

RESPONSE TO CESR CALL FOR EVIDENCE RE MANAGEMENT COMPANY PASSPORT FROM FIL INTERNATIONAL

Dear Sirs

FIL International is pleased to respond to the CESR *Call for evidence on the request for advice to CESR on the UCITS asset management company passport* of 17th July 2008.

FIL International has long been a supporter of the EU single market agenda and as a pan-European fund provider and distributor has advocated a passport for UCITS management companies for some years. However, we also recognise the importance of an orderly and well-supervised market and accordingly welcome the work being done to create a robust regulatory framework for such a passport.

We endorse entirely the statement in paragraph 2 that the “CESR advice on management company passport should be mindful of the need to minimise compliance costs and complexity” where this is consistent with investor protection.

The appropriateness of split supervision

We might begin by stating that we do not believe the concept of split supervision to be in any way antithetical to investor protection. Indeed, split supervision sits at the heart of the EU single market initiative and has been enhanced through the creation and work of CESR. By split supervision we mean a system whereby regulators have common goals and interests, but have a basis for mutual reliance coupled with a partnership structure which can facilitate prompt enforcement action when required.

Examples of such an approach already exist in the UCITS, CRD and MiFID areas. What is important is that the allocation of regulatory responsibilities between different supervisory bodies is clear to both the regulators and the regulated. Nothing is more likely to create unnecessary cost and complexity than a regulated firm or fund having to report the same material twice, or to vary reporting based on non-substantive factors.

Even worse would be a situation where a management company is subject to two sets of rules which are not the same. Such an approach simply doubles the amount of work required to validate a particular process or course of action and where differences occur can lead to operational and regulatory paralysis.

In this regard we would encourage CESR to consider rule amendment options to UCITs under a maximum harmonisation structure if these are to be introduced in amending Directive format or by way of regulation to the extent possible. This coupled with appropriate guidance should help ensure a consistent level of interpretation by EU regulators.

Where to draw the line

Modern communications have rendered largely irrelevant in operational terms the physical location of conduct of business. In addition, regulatory convergence through UCITS has rendered geographical location within the EU less critical, and regulators have developed a series of mutual dependencies through a series of single market measures, not just UCITS.

We believe that the regulator in the country of the management company's location should be responsible for supervision of the entirety of the conduct of the management company. This is simply an extension of the existing UCITS model for investment managers where the fund is entitled to delegate investment management to another EU country registered entity and the conduct of that investment manager is solely within the purview of its regulator. Indeed we believe that the existing UCITS and MiFID models for delegation provide not just a template but a live and functioning precedent for how split supervision can work.

There are those who will raise the question of the fund's substance (particularly where the fund is constituted on a trust basis), but this is more of a fiscal concern than a regulatory one and we do not believe an issue with which CESR needs to concern itself.

Provided that the management company is accountable to a regulator enforcing an EU commonly interpreted standard of conduct, and the fund remains accountable to its regulator for its actions and those of its delegates, and the fund's regulator has the power to take enforcement action against the fund, we do not believe there to be a risk to investor protection.

Passport notification

We believe it should be left to the senior management of a management company to decide whether to manage a fund domiciled outside its jurisdiction and therefore apply for a management company passport. It must ensure it has the 'adequate qualifications' to manage a UCITS domiciled in another territory. There are provisions in the UCITS Directive relating to requirements to act with due skill care and diligence and in the interests of the UCITs it manages in this regard.

If CESR considers the regulator of the management company should take additional measures over and above its routine local authorisation process before granting a passport we would suggest this is achieved through the existing passport application process set out at article 6b of the UCITS Directive. For example, further detail may be requested to demonstrate competency part of the program of operations already required.

We would not be in favour of any shared or joint 'authorisation' process by home and host state regulators as may be implied in section 3.3 in the Request for Assistance.

Communication and interaction between regulators

The fund will be obliged to comply with the rules applicable to it in order to maintain its authorisation in its country of domicile and that compliance will be contingent (in part) upon the management company acting in accordance with its rule obligations. It is therefore imperative that appropriate mechanisms exist between regulators to ensure that relevant information is shared expeditiously. We would expect regular regulator-to-regulator communication on matters such as serious rules breaches, inspection findings and financial and complaints reporting for example. We believe there are working models for such co-operation in areas such as financial supervision.

We would characterise the use by a fund of a management company as, in MiFID terms, a material outsourcing. We feel that the conditions of a material outsourcing requiring the delegatee to allow the delegator's regulator access to data and premises would be a sensible element of the arrangements. We do not see this as mandating routine inspection visits, but as a necessary facility if problems were to arise and it became appropriate for the fund's regulator to visit either on a standalone basis or alongside the management company regulator.

The depositary and the role fund auditors

In many jurisdictions various aspects of supervision have been passed to the depositary. There is no current intention to allow a depositary based outside a fund's domicile to act for it. While we believe that long term the depositary should benefit from a passport, for now the localised presence of the depositary adds an extra layer of comfort for the fund regulator in the context of a passporting management company.

Depositaries already cope well with the fact that investment management is conducted in locations different from the fund domicile and there seems little substantive impediment to their being able to establish good communication processes with a management company located in another member state.

In extreme circumstances where action is needed to protect fund assets, the regulators of a fund should also be reassured by the assets of the fund continuing to be held by a regulated entity subject to their jurisdiction and law.

The activities of the management company in relation to the funds will also be regularly audited. In some territories auditors are mandated broad remits by regulators in relation to fund regulatory oversight. For example, in Luxembourg fund auditors oversee the resolution and compensation process for all unit pricing errors. They are also required to report to the regulator each year in detail on the following defined areas of fund operations: valuation methods and pricing errors, risk management systems, late trading and market timing, the compliance function and anti-money laundering controls.

Centres of excellence

It will come as no surprise to CESR that the demands on systems and personnel within a management company have increased over the years. It is becoming more difficult for even large organisations to deliver the highest possible level of conduct across a variety of jurisdictions where local rules and conditions vary due to systems and human expertise constraints. A management company passport under which firms can invest in people and processes cost effectively, confident of consistent and scalable management of regulatory standards will materially improve the potential for investor protection.

Should you wish us to provide further clarification or support please contact the undersigned

Yours faithfully,

Gareth Adams
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