



**Eurofi 2008 -
Thursday 11/09/08
Session [3B] UCITS
REGULATORY FRAMEWORK
EVOLUTIONS:
Conditions for UCITS funds
to receive services from
a management company**

based abroad and further clarification or harmonisation opportunities for administrative activities.

The Panel

Moderator: **Wolf Klinz**, MEP, Committee on Economic and Monetary Affairs, European Parliament

Panellists: **Niall Bohan**, Head of Unit, Asset Management, DG Internal Market and Services, European Commission;

Carlo Comporti, Secretary General, Committee of European Securities Regulators (CESR);

Simon Fraser, President, Investment Solutions Group, Fidelity International and Chairman, FEAM;

Wolfgang Mansfeld, Member of the Executive Board, Union Asset Management Holding AG and Chairman, BVI;

Stefano Pierantozzi, Head of European Fiduciary Oversight and Research, Global Transaction Services, Citi;

Florence Fontan, Head of European Affairs, BNP Paribas Securities Services

The Debate

The moderator, **Wolf Klinz**, asked Niall Bohan to explain why the Commission had reviewed the fund management passport – which would enable funds to be distributed across borders without having to establish a management presence in each country – and had decided to leave it out of the proposed review of the UCITS legislation (UCITS IV). The Commission had instead referred the matter to CESR for further discussion and consultation. The passport issue was originally included in the proposal for the update the UCITS package, said Mr **Bohan**, as it was clear it could help achieve long-awaited rationalisation within the investment management industry. But on closer examination it emerged that the supervisory and regulatory implications were more complicated than originally envisaged. This had become clear following the publication of the 2007 Exposure Draft. “This may all seem straightforward to some, but it is in fact highly complicated because the fund and management company are inextricably linked,” said Mr **Bohan**. “The fund has no distinct life of its own unlike a bank subsidiary or branch.”

The Commission could not come up with a solution to this problem so had referred to CESR to identify possible remedies. Key areas were to be explored included:

- There should be a clear separation between entities allowing a clear allocation of responsibilities between the management company and the fund. Identifying which was responsible for management, portfolios and administration was crucial. It also needed to be worked out which country’s rules applied to each of these functions.
- How does each domicile monitor and control compliance and enforce penalties if a passport comes into being? They would presumably need direct access to the functioning parts of a fund and tools to perform the monitoring and supervision.
- The establishment of mechanisms that allowed co-operation, data flows and exchanges between all players as well as cross-border enforcement in the case of an infringement. There needs to be a mechanism that allows enforcement against contractual funds which have no legal personality of their own.

The fund industry was very disappointed that a passport had not been included in the final legislative proposal, said a clearly disgruntled **Mr Mansfeld**. There had been a long discussion process, an open and transparent dialogue, and the industry had been led to believe that the passport proposal would be an integral part of the efficiency measures. “It is irritating that this fell out of the draft,” said Mr Mansfeld. “It is clear there are regulatory challenges, but the Commission appeared to be tackling the challenges involved in notification and fund mergers. We have lost much time now.” Hopes now rested with Cesr, but there was a risk that the passport issue could be delayed for two more years.

FEAM is actively involved in the process and supports the adoption of the passport, said **Simon Fraser**, FEAM’S president. The current requirement to set up a management company in each domicile acts as a brake to smaller promoters wishing to enter new jurisdictions. At the same time, efficiency savings would be made as administration could come together in the same place in centres of excellence. But FEAM was concerned about the risks to the other components of the UCITS IV legislative package and did not wish them to be jeopardised over the passport issue.

The UCITS framework must be moved on from the bare minimum, Mr Fraser said. Additional actions are required to increase the competitiveness of the European market compared to Asia and the US in the future. “UCITS IV is not the end of the story, we need to do more things after this,” he said. But care must be taken not to undermine the UCITS brand and to retain UCITS for retail investors and, in this, he agreed with the Commission’s view.

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Some participants were philosophical about the passport proposal. **Stefano Pierantozzi** said: "The industry has lived without a passport for 20 years and managed to expand across borders so it can continue to live without it, even if this situation is not optimum." But without the passport, Ucits IV was perhaps not entirely worth the cost of implementation, he added. The main problem as he saw it was the clarification of responsibilities. The passport was all about clarifying responsibilities along a value chain which stretched from the manufacturer to the distributor, and was instrumental to the future success of master-feeder structures in particular.

Mr Pierantozzi pointed out that Citi, as a service provider, had no asset management business so no direct interest in the passport. "But we want to be able to provide fund services more efficiently," he said. "We need economies of scale and do not want to have to develop a plethora of platforms and structures. We want to develop something that adds value to the value chain."

Carlo Comperti, of secretary general of CESR, said the November 1 deadline to respond to the Commission's passport queries was "challenging".

Regarding process, CESR had immediately published a call for evidence, given the short timeline. It would not be possible to conduct extensive consultations but there would be an open hearing in Paris, in October. CESR would publish a paper outlining the lines that it would follow in advance of the hearing. The organisation would only interact with the industry through the consultation process with respect to the short notice.

In terms of evidence, there were, at the time of speaking, 29 responses, mainly from asset managers, on the CESR website. Most were in favour of a passport and felt that an effective framework could be designed in the short-term. A few highlighted the risk of such cross-border arrangements and warned of possible damage to the UCITS brand and higher costs. There was also concern about the lack of harmonization particularly in the role and responsibilities of depositaries which may give rise to supervisory issues. Most contributors thought that a framework could be proposed in the short term with a clear split between stakeholders and regulators, a clear split of responsibilities between regulators and the ability for the different stakeholders to discharge their responsibilities. Some proposals suggested a hybrid route whereby there would be some sort of physical presence, but only as a contact point and not involving heavy costs.

