

DILLON EUSTACE
S O L I C I T O R S

Our Ref: AB/LH

22nd August, 2008

M. F Demarigny
Secretary General
CESR
11-13 Avenue de Friedland
75008 PARIS
France

Re : *Response to CESR call for evidence on the UCITS Management Company Passport*

Dear M. Demarigny,

We note that CESR has been invited by the European Commission to advise it on the structure and principles which should guide potential future amendments to the Level 1 UCITS Directive which may be needed to give effect to a UCITS management company passport ("MCP") and that CESR has issued a call for evidence from interested parties in that regard.

Dillon Eustace is legal adviser to a large number of UCITS funds (and their management companies) domiciled in Ireland and has been closely following the MCP proposal through various stages over the last number of years. In response to CESR's call for evidence, we have set out our thoughts on the questions raised on the MCP proposal below.

High Level Summary

At the outset we would wish to emphasise that we are very much supportive of any developments which can deliver efficiencies within the European funds industry and we are, in principle, supporters of the MCP proposal.

However, for a number of reasons as outlined below, we feel that the Commission's current MCP proposals may not deliver those efficiencies and, in fact, may operate to the detriment of the funds industry by hard-coding certain requirements into the UCITS Directive and by having the result (albeit not necessarily intended) of imposing a uniformity of approach on the practical application of rules to management companies whereas a element of regulatory competition is more likely to lead to positive evolution within the industry. Furthermore, we are concerned that fiscal uncertainties may undermine the efficiencies sought to be delivered by the current MCP proposal.

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In particular, our concerns relate to:

- the suggestion that a minimum set of “core administrative functions” be introduced into the UCITS Directive which would have to be performed in the fund’s domicile. We believe this would restrict evolution of the fund administration industry. It appears that this suggestion is being considered principally to try to address fiscal issues in an indirect fashion but with, in our view, unwarranted consequences for the fund administration industry;
- the concept of split supervision (as between the supervisor of the fund and supervisor of the management company) is in principle a sensible proposal. However, not only does it trigger a new set of multilateral and/or bilateral arrangements to be created between regulators but it creates a concern that without very clear segregation between responsibilities, with no capacity for a host Member State to impose host Member State rules on a foreign management company, then the current UCITS regime rules as to the respective responsibilities of home and host Member States which work well may be muddled. Furthermore, split supervision may face practical obstacles given the legal nature of unit trusts and common contractual funds. Split supervision could also, in our view, result in a uniformity of approach being adopted for matters such as governance / risk management / substance whereas what the industry really needs is regulatory competition in order to drive forward industry evolution;
- we also have some concerns regarding the issue of the “domicile” of unit trusts and contractual funds. Again, the intention behind the proposal does not seem unreasonable but we do not think that one can readily disregard the absence of legal personality in those structures and one has to bear in mind the existence of non-UCITS unit trust and contractual fund schemes which follow the same legal principles in their construction.

The domicile issue, although discussed mainly in the context of split supervision and “core administrative functions”, is really one of tax more than anything else. The industry cannot be left in the situation where there is uncertainty as to where a fund will be considered to be domiciled from a tax perspective. If a management company is domiciled in a jurisdiction other than in the jurisdiction where the fund is authorized, simply saying that that the domicile of the fund is where it is authorised seems to fail to take account of principles of taxation that have been built up over many years in different jurisdictions. We do not consider that tax authorities will be willing readily to agree to such an interpretation. Our fear is that such agreement is unlikely particularly given the implications that such an interpretation could have for non-UCITS unit trust and contractual fund products.

Additionally, in considering the domicile issue, it is not correct to assume that the depositary of a UCITS is domiciled in the UCITS’ jurisdiction. In Ireland, at least, branches of EU credit institutions domiciled in other EU Member States can act as depositary but it would not be correct to consider the location of the Irish branch to be the “domicile” of the depositary.

- we also think as the discussions regarding the MCP have developed over the last year or so there seems to be less focus on what the original objective was, being to reduce the inefficiencies suffered by

promoters/asset managers by having to have management companies in a number of different jurisdictions where they have funds domiciled in those different jurisdictions.

