



August 22, 2008

Mr. Eddy WYMEERSCH
Chairman
CESR
11-13 avenue de Friedland
75008 Paris
France

Re: Citi considerations on the call for evidence on the management company passport

Dear Mr. Wymeersch,

Citi's businesses, service offerings and client base cover the entire fund management and administration value chain, in a number of European jurisdictions.

As a global service provider, Citi has a natural interest in ensuring it can run its business in the most efficient manner under shared platforms and infrastructures, and that its shareholders and retail investors can benefit from efficiencies that can be so generated.

We hope you find the attached contribution useful and we would be delighted to have the opportunity to present this analysis to you and your team in person and to engage into a more detailed dialogue.

Finally, please note that in our response we will usually make reference to the current consolidated text of the UCITS Directive, unless otherwise stated.

Yours faithfully,

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Call for evidence on the request for advice to CESR on the UCITS asset management company passport

Citi considerations

August 2008



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A) Citi – overview

Citi is one of the largest financial services company with about 200 million customer accounts in more than 100 countries. Our history dates back to the founding of Citibank in 1812 and although our headquarters are in the United States, Citi has been present in Europe since 1902. We are now present in 21 of the 27 EU Member States, employing approximately 39,000 people.

2. Citi's business

Citi is aligned into four major primary business groups: 1) Global Cards; 2) Consumer Banking; 3) Global Wealth Management and 4) Institutional Client Group (ICG) that incorporates Investment and Corporate Banking, Global Transaction Services (GTS) and Alternative Investments.

Citi's GTS business provides a variety of cash management, securities and fund services as well as trade finance worldwide. We are part of Citi's ICG segment that provides a broad range of financial services to wholesale clients such as investment banking, institutional brokerage, advisory services, foreign exchange, structured products, derivatives and loans.

2. Citi GTS Fund Services in Europe

Citi GTS fund services has a presence in key EU Member States such as the United Kingdom, Ireland, Luxembourg, Poland, Germany, Greece, Czech Republic and Hungary. Our team in Europe of about 1700 employees ensure high quality servicing of our clients covering the full scope of fund administration services.

In August 2007, Citi completed the acquisition of the Fund Services and Alternative Investment Services divisions of Bisys, that now have joined GTS and place Citi among the top five providers worldwide in mutual fund and hedge fund administration.

Citi's GTS Fiduciary Services in Europe (EFS) is the business unit responsible for managing depositary/trustee services provided by Citi to undertakings for collective investments. Citi legal vehicles currently act as depositary bank or trustee ("fiduciary") for undertakings for collective investments (UCITS and non-UCITS). We provide fiduciary services to fulfil regulatory duties such as risk ranking of funds, NAV reviews, breaches reviews, on-site inspections, web-based compliance monitoring and annual trustee reports.

In addition, other business units provide custody, fund accounting and transfer agency services. Our custody offerings include all services regarding the safekeeping and servicing of assets as well as the provision of securities lending. The GTS fund accounting team carries out calculations of NAVs for funds or portfolios including pooling, fair valuation, financial and regulatory reporting and reconciliation. The transfer agency unit provides recordkeeping, runs the call centre and offers shareholder servicing to funds including subscriptions, redemptions, account maintenance and anti-money laundering.

Our global capabilities enable us to offer fund administration services to alternative funds on-shore in the US and Europe as well as in all major off-shore domiciles and have the ability to handle complex structures for a large range of funds such as UCITS funds (equities, bonds, mixed and financial derivative instruments), non-UCITS funds, professional and institutional funds, fund of funds, funds of hedge funds and segregated funds. Furthermore, we provide middle office solutions to asset managers including trade operations, performance measurement, portfolio accounting, risk analytics and client reporting.

B) Citi general observations

1. *Background observations*

Citi supports the European Commission's objective to enhance the cross-border efficiency of the fund services industry in Europe and we have a vital interest in the creation of a single market for the asset management and fund services industry.

Although we share the European Commission's concerns to ensure a high level of investor protection, we consider there is little evidence that improving passporting rights for the provision of fund management, fund administration and/or depositary services would constitute a material threat to the investors, as long as such improvement is supported by an adequate regulatory regime.

