company only by way of the establishment of a branch in the UCITS home Member State. The stance taken by CESR in respect of a cross-border provision of services by management company branches confirms that the free provision of services by a management company is not appropriate either.

ALFI proposal for a revised BOX 1

In view of the above, ALFI proposes a revised Box 1 as below.

Management company
1. The management company's home Member State should be the Member State in which the management company's registered office is situated or, if the management company has, under its national law, no registered office, the Member State in which the head office is situated.
2. Authorisation of the business of management companies should be granted by the management company competent authority pursuant to the provisions set out in Title A of Section III of the Directive (Conditions for taking up business).
3. The management company competent authority should not grant the authorisation unless and until such time as it is fully satisfied that the applicant complies with all requirements under the provisions adopted pursuant to the Directive.

[8] See point 10 of Explanatory text to Box 1.
[9] See Commission interpretative communication "Freedom to provide services and the interests of the general good in the Second Banking Directive", 20 June 1997, SEC(97) 1193 final, p. 16.

4. The management company competent authority should refuse or withdraw authorisation where factors, such as the programme of operations, the geographical distribution or the activities actually carried on indicate clearly that a management company has opted for the legal system of one Member State for the purpose of evading the stricter standards in force in another Member State within the territory of which it intends to carry on or does carry on the greater part of its activities.
5. The authorisation should be valid for the entire Community and should allow a management company to provide the services or perform the activities, for which it has been authorised, throughout the Community through the establishment of a branch.

Box 2: UCITS

24. Questions for consultation:

Do you agree with CESR's proposals in Box 2?
Do you consider that additional criteria should be set to define the domicile of contractual funds? Please provide details.

25. As a preliminary remark, ALFI points out that a wish expressed by a majority of respondents to the call for evidence[10] does not necessarily mean that such a solution is viable and safe.

26. ALFI notes that CESR's proposals in Box 2 deal only with UCITS of the contractual type, even though the issues relating to the domicile are crucial for all UCITS, irrespective of their form. ALFI assumes and considers it crucial that the current solution (registered and/or head office) be maintained for a UCITS set up as an investment company.

27. ALFI would like to caution against the legal uncertainty that would be created as a result of the reliance on an application for fund registration as a determining factor to decide where a UCITS is established (such a concept is not consistent with any accepted legal principles).

Legal principles and legal certainty dictate that in order to decide without risk on the nationality of a UCITS, reliance cannot reasonably be placed on the place where an application for authorisation is made. It must also be highlighted that Box 2 refers to a request for authorisation and not to the authorisation itself. What will the solution be in case of several or successive applications for authorisation? Obviously, the chosen criterion is neither legally safe nor reasonably implementable. As said previously, the application for authorisation and even the authorisation proper are not solid enough concepts to safely define a UCITS domicile and nationality.

As a matter of fact, in the case of non-corporate funds, the nationality of a co-ownership structure is never determined having regard to an administrative demand for authorisation.

A common fund is a joint ownership structure. It is classically considered that such a structure needs to be treated legally as being subject to the laws attaching to the property or co-ownership. Under private international law, the applicable law will be the lex rei sitae (law of the place where the property is located). If application of the law of the UCITS, as advocated by CESR, is sought, the property constituting the jointly-owned property will need to be located in the territory of that State, to avoid risks of a conflict of laws. The same considerations apply if, as also proposed by CESR, it is envisaged to apply the law of liquidation of the Member State of the UCITS. The proposed solutions are not workable in this respect.

[10] See point 1 Explanatory text to Box 2.

28. ALFI considers that traditional and legally tested criteria are needed in order to define without undue legal and regulatory risk the domicile of a UCITS both of a contractual and corporate type.

A management company branch (see below, Box 3) as a necessary linkage to the UCITS home Member State, especially for common funds, will avoid or at least help reduce legal, regulatory and tax risk, especially if appropriate substance is available at the branch.

Importantly, from a legal point of view, the domicile of the UCITS can then not be called into question or requalified (with all the damaging consequences that would otherwise result therefrom for the UCITS and the investors in the UCITS). It is crucial to have an effective solution which leaves no room for doubt or for structural and legal weaknesses.

- **Point 2 of Box 2**

29. ALFI welcomes the aim pursued that the UCITS should be regulated in accordance with the law applicable in its home Member State. For that purpose, a specific provision of the Directive must however provide that the agreement between the management company and the depositary will be governed by the law of the UCITS' home Member State.