Asked again to explain the Commission's position, Mr Bohan said the Commission had indicated from the start of the review that the management company passport could find its place within the Ucits framework. But the legal and support mechanisms were unfortunately not in place. In its proposal on July 16, the Commission said it would come forward at the "appropriate time" to support a passport within the

lifetime of the legislature. "This is a clear commitment and we will be held to account," said Mr Bohan. "But we will not have a passport at any price. It has to function well and make sense and work for all stakeholders." This meant not just the industry but its customers and unitholders, plus regulators. The questions submitted to Cesr were real and legitimate. It was not a case of hiding behind Cesr, and the Commission was happy that Cesr was moving forward with the issue. "We want to bring this chapter to a close," he added.

Mr Mansfeld spoke about Eurofi's proposal for a two-step approach, which involved introducing a short-term version of the passport - keeping a point of contact for the management company in the fund domicile in the form of a non-capitalized representation and going towards further harmonisation of administrative activities which would make the local representation redundant over time. "Everyone agrees that the regulatory conditions have to be fulfilled but no work had been done on this until Eurofi intervened," he said. It should be possible to create a sufficiently working passport to capture the full benefits without creating regulatory gaps. Eurofi's draft shows how different players could operate within the landscape. Regulators had the tools to manage this arrangement, including with reference to depositary banks. "The fund supervisor is in a strong position because it has to authorise the fund and has a lot of tools at its disposal with the depositary and the auditor," Mr Mansfeld added. There was no evidence that it was necessary to maintain specific administrative functions in the fund domicile to put the regulator in a position to discharge its duties. Anyone who believed this would have to provide proof in the forthcoming discussions. To reap sufficient benefits of the passport it would be good if certain administrative activities were harmonised across Europe. Valuation processes were one example. "Currently if I have a management company in different domiciles I have to comply with different valuation procedures in each." This was not efficient and pressure is building to harmonise such standards.

Eurofi had quantified the benefits of such actions. Overall, € 1 trillion of assets could be affected positively if a passport was to be created. Around five basis points of costs could be saved, amounting to € 500m overall. These figures were in line with the evaluations made by the Commission.

Eurofi's ideas – contained within the current proposal - for solving the passport difficulties were on the table and represented a practical solution, said Florence Fontan. It was vital that the Ucits legislation was passed for the framework to remain competitive and achieve further levels of efficiency. "We need harmonisation on other aspects too, not just for the passport," Ms Fontan said.

The issue for depositaries was less about cost savings than about not increasing costs, said Ms Fontan. This was because of the nature of the depositary business which was about safekeeping assets, and ensuring

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compliance with the prospectus and local regulations. If there is a management company and a depositary in a single domicile, there was a reasonable probability that the fund would comply with local rules. But where there was a separation, this could be harder to achieve. In an effort to reduce cost, there was a risk that safeguards were reduced and that the requisite expertise of the fund domicile rules would not be available within the management company. "The passport must not transfer the risk to the depositary or it misses the whole point. Regulators share our concern." If there was no guarantee on this point, investor protection would be jeopardised and the regulatory burden would be increased. Depositaries ought to have at least the same level of access as they have now so they could discharge their responsibilities without increasing their costs. Ms Fontan was in favour of Eurofi's proposal for a small local presence. "A small presence would not require capital so small companies too would be able to benefit from the passport." Fund management companies should, though, make sure they have an interface with depositaries and regulators, and it should be their responsibility to make sure that administrative functions are compliant with local rules.

The proposal of a physical presence in the local domicile was the cornerstone of Eurofi's working paper and was a well thought out proposal, said Mr Comporti. He agreed it could work as an interface with capital no longer required until full rules have been implemented, and the idea should be further analysed to assess whether the physical presence would bring sufficient benefits to supervisory arrangements. He asked whether the purpose was to create a legal responsibility towards clients and regulators or whether it would perform specific functions. "Is it the first,

the other, or a combination of the two?" Mr Comporti said. The additional cost, even for a light scheme, needed to be borne in mind. Cesr's advice would follow the Lamfalussy process. It would set out the provisions for Level 1, which the Commission could then make into legal text. There was still important work to be done on harmonising rules between member states, which Cesr was involved in. There needed to be a clear split of the responsibilities between the fund managers, depositaries and regulators, which was not easy in all cases. Depositaries played an important role, Mr Comporti said, but there was some discussion about whether they should be given additional functions. There also needed to be a sound framework between regulators in terms of co-operation, supervision and enforcement. Mr Comporti emphasised that his comments should be regarded as personal thoughts ahead of CESR'S formal deliberations.

Ucits was a good brand and it should be kept that way, said Mr Klinz, summing up the debate. Mr Klinz was satisfied that the industry at large believed that a passport could become reality. But it was paramount that the retail investor should not suffer under any circumstances and that protection should be maintained. At the same time, the market should be opened up further and go towards more harmonization. In the European Parliament, there was a group working on the Lamfalussy process and supervisory structures to ensure the future of Ucits and other products in future years. The Commission, he said, had taken the question of the management passport seriously. Cesr too, was working hard to come up with answers. In addition, there seemed to be a large consensus within the industry about how to deal with the challenges.

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