It is our view that, unless the fiscal issues can be tackled in a clear and definitive fashion (which we consider unlikely in the short to medium term), other steps should be taken to try to reduce the impact of those inefficiencies. These might include:

- a single capital adequacy requirement at parent level for all management companies maintained by a single group; and
- removing any residency requirement for directors of management companies;
- a single consolidated audit for all management companies in a group.

If the end result (pending dealing with the fiscal issues in another fashion) was that there remained a requirement to have a management company based in the jurisdiction that the fund was domiciled (and in the case of unit trusts common contractual funds, being the feature of which makes them so domiciled) but there was a single capital adequacy requirement rather than a one per management company, no residence requirement for board members and a reduction in audit requirements, we think that that would be a significant forward step.

At the same time, we feel that it should be left to individual fund regulators to determine to what extent they will allow cross border provision of fund administration services so that evolution in that part of the industry will continue, where justified, adequately explained and controlled.

Interested Parties

There are clearly a number of different “constituencies” which are or may be interested in the MCP proposals including investors, promoters/asset managers, fund administrators/depositories and regulators. These need to be kept to the forefront of the MCP discussions as should in the Commission's request that CESR's advice be “mindful of the need to minimise compliance costs and complexity for business operators of the supervisory framework”.

Investors already experience a situation where both the UCITS and its management company are domiciled in a jurisdiction different to the investors' domicile. We suspect that in some (if not many) cases the investor may not even be aware where the UCITS itself is domiciled, let alone where its management company is domiciled as it is mainly looking to the promoter/investor manager in the context of its decision to invest and stay invested in the UCITS. We suspect that the real interest that investors may have in the MCP proposal is whether the proposal will reduce the costs that they are directly or indirectly charged and clarity as to which legislative regime they would have recourse to in the event of some problem with the fund. If, for example, the tax issues are not dealt with clearly or if it is decided to hard code a requirement for core administrative functions to be carried out in the UCITS domicile, then it is questionable whether cost savings or other efficiencies will really be made.

In the case of fund administrators, it would seem clear that their interest is being in able to service their clients in what they (the fund administrator) consider it to be the most efficient manner and this clearly includes being able to deliver services to funds domiciled in different jurisdictions through as few platform(s) as possible with capacity and freedom to use operating centres in different locations which would be able to deliver the service at the lowest possible cost without compromising service levels to clients. We favour a flexible outsourcing/delegation arrangement as determined by individual regulators rather than being prescriptive in the UCITS Directive. The suggestion of imposing prescriptive rules on what elements of “fund administration” need to be performed in a fund’s domicile (if it is decided to introduce the concept of a minimum set of “core administrative functions”, such as the verification of the valuation and pricing and the maintenance of the unitholders registers) would run contrary to the objective of allowing the fund administration industry evolve.

From the promoter/asset manager’s perspective there would also appear to be a number of issues somewhat overlooked in the most recent discussions of the full or partial MCP discussions. These include:

- the majority of fund promoters/asset managers are not interested in providing the fund administration services through their own management company. In most cases when they set up a management company the management company delegates out the fund administration and asset management services and distribution activities and has been set up either because of a legal requirement to do so (unit trusts/CCFs), for control reasons (as the vehicle through which delegates are appointed), or where the promoter has a number of different fund platforms and wishes to avoid seeding the Euro 300,000 required for SMICs on multiple occasions;
- most promoters/asset managers are likely to be more interested in the level of service they obtain from fund administrators/custodians and their costs, rather than where those services are provided from;
- we have not witnessed any significant uptake in promoters wishing to use their management companies for individual portfolio management as that is primarily provided by MiFID (or third country equivalent) firms and given further the restricted activities that fall within individual portfolio management when compared to the broader range of activities under MiFID;
- the main issue from a promoter/asset management perspective boils down to the fact that they have ended up having management companies in more than one jurisdiction, that they have capital requirements multiplied by the number of management companies that they have, as well as all of the additional costs that relate to such management companies including, for example, the requirement to have local directors, to hold and attend board meetings in different jurisdictions, to have multiple audits, to meet/comply with different regimes or interpretations of the “two person” management concept etc. This we think is the key bugbear for the industry.

From a regulator’s perspective it appears that the concerns relate less to the management company *per se* but rather to the fund administration type services, seeing their capacity to effectively supervise and regulate the provider of those services as a key component of their capacity to regulate/supervise the UCITS fund product itself. There are clearly arguments for and against such a position but there are examples from other financial

services industries where cross border provision of administration type services has not been an obstacle but in those cases the recipient of those services is domiciled in the same jurisdiction as the regulator.