Instead, we do have material concerns regarding the solidity of the current framework, that is often the source of unjustified costs (e.g. duplication of systems and processes), uneven level of investor protection (e.g. different rules applicable to NAV correction procedures), unresolved conflicts of interests (e.g. universal banks that also run substantial asset management businesses) with the added risk of regulatory competition (e.g. innovative or too flexible interpretations of UCITS rules).

We consider that this consultation process will achieve its objectives as long as two key goals are met: 1) simplify the current regime, and therefore achieve a significant reduction of fund processing costs; and 2) clarify the responsibilities of the parties, ensuring that each service provider is clearly and undisputedly accountable for the section(s) of the funds' value chain it is in charge of.

2. *The self-managed investment company, and consequences to be drawn*

A self-managed investment company can be defined as a UCITS established in corporate form that internalises the activities listed in Annex II or, to use the wording of the Directive, that "has not designated a management company" (Art. 13b of the UCITS Directive).

As an investment company is a particular kind of commercial company, the appointment of a management company entails the delegation/outsourcing of activities.

The management company passport in the case of a corporate funds is a non-issue, as under any circumstance, all the functions listed in annex II will always be "legally based" in the country where the investment company is incorporated. If substance requirements apply to administrative functions, these requirements should be applied to the investment company (the outsourcer) – not to the management company (the service provider).

Whilst the concept of management company passport is being reviewed in parallel for both corporate and contractual UCITS, due to practical considerations, we believe this is unsuitable from a technical and legal standpoint.

3. *The contractual UCITS*

A contractual fund is usually defined as a pool of assets.

No matter how the above definition is accurate, we believe that most of the discussions around contractual UCITS and their substance requirements are, to a good extent, based on the wrong assumptions.

We acknowledge the need to ensure that the pool of assets is managed in a way to ensure safeguard of the investors; we find it difficult, however, to see why the contracting parties (ie the investors and the fund's service providers) should be obliged to accept incurring into higher costs

and enhanced complexities, in order to qualify a contractual fund as a quasi legal entity – which is probably the reason why little progress has been made so far on the management company passport.

We do not see any stumbling block to allow contractual UCITS being organised as a contract between parties based in different jurisdictions as long as certain requirements are met, such as:

- fund service providers are qualified financial professionals;
- the fund is managed in accordance with the expected investor safeguards;
- regulators receive all the required information flows to allow them exercising the supervisory duties;
- practical co-operation and common regulatory understanding is established amongst regulators.

We also query whether other structured products, or in general to portfolio management services provided to retail investors, are required to comply with organisational and regulatory requirements comparable to those currently applicable to UCITS.

C) Content of the advice

I. Definition of domicile

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

I.1. Corporate UCITS

A corporate UCITS is a particular kind of commercial company. Therefore a corporate UCITS is domiciled in the Member State where it is incorporated. The fact that the corporate UCITS decides to delegate some of its functions to a management company or not (the latter being the case of the self-managed investment company) should not affect the UCITS domicile.

However, in the interest of avoiding discussions around brass-plating and tax liabilities, minimum corporate governance criteria could be defined to satisfy the substance needs. Those criteria should, in our view, focus on the frequency and location of board meetings, and on the maintenance of a (aggregate – i.e. number of units in issue) shareholder register in place.

I.2. Contractual UCITS

We believe there are two possible alternatives. The first one would be to define the domicile of the contractual UCITS as the state where the fund's prospectus is approved. We believe the regulator's stamping of the prospectus should be an adequate proof of domicile.

Alternatively, a contractual fund could be deemed as being domiciled in the country where the prospectus is approved and the depositary is based (the wording should cater for the possibility of the depositary being a branch). This approach would be coherent with the definition of a contractual fund as a "pool of assets", as the assets are safekept by the depositary. However, we consider this option to be suboptimal as in the long term it would pose additional limitations to the depositary passport.

II. Applicable law and allocation of supervisory responsibilities

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 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.

II.1. Allocation of responsibilities – fund vs management company vs depositary

As briefly mentioned in the introduction, the concept of management company passport in the case of corporate funds does not pose any issue in our view. To the risk of being repetitive, we

consider that since the status of the investment company is that of a regulated firm, it is the corporate UCITS that is responsible for the activities listed in Annex II, not the management company, which is acting as delegate in the case it is appointed.