ALFI proposes the following revised BOX 2

UCITS
1. The UCITS home Member State for common funds constituted under the law of contract or trust law should be the Member State in which the management company, or in the case of a management set up in another Member State a management company branch and the depositary are established and in which the common fund is authorised.
2. The UCITS, the fund rules and the relationships between the management company, the depositary and the investors should be regulated in accordance with the law applicable in the UCITS home Member State.
3. A UCITS should be authorised only if the UCITS competent authority has approved the choice of the management company, the fund rules and the choice of depositary.

Box 3: Local point of contact in case of common funds

30. Questions for consultation:

Do you agree with CESR's proposals in Box 3?
Do you agree that there is an interest for investors and the UCITS competent authority in having the functions indicated in Box 3 performed by an entity located in the same Member State as the UCITS?
Do you believe that there is an interest for investors and the UCTS competent authority in having a legal address in the jurisdiction where the UCITS is located?

Do you consider that the local point of contact should provide additional functions, and namely the maintenance of the unit-holder register?

31. Yes, ALFI is of the view that having a legal address in the jurisdiction where the fund

is located must be a mandatory requirement.

ALFI is however of the view that such necessary local point of contact cannot be a substitute for appropriate substance in the UCITS home Member State and that it must afford enough substance in view of proper supervision in the UCITS' home Member State.

32. ALFI emphasises the need to keep the required administrative functions of a UCITS in its home Member State in order to give the necessary means to the home Member State supervisor, as well as to the UCITS depositary and the UCITS auditor to discharge without risks their respective supervisory duties.

33. ALFI recalls that the concept of establishment within the meaning of the Treaty is a very broad one, allowing a Community national to participate, on a stable and continuous basis in the economic life of a Member State other than his State of origin and to benefit therefrom, so contributing to economic and social interpenetration within the Community in the sphere of activities as self-employed persons" [11].

More precisely for that purpose ALFI argues that in the case of a management company that does not have its registered office in the UCITS home Member State, the "point of contact" has to consist in a branch of the management company that, moreover, cannot be an empty shell. Article 1a(7) of directive 85/611/EEC defines in that respect the branch as a "place of business which is a part of the management company, which has no legal personality and which provides the services for which the management company has been authorised". The concept implies that three conditions, be fulfilled:

- the secondary entity will be endowed with a permanent mandate;
- it is subject to the management and control of the head office;
- it can be held to engage the legal responsibility of the head office[12].

Legal and supervisory certainty require that these conditions be met, in this context.

34. ALFI takes the view though that administrative tasks attaching to the UCITS may be delegated (by the management company branch) to a third-party operator, such as any financial institution, if performed under the supervision and responsibility of the management company branch of the UCITS home Member State.

35. ALFI doubts that unit-holder related functions as envisaged by CESR could validly be assumed by the depositary. Reciprocal independence of the management company and depositary are one of the core concepts at the heart of the UCITS directive. On the one hand, Article 10(1) of the directive provides that the functions of management company and depositary cannot be exercised by the same company, which appears to be ignored by CESR's proposal. On the other hand, in the exercise of their respective functions, the management company and the depositary must act in an independent manner and exclusively in the interests of the unit holders (paragraph 2). The independence of the

[11] ECJ, 30 November 1995, Gebhard, C-55/94, Rec. p. I-4165, para. 25 ; ECJ, 11 December 2003, Schnitzer, C-215/01, Rec. p. I-14847, para. 28.

[12] Commission interpretative Communication, *Freedom to provide services and the interest of the general good in the second banking directive*, 20 June 1997, SEC(97) 1193 final. The Court held that "the concept of branch, agency or other establishment implies a place of business which has the appearance of permanency, such as the extension of a parent body, has a management and is materially equipped to negotiate business with third parties so that the latter although knowing that there will fi necessary be a legal link with the parent body, the head office of which is abroad, do not have to deal directly with such parent body but may transact business at the place of business constituting the extension" (ECJ, 22 November 1978, Somafer, ECR p. 2183).

depositary and its function of control of the management company would in ALFI's view be distorted if the depositary could carry out the unit-holder related functions envisaged.