Domicile and Core Administrative Functions

The proposal that a separate domicile be identified for the UCITS fund to that of its management company (as a basis for the establishment of a new distinct regulatory regime applicable to the UCITS fund and to that of its management company) is an interesting proposal but we are concerned that it may not work in the case of UCITS unit trusts and common contractual funds which as you are aware do not have separate legal personality. Attributing a domicile to a UCITS which has no legal personality independent of the domicile of its management company is problematic to say the least. Note also that relying on the domicile of the depositary is not acceptable as branch type depositories would not satisfy that test.

It is important to bear in mind that the vast majority of fund promoters/asset managers are not interested in providing the fund administration services through their own management company. In most cases when they set up a management company the management company delegates out the fund administration, asset management services and distribution activities. Management companies are set up in most cases either because of a legal requirement to do so (unit trusts/CCFs), for control reasons (as the vehicle through which delegates are appointed) or where the promoter has a number of different fund platforms and wishes to avoid seeding the Euro 300,000 required for SMICs on multiple occasions. Most promoters/asset managers are likely to be more interested in the level of service they obtain from fund administrators/custodians and their costs, rather than where those services are provided from. In that context, linking domicile to “core administrative functions” would be a retrograde step.

Any such proposal would restrict evolution of the fund administration industry, does not fulfil any particular investor protection function, does not properly address potential tax issues that might arise and is unlikely to be enthusiastically welcomed by the promoter/asset management community other than as part of some overall compromise.

Allocation of supervisory and regulatory responsibilities

The proposal that the competent authorities of the management company's home Member State should be competent to ensure its supervision, whilst the competent authorities of the UCITS's home Member State should be competent to ensure the supervision of the UCITS, whilst appearing feasible at a high level, is problematical upon further examination.

Noting that other commentators have concerns that such a proposal could give rise to supervisory uncertainty which might undermine the effective supervision of the fund and its service providers, we feel that consideration has not fully been given to the position of UCITS funds which have no separate legal personality independent of that of its management company. It seems difficult to envisage how the competent authority of the home Member State of the UCITS could effectively discharge its responsibilities against that UCITS without stepping into the terrain reserved for the competent authority of the management company, notwithstanding the fact that the new proposals may seek to clearly define the various responsibilities and obligations of the various parties (the UCITS,

the management company, the depositary etc) and the role of each respective competent authority thereto.

Furthermore, split supervision could result in a uniformity of approach being adopted for matters such as governance / risk management / substance whereas what the industry really needs is regulatory competition in order to drive forward industry evolution.

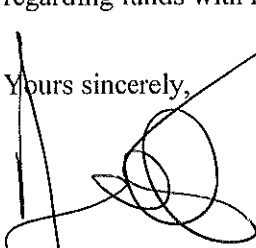
Taxation

We also note that in the Commission's request to CESR it indicates that amendments to the UCITS Directive "*should not generate fiscal uncertainty which might undermine the affect of tax efficiency of the management company/fund chain*". Footnote 3 of the DG Internal Market working document notes that the Commission "has set out the reasons which have led it to conclude that the scope for potential tax inefficiencies arising in the case of cross border UCITS management is confined to some non-fiscally transparent structures (some contractual funds, limited partnerships)". This is a real obstacle and unless there is a very clear way of dealing with the taxation of management companies (and we do not see that as a medium term reality), the uncertainty surrounding the issue may be too great and may undermine the MCP proposal.

Taking, as an example, a UK promoter who establishes a German domiciled fund, with a UK Investment Manager and a UK management company and with fund administration activities taking place in the UK (even if the verification and pricing was carried out in Germany), real fiscal risks arise. Bear in mind that the tax authorities in various jurisdictions may take a very different view to the Commission or CESR particularly as that view could have significant implications for the taxation of a variety of non-UCITS fund types depending on where they are managed from.

In conclusion, we feel that the key concerns of the promoters/asset managers are not really being addressed by the current MCP proposals but that they could be (capital adequacy, directors and audits) without raising regulatory concerns or imposing unnecessary constraints on the fund administration industry nor raising fundamental issues regarding funds with no separate legal personality.

Yours sincerely,



Andrew Bates
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