News Bulletin

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CESR Consultation Paper on UCITS Management Company Passport

Background

On 30th September 2008, the Committee of European Securities Regulators ("CESR") issued a consultation paper on the "management company passport" ("MCP") relating to Undertakings for Collective Investment in Transferable Securities ("UCITS").

The public consultation was launched in the context of the European Commission ("Commission") mandate of 16th July 2008, which requested CESR to provide technical advice, by 1st November 2008, on the conditions under which the MCP could be introduced without compromising regulatory supervision and investor protection.

Under the existing UCITS framework under Council Directive of 20 December 1985 (85/611/EC), as amended ("UCITS Directive"), a UCITS fund, its management company and its depositary must all be located in the same Member State ("MS") of the European Economic Area ("EEA"). Therefore, all the activities related to the collective portfolio management and administration of the UCITS are currently subject to the laws of a single MS, and the relevant entities accountable to a single competent authority in that MS.

Although the UCITS Directive currently provides that asset management companies may provide certain investment services (such as individual portfolio management or investment advice) through the establishment of a branch or under the free provision of services under Article 49 of the Treaty establishing the European Community, it does not allow them to engage in the full scale management of a UCITS fund on a cross-border basis.

The introduction of the 'full' MCP would allow a UCITS fund which is established in one MS to be managed by a management company which is authorised and supervised in another MS on a cross-border basis throughout the European Union ("EU"), either through a branch or under the free provision of services.

The MCP was conspicuous in its absence from the set of proposals announced by the Commission on 16th July 2008, which are intended to reform the existing legislative framework for UCITS in the EU (commonly referred to as "UCITS IV"). Despite being regarded as the centrepiece of the reform by many market participants, the MCP was left out of the UCITS IV proposals due to concerns that it could make it difficult for the competent authorities to supervise the relevant entities properly and to maintain a high investor protection standard which has been to date the hallmark of the UCITS brand.

In particular, it was considered necessary first to clarify the rules governing the activities of the management company and the UCITS as well as the respective responsibilities of the competent authorities for the management company, UCITS and the depositary. In addition, in order to enable the competent authorities to monitor and

enforce compliance with the applicable laws, it would also be necessary to introduce certain mechanisms in support, such as the exchange of information and mutual assistance among the competent authorities.

The following summarises the draft recommendations of CESR which are set out in the consultation paper and on which the market participants have been asked to provide their comments by 15th October 2008. They are partly based on the feedback received by CESR in its call for evidence between 17th July and22nd August 2008. CESR also recommends that the Commission adopt, where appropriate, the implementing measures necessary to give effect to the proposed rules and principles, including relevant scope, contents, procedures, timeframes and other details:

1. Definition of domicile - the elements to be used to distinguish the home MSs of the management company, the depositary and the UCITS

1.1 Management company

The home MS of a management company should be the MS in which its registered office is located or, if it has no registered office, the MS in which its head office is located. Authorisation should be granted by the competent authority of the management company's home MS in accordance with the provisions of the UCITS Directive.

The management company's competent authority should refuse or withdraw authorisation where its programme of operations, geographical distribution or activities or other factors clearly indicate that it has opted for the particular MS for the purpose of evading the stricter standards (e.g., investor protection) in another MS where the greater part of its activities will be conducted.

The authorisation by the home MS's competent authority should be pan-European and allow the management company to engage in the authorised services or activities throughout the EU, either by establishing a branch or under the free provision of services.

These provisions on management company domicile and authorisation will be in line with the requirements of the Markets in Financial Instruments Directive ("MiFID"). UCITS management companies which provide investment advice or portfolio management services are already subject to most of MiFID's operational requirements (including those regarding the suitability of the products for the particular investor).

1.2 UCITS

The home MS of a UCITS fund which is established under contract or trust law should be the MS in which the management company has applied for the UCITS to be authorised and in which the depositary is established.

The UCITS should be regulated in accordance with the laws of its home MS, including the law applicable to the liquidation of the fund's assets.

The UCITS should only be authorised if the competent authority of its home MS has approved the choice of the management company as well as the depositary and the fund rules.

1.3 Local point of contact

If the management company is not established in the UCITS home MS, it should designate a financial institution or the depositary in that MS (including through a branch) to act as a local point of contact for the investors and the UCITS competent authority.

The functions of the local point of contact will be to facilitate the flow of information and communications between the 'remote' management company and the local investors as well as the UCITS competent authority and to provide the facilities for the unit-holders to exercise their rights, such as subscriptions, redemptions and payments.

1.4 Depositary

The depositary should either have its registered office or be established in the home MS of the UCITS . This will be a change from the current UCITS legislation which requires the depositary to be established in the home MS of the management company.

The depositary should be liable to the management company and the unit-holders for any loss resulting from its breach of duty pursuant to the laws of the UCITS home MS.

2. Applicable law and the allocation of supervisory responsibilities between the competent authorities responsible for the management company, the depositary and the UCITS

Whether acting through a branch or the free provision of services, a management company engaged in cross-border UCITS management should comply with the rules of the UCITS home MS relating to the constitution and functioning of the UCITS. These include the rules governing its set-up, authorisation, fund