36. Finally, ALFI underlines that the necessary setting up of a management company branch in the UCITS home Member State would allow management companies and depositaries to be treated equally. Apart from being easily understandable and applicable, the proposed solution and identical treatment of both management company and depositary would allow legal and supervisory uncertainty and risk to be substantially limited.

ALFI proposal revised BOX 3

Local point of contact in case of common funds
1. If the registered office of a management company of a common fund is not situated in the UCITS home Member State, the management company should set up a branch to perform or have performed under its responsibility, the administration functions listed from (a) to (i) under Annex II of the directive 85/611/EEC, as amended and to act as a local point of contact for investors and the UCITS competent authority.
2. As a contact for investors and the UCITS competent authority, the management company branch should perform the following functions:
- supervise the management of the UCITS
- maintain relations with unit-holders, including receipt of complaints;
- provide a legal address for receipt of all documents addressed to the UCITS and the management company by investors and by the UCITS competent authority;
- provide facilities to the unit-holders in relation to the exercise of their rights, including facilities in relation to payments to unit-holders and to the reception and transmission of orders for subscriptions, issuance and redemption of units;
- make information available at the request of the public or the UCITS competent authority;

Box 4: Depositary

37. Questions for consultation:

Do you agree with CESR's proposals in Box 4?

Do you consider that there is an interest for investor in harmonising the possible standard agreements to be used by depositary and management company?

38. In the first place, ALFI recalls that the depositary is essential to avoid any abuse or misappropriation by the management company. In its communication of 2004, the European Commission correctly underlines that the intervention and role of the depositary probably explains why Europe has not to date, known any problems with misappropriation of funds since 1985, in contrast to the United States which does not have this system of counterbalance with regard to the manager[13]. The UCITS directive entrusted to the depositary certain controls over the activity of the management company. It constitutes a "vital prudential safeguard for savers who invest in UCITS"[14].

39. In this respect, ALFI welcomes the requirement that the depositary should either

[13] Communication from the Commission to the Council and to the European Parliament, Regulation of UCITS depositaries in the Member States: review and possible developments COM(2004), 207 final, point 1.
[14] Communication from the Commission to the Council and to the European Parliament, Regulation of UCITS depositaries in the Member States: review and possible developments COM(2004), 207 final

have its registered office in the UCITS home Member State or be established in that Member State if its registered office is in another Member State. ALFI wishes to emphasise the need for a permanent establishment in a UCITS' Member State. This permanent establishment justifies the exclusive application of the law of the UCITS' Member State and justifies the supervision exercised by the UCITS' home Member State authority over the depositary.

- **Point 3 of Box 4**

40. A written agreement between UCITS depository and the management company limited to regulating flows of information is in ALFI's view not sufficient to allow the UCITS depository to properly discharge its duties. It needs to be substantiated by (i) a management company branch in the UCITS home Member State and (ii) by administrative substance in the UCITS home Member State.

- **Point 5 of Box 4**

41. ALFI points out that the triangular relationship between the UCITS home Member State authority, the management company and the depositary is vital for the safety of investors. In this respect, the depositary which acts partly as an arm of the supervisory authority is monitored by the UCITS home Member State authority even if it has merely set up a branch in that state. Box 4, point 5 must not imply that, in such a case, the UCITS' home Member State authority loses any authority over the depositary.

ALFI proposal for a revised BOX 4

Depositary
1. The depositary should either have its registered office in the UCITS home Member State or be established in that Member State if its registered office is in another Member State.
2. A UCITS should be authorised only if the UCITS competent authority has approved the choice of the depositary.
3. The depositary and the management company should sign a written agreement regulating the flow of information deemed necessary to allow the depositary to perform the functions referred to in Articles 7 and 14 of the Directive. <u>The location of the management company's registered office abroad may not impede or make more difficult the fulfillment of the depositary's duties</u>.
4. A depositary should, in accordance with the national law of the State in which the UCITS is authorised, be liable to the management company and to the unit-holders for any loss suffered by them as a result of its unjustifiable failure to perform its obligations or its improper performance of them.
5. A depositary should be an institution which is subject to on-going supervision by its home competent authority, including for prudential purposes, <u>and by the UCITS home competent authority.</u>
6. The Commission, in accordance with the procedure set out in article XX, should provide for implementing measures on the measures to be taken by the depositary in order to fulfil its duties in the case of UCITS managed by a management company established in another Member State, including possible standard agreements to be used by depositary and management company.