We believe that the wording of the UCITS Directive in this respect should be substantially clarified as it presents the case of the self-managed investment company as the exception rather than the norm.

From a legal perspective the investment company is always self-managed as the delegation of some activities to the management company does not entail also delegation of the investment company's Board of Directors' legal and regulatory responsibilities.

We also consider that although the wording of the UCITS Directive provides for a fair description of the split of responsibilities between the UCITS, the management company and the depositary, this description is too generic in its wording to ensure consistency of implementation.

Citi operates fund services in several EU member states and in our experience the regulatory practice has often translated into diverging, if not conflicting, rules mainly as far as the depositary oversight role is concerned.

We also remind you in this context, that the European Commission has recognised long ago¹ that:

- 1) depositaries are defined vaguely and by default (*"the depositary's legal nature is thus left to Member States' discretion"*);
- 2) depositaries have certain prudential duties, but with vague legal content (*"the Directive does not specify whether the performance of any control duty is subject to an obligation of result, or rather to a (lesser) obligation of means"*);
- 3) there are a few precise safeguards against conflict of interests in depositaries.

We consider that the current tenacious approach to defer the clarification and harmonisation of the role and responsibilities of depositaries is not only unsustainable because of the potential risks it generates, but will also provide for serious practical issues in the context of the definition of the management company passport and of proposed master-feeder structures.

Regarding the content of the request for advice, we would therefore strongly support a Level 2 all-encompassing clarification of the role of all the parties, and a clarification of the responsibilities of the depositary, to ensure that a common language is used by regulators and that investors enjoy a level playing field of protection – which is currently not the case.

II.2. Avoiding and preventing gaps in case of dual supervision

In the case that an all-encompassing Level 2 clarification exercise is carried out as per section II.1 above, we consider that the exercise would ensure there are no gaps or overlaps in the regulatory regime. Should this not be the case, our position is that the question as posed by the EC is too vague to be given a definitive answer.

Although from a generic point of view one could consider that a high-level clarification may resolve any possible contradiction, in our practical experience regulatory practices and interpretations are so diverging that gaps and overlaps could be identified only by reviewing all possible combinations of management company/depositary.

By way of example, if business practice in country A is for the depositary to issue the NAV price, while in country B this is the task of the management company, there could be a regulatory clash for the issue of NAV prices in case a management company established in country B manages a UCITS established in country A.

¹ Communication from the Commission to the Council and to the European Parliament, COM(2004) 207 of 30 March 2004

As those practices do not relate directly to the text of the UCITS Directive, CESR would need to assess all the possible combinations, for the 27 Member States. This bottom-up approach is clearly unsustainable, also in consideration of the fact that the advice is due by 1 November 2008.

II.3. Ensuring co-operation amongst regulators

Citi proposes establishing a standing regulatory/industry committee (which may or may be not represented by CESR) in the area of UCITS. Although we do not advocate for a single regulator, we consider that all the efforts made so far in the definition of asset eligibility for instance, but also in the area of investor documentation, may eventually be ineffective if the co-ordination effort is not consistent and prolonged in time.

Such committee would ensure convergence of UCITS practices and their continuing harmonised evolution in the future and avoid regulatory surprises (eg allowing short selling techniques) that regardless of their practical impact or technical feasibility may jeopardise the UCITS brand as a whole and introduces additional divergences leading to additional complexities to the passporting of services or products.

III. Authorisation procedures for UCITS fund whose management company is established in another Member State

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.

III.1. Ongoing qualifications assessment

We believe that there are two separate aspects to be considered. The first relates to the regulatory status of the management company, i.e. its permissions and its authorisation/ability to perform regulated business. The second aspect, relates to its ability to manage one or more specific UCITS.

As far as the regulatory status of the management company is concerned, we believe there is plenty of regulatory expertise already available. The decision of a management company to provide services on a cross border basis should be followed by a notification process, from the home member state regulator to the host member state regulator. The home state regulator should ensure ongoing monitoring of the regulated business of the management company and inform concerned host state regulators of any amendment thereof.

Regarding the ability to manage a specific UCITS, including the expertise in the usage of particular financial instruments or understanding of specific markets or techniques, we think that the management company's management body that should be held accountable – and therefore ensure that there are appropriate and adequate systems and controls in place for a correct management of the assets.

The following should be considered:

- 1) There is a wealth of evidence and business practice that management companies often do not manage the assets directly (this is particularly true in "offshore" fund administration centres).

Also, in the case of funds employing very sophisticated strategies or investing in highly specialised markets, third party portfolio managers or third party risk managers are often hired to provide support to the investment process.

- 2) In those countries where third party management companies provide “substance requirements” to foreign promoters, these management companies may not have the necessary expertise/infrastructure either. Therefore even though regulators may consider that physical proximity may allow them enforcing a stricter control on the portfolio management and risk management functions, this does not necessarily apply.

The two considerations above lead us to think that from this specific angle, there is no particular reason to believe that the provision of management company services in country provides better investor protection than cross-border provision of the same services.

What best serves the interest of the investors is to ensure that regulators oversee the activities of the firms under their supervision, and that homogenous supervision criteria and practices are applied across EU member states.

Although we could envisage for instance an annual or regular certification (whose contents should be clarified) from the home state regulator to the host state regulator that the management company meets all the requirements and is capable of managing the UCITS on a cross-border basis, we should ensure that such certification is not used to discriminate foreign management companies to the advantage of local third party management companies.

In respect of the above, we consider title C (operating conditions) of the UCITS directive should be subject to a Level 3 clarification exercise.

III.2. Refusal of permission to carry out cross-border management company services

We believe that refusal should be possible only if the host state regulators are aware of any material issue of non-compliance with the UCITS Directive. As far as withdrawal of permission is concerned, please refer to the following section.

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

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).

IV.1. Allowing effective supervision

We believe that rules proposed in Chapter XII of the revised UCITS Directive provide for a good basis to ensure ongoing supervision, although we reiterate again that even regulatory expectations and practices are a prerequisite for the supervision of cross-border activities.

We also suggest that additional deterrent mechanisms could be introduced, for example allowing the UCITS home state regulator (or even the depositary) to replace the cross-border management company in case of lack of co-operation or material concerns about its conduct of business should emerge. This might also take the form of a withdrawal of authorisation for instance.

IV.2. Co-operation between management company and depositary

We strongly support a clarification and harmonisation of the respective roles as a matter of priority. If reciprocal expectations and regulatory obligations differ, we cannot envisage a situation whereby practical and common mechanisms can be applied within a short timeframe.

However, should our suggestion not be considered a priority or not be considered feasible, management company and depositary should, when established in different jurisdictions, enter into a Service Level Agreement detailing reciprocal obligations, subject to the UCITS' home state regulator approval and to be notified to the management company's home state regulator.

IV.3. Ensuring timely and effective communication amongst regulators

Citi considers that such mechanisms or procedures would be required only in case of material regulatory issues, whereby on an ongoing basis each regulated entity would be reporting to its home state regulator as normal.

In this respect it might be sufficient for each regulator to publicly appoint one suitably senior individual amongst its employees to be seen as contact point for other regulators.

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

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.

V.1. Dealing with breaches and enforcing remedial actions

Our general stance is that UCITS home state rules should apply. Therefore investment restriction breaches and NAV errors should be treated in compliance with the UCITS home state regulations. Also in this case, we believe there may be instances where uneven regulatory approaches can result in unexpected consequences so that breaches maybe not identified as such due to conflicting interpretations.

As far as enforcement is concerned, two considerations are key: firstly, rules laid down to facilitate ongoing supervision should apply also under these circumstances. A mediation mechanism can be established, and as a matter of fact this seems to be also the EC's approach as with reference to the passporting of UCITS products, the revised UCITS Directive (Article 96) suggests that regulators may bring specific cases to the attention of CESR.

Secondly, financial institutions have an ultimate interest in complying with regulators' decisions, unless such decisions appear illegitimate or incorrect – and even in those circumstances they would probably seek for a mediation or appeal against that decision rather than non-complying.

V.2. Additional measures in case of contractual UCITS

Similarly to the above-stated, we do not believe that physical presence and compliance are directly related, when it comes to the enforcement of regulatory decisions. An EU-regulated financial institution has a natural interest in co-operate with home state and host state(s) regulators, and pursue its rights across EU jurisdictions if it believes a regulator's decision was erroneous.