CHAPTER 2

Applicable law and allocation of supervisory responsibilities

Box 5: Applicable law and allocation of responsibilities in case of free provision

of services

42. Questions for consultation:

Do you agree with CESR's proposals in Box 5?
Do you agree that further harmonisation in the areas indicated in Box 5 above will be beneficial for ensuring a level playing filed and adequate investor protection in the European market?

Do you suggest other areas that would benefit from further harmonisation?

43. ALFI reiterates its reservations in relation to the possibility for a UCITS to be managed from abroad by way of a simple provision of services. The free provision of services would in ALFI's view not be implementable and would give rise to too many risks in the absence of appropriate substance in the UCITS' Member State. Consequently, ALFI must suggest the removal of the whole of Box 5, acknowledging though the considerable efforts made by CESR in attempting to solve the highly complex issues at stake.

44. ALFI outlines that a free provision of services may validly be excluded and the setting-up of a permanent establishment required where reasons of general interest such as investor protection or the proper functioning of a collectivity such as a UCITS so demand[15]. Moreover, a directive may restrict a fundamental freedom more easily than a unilateral measure of a Member State.

45. Assuming that the proposal for a cross-border management of UCITS through the provision of services is maintained, the objectives stated in Box 5 offering a possible split of supervisory functions and the allocation of responsibilities between the respective competent authorities of the management company home Member State and of the UCITS' home Member State need to be reviewed.

ALFI reiterates its position that in order for the supervisory authority of the UCITS' home Member State to properly carry out its tasks and assume its responsibilities as foreseen in Box 5, it is absolutely necessary that at least appropriate and sufficient substance should remain in the UCITS' home Member State and it is for the UCITS' home Member State authority to approve all the UCITS' features and to ensure its proper and permanent supervision.

46. ALFI welcomes the non-exhaustive list of matters relating to the law and the control of the authority of the Member State of the UCITS. The detailed character of this list is testimony to the fact that the foreign management company is undeniably subject to the law of the UCITS' Member State. A UCITS is a complex set up of which the management company is one of the composite elements. As a consequence, it cannot ignore the rules applicable to the UCITS which it manages. The centre of gravity of the structure is the UCITS, to which the management company provides services, necessary to the overall service provision to investors. ALFI therefore welcomes, in principle, CESR's position, as expressed in paragraph 2 to Box 5, according to which the rules governing the constitution and the functioning of a UCITS must be the same irrespective of whether it is managed by a domestic or foreign management company, on pain of misleading investors.

47. ALFI proposes though to add to the list of tasks the following:

- account keeping;
- risk monitoring;

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[15] In a similar In a similar way, the ECJ has recently considered that the removal of the free circulation of goods may be justified by the necessity to ensure regular provision of drugs to a hospital. See Case C-141/07 Commission /Germany of 11 September 2008.

- choice of the UCITS' auditor and audit functions with regard to the UCITS,
- demonstrated experience of the management company's conducting officers with regard to the UCITS' investment policies

48. Last but not least, ALFI considers that delegation arrangements relate to the functioning of the fund. Thus, they must be integrated into the list laid down in Box 5, point 2 and not left to the competence of the jurisdiction of the UCITS' home Member State on a temporary basis only until the approximation of the national rules in that field by the European Commission (see Box 5, point 7).

49. ALFI does not believe that the UCITS' competent authority should merely be able to ask the management company on the spot for further information necessary to ensure compliance with the rules for which it is responsible. ALFI is of the view that the splitting of functions foreseen in Box 1 and Box 5 (and 6) remains a serious cause for concern, if read in conjunction with Box 8. ALFI believes that the current approach for splitting supervisory attributions is not sufficiently clear to allow supervisory authorities to properly perform their duties and discharge their responsibilities. This organisational split may be difficult to carry out in practice. Furthermore, in practice it could operate only at the price of additional costs.

While taking into account proper cooperation among competent authorities, the lead for such cooperation can only be with the UCITS' home Member State authority.

50. ALFI questions the allocation of tasks as set out in Box 5, paragraph 5 and wonders in that respect what the precise meaning of 'are adequate for UCITS proposed to be managed is?

51. The management of a UCITS implies a permanent activity towards the Member State of the UCITS. For this reason no parallel can be made with the rule of division of legislative competencies and administrative functions relating to the rules of conduct for investment companies acting under a free provision of services, mentioned in paragraph 6 of Box 5 (application of the law of the Member State of origin of the management company) . If a parallel is to be drawn with the MiFID directive it is with the rules applicable to a branch. These rules accord the essential role to the law and the authority of the Member State of origin.

ALFI is in agreement with CESR's proposal, expressed in explanatory paragraph 5 after Box 5, that it is for the UCITS' Member State to assess the adequacy of the organisational rules of the Member State of origin of the management company to be authorised to manage the UCITS in question.

ALFI proposes to remove BOX 5 entirely

Box 6: Applicable law and allocation of responsibilities in the case of establishment of a branch

52. Questions for consultation:

Do you agree with CESR's proposals in Box 6?

Cf. comments under Box 5.

53. Considering ALFI's view that a UCITS may not reasonably be managed from abroad in the context of a simple provision of services, relevant provisions laid down in Box 5 must be incorporated into Box 6.

The presence of substance in the UCITS' Member State justifies the application of the law of the UCITS Member State and the supervision by the authority of the UCITS' Member State. It allows for unity, simplicity and efficiency. It also facilitates the idea of legal certainty (i.e. what is the applicable law and which authority has jurisdiction to intervene effectively and rapidly). It also, importantly, enables the origin or 'marque d'origine' of the UCITS to be identified, which is vital to international distribution. This is the reason why ALFI considers that the functioning of the UCITS must be monitored entirely and in all its several aspects and components by the UCITS' home Member State authority.

ALFI revised proposed BOX 6

Applicable law and allocation of responsibilities in the case of establishment of a branch

1. Member States should not impose additional requirements, save those allowed under this Directive, on the organisation and operation of the branch in respect of the matters covered by this Directive.
2. Management companies authorised in a Member State other than that of the UCITS providing the service of cross border management of UCITS by the establishment of a branch should comply with the rules of the UCITS home Member State which relate to the constitution and functioning of the UCITS and namely the rules applicable to the:
- set up of the UCITS;
- fund rules;
- authorisation of the UCITS;
- format/contents of the unit holder register;
- exercise of unit holders' voting rights;
- investment policies and limits;
- calculation of total exposure and leverage;
- restrictions on borrowing, lending and uncovered sales;
- valuation of UCITS assets and UCITS accounting;
- issuance and redemption of units or shares;
- calculation of the issue price and/or redemption price;
- distribution or reinvestment of the income;
- disclosure (prospectus, KID, periodic reports);
- marketing/distribution of the units;
- relationship with unit holders (customer enquiries);
- merging and restructuring of UCITS;
- delegation arrangements;
- winding up and liquidation of the UCITS.
3. The management company should comply in all cases with the obligations set out in the fund rules and/or in the prospectus. The Commission, in accordance with the procedure set out in article XX, should adopt implementing measures that specify the scope and content of the fund rules.
4. The UCITS competent authority should be responsible for supervising compliance with respect to the matters listed under paras. 2 and 3 above.
5. The management company should comply with the organisational measures (including risk management process and conflict of interest procedures) provided for in its home Member State. The UCITS competent authority should be satisfied that the management company's risk management process and conflict of interest procedures are adequate for the UCITS which is proposed to be managed, based on the description of the risk management process and the information on arrangements for dealing with conflicts of interest delivered to it by the management company (as required under Box 8).
6. The Commission, in accordance with the procedure set out in article XX, should adopt implementing measures that specify the organisational and operating conditions to be complied with by management companies in the performance of the activity of collective portfolio management, including:
- organisational requirements;
- risk management;

- conflicts of interest;
- conduct of business rules.
7. The competent authority of the Member State in which the branch is located should assume responsibility for ensuring that the services provided by the branch within its territory comply with the rules of conduct applicable in the host Member State of the branch.

Box 7: Cooperation between competent authorities

54. Questions for consultation:

Do you agree with CESR's proposals in Box 7?

55. 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).

56. 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, as is the case in the banking sector[16]. ALFI is of the opinion that even an enhanced cooperation regime between competent authorities cannot be a substitute for a lack of substance and thus represent the necessary means to efficiently supervise without risks in the fund's home Member State.

In relation to any overlap in responsibilities between the authorities in the UCITS' home Member State and those in the management company's home Member State which may result from Box 1, 5 and 6, 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.

CHAPTER 3
Authorisation procedure for UCITS fund whose management company is established in another Member State

Box 8: UCITS authorisation

57. Questions for consultation:

Do you agree with CESR's proposals in Box 8?
Do you agree with the role envisaged for the UCITS competent authority in the areas referred to above?

58. In the event the principle of a passport for management companies is opted for at a European level, provided all other legal, regulatory and fiscal issues have been resolved in a satisfactory way, ALFI agrees with CESR's advice stating that the competent authority of the UCITS home Member State may authorise a UCITS only if it has approved the fund rules, the choice of the management company and the choice of the depositary.

- **Point 4 of Box 8**

[16] See Article 129 of Directive 48/2006/EC.

59. Paragraph 4 of Box 8 leaves it to the responsibility of the management company's Member State to control the measures taken by the management company regarding, amongst other matters, internal organisation for compliance with the rules and obligations regarding the functioning of UCITS managed remotely by this company. This actually results in entrusting a national authority with the control of compliance by an entity under its supervision of the legal provisions of other Member States. Such split of administrative and legislative powers is contrary to international public law principles.

- **Points 4, 5 and 10 of Box 8**

60. Par. 4 and 5 of Box 8 relating to the approval of the management company's choice is based purely on the "satisfaction" of the UCITS' home Member State authorities that the management company is duly authorized, is able to comply with the provisions which fall within its own remit of competence and that its choice does not prevent the effective exercise of the supervisory functions.

From a practical and regulatory perspective, one can wonder how the supervisory authority of the country of domicile of the fund would exercise its duties efficiently regarding any aspect of the fund's functioning if it has no residual power at all, which would be the case here. For example, the wording of point 10 is unduly and dangerously restrictive when requiring that the UCITS' competent authority may only ask for clarification and information only insofar as such information is necessary to verify compliance with the rules falling within its remit.

CHAPTER 4

On-going supervision of the management of the fund

Box 9: Information flow to the competent authorities

61. Questions for consultation:

Do you agree with CESR's proposals in Box 9?

62. As a general remark ALFI would like to stress that the measures proposed by CESR are so complex, numerous and time consuming that their implementation might actually result in more work and thus substantial added cost.

63. As regards paragraph 10, ALFI agrees with CESR that in the event a passport regime for the management company is established, the Commission should elaborate implementing measures on the co-operation arrangements necessary to give effect to the obligations pertaining to them.

Box 10: Information flow between management company, UCITS and depositary

64. Questions for consultation:

Do you agree with CESR's proposals in Box 10?

65. The principles outlined in CESR's advice in terms of information flow seem to be easy to apply in theory. They would however prove difficult to put into practice in real life. ALFI agrees for example that the depositary should have access to the books and records held by the management company, but the question arises as to how this will be achieved in practice?

Flows of information between the management company, the UCITS and the depositary are crucial for the proper functioning of the UCITS to protect the interests of investors. Are they sufficient though to avoid legal and regulatory risk? ALFI is of a view that they are not as extensively explained above.

ALFI considers, with all due respect, that the proposals from CESR do not fully meet the request for advice/mandate which was addressed to it by the Commission, namely the request to establish an overall series of practical and operational measures guaranteeing a harmonious functioning of UCITS without aggravating risks for investors.

Box 11: Auditors

66. Questions for consultation:

Do you agree with CESR's proposals in Box 11?

67. ALFI agrees that it is necessary to ensure that the audit costs of the intervention of the foreign management company will not be passed on ultimately to investors. ALFI considers though that it is equally important to be in a position to check that this does not actually happen.

CHAPTER 5
Dealing with breaches of rules governing the management of the fund

Box 12:

68. Questions for consultation:

Do you agree with CESR's proposals in Box 12?

69. ALFI agrees with CESR's conclusion that in the event of UCITS managed by a foreign management company the UCITS' competent authority should be able to impose directly appropriate administrative sanctions and measures for violations of the rules which fall within its exclusive remit. ALFI also agrees that, if the conditions under which the choice of the management company was approved are no longer fulfilled, and if the interests of unit-holders are prejudiced or the management company has seriously and/or systematically infringed the provisions adopted pursuant to the Directive, the UCITS' competent authority should have the power, as a measure of last resort, to withdraw the approval of such choice, and to require the management company to suspend the issue or redemption of units in the interest of the unit-holders or of the public. ALFI agrees further with the conclusion expressed in paragraph 3 of the explanatory text of Box 12 that there are violations of laws that refer to rules falling within the exclusive competence of the UCITS' competent authority that need to be enforced directly and cannot be subject to an evaluation by the management company (e.g. violation of the provisions on disclosure).

70. However, ALFI is of the opinion that securing sufficient supervision and enforcement tools will, at best, be difficult, if not impossible to achieve in practice, even in the event of a mechanism which recognises the right for an authority to impose sanctions for violations of rules falling within its remit upon entities established abroad.

ALFI expresses doubts as to whether the authority of the UCITS can take effective measures as regards the management company in the absence of a branch of such management company in the Member State of the UCITS.

ALFI questions the ability of the authority of the Member State of the UCITS to impose sanctions of a financial nature on a foreign management company, as proposed by CESR at paragraph 3 of Box 12.

Box 13:

71. Questions for consultation:

Do you agree with CESR's proposals in Box 13?

72. At the outset, ALFI respectfully points out to CESR that the question as to whether an investor can sue a foreign management company before the courts of the Member State of the UCITS is not a question of national law but is dealt with in accordance with EC Regulation 2001/44/EC on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters ('the Brussels I Regulation').

73. In this regard, two provisions of the Brussels I Regulation appear at first sight to be able to provide the basis for bringing legal action on the part of the investors before the courts of the Member State of the UCITS against the management company. On the one hand, Article 5(5) of Regulation 2001/44/EC provides that a person domiciled in a Member State may be sued in another Member State, as regards a dispute arising out of the operations of a branch, agency or other establishment, in the courts of the territory in which the branch, agency or other establishment is situated. The same rule applies for matters relating to a contract, in the courts for the place of performance of the obligation in question (Article 5(1)).

However, an analytical approach to the text (obligation by obligation) in conformity with European Court of Justice case law, opens the door to several points of challenge on the subject. As a consequence, only the competence based on the existence of a secondary establishment of the management company in the Member State of the UCITS (Article 5(5)) can provide a reliable solution for investors. It is a further argument which further supports imposing the requirement of having a branch in the Member State of the UCITS.

CONCLUSION

74. Any possible passport for the management company would amount to a substantial modification of the proposal for a UCITS directive revision. Taking into account the very negative impact assessment on that point to date, if CESR's advice were followed, in ALFI's view, a second impact assessment would be necessary in relation to such proposal.

75. ALFI is of the opinion that the only sensible way to extend the management company passport would be to require the establishment of a branch in the Member State of the UCITS. This solution would allow management companies to achieve economies of scale without however reducing the effectiveness of controls, which would continue to be exercised in the main by the authority of the Member State of the UCITS.

76. From this perspective, having a branch in the UCITS home Member State offers a series of advantages. It permits gains in efficiency and economies of scale without aggravating the risks or increasing costs unduly. The benefits are obvious:

i. Firstly, the management companies benefit from the cost savings of having a branch in the Member State of the UCITS, rather than setting up a subsidiary;
ii. Secondly, the rules and the supervision of the Member State of the UCITS will continue to apply, following the approach adopted in the

MiFID directive. This will therefore allow unity to be preserved by keeping a single system of law and supervision;

iii. It will allow to avoid confusion in the minds of investors as regards the origin of the product, which is a preoccupation of CESR's;

iv. The proposed solution will also meet the concern of CESR according to which:
"The principle should be preserved according to which the rules governing the constitution and functioning of a UCITS should be the same irrespective of whether it is managed by a domestic management company or by a foreign management company via a branch or under the free provision of services. Otherwise investors could be easily misled";

v. The solution of the branch would allow a real level playing field between foreign management companies and domestic management companies, without creating inconvenience or risk for the investors and without discriminating against foreign management companies, which is another concern of CESR;

vi. The proposed solution is in line with the suggestion of CESR that the authority of the UCITS Member State approves the choice of management company;

vii. Finally, it is appropriate to add that the presence of a branch in the UCITS Member State will allow the controlling authority of this Member State and investors alike to intervene effectively. The authority of the Member State of the UCITS will be able, need be, to impose and execute sanctions against the management company. On the other hand, if, as is required by CESR, the investor must be capable of taking legal proceedings before the courts in the Member State of the UCITS against the management company, the management company will need to have a branch in that Member State, having regard to the legal rules of competence and jurisdiction contained in the Brussels I Regulation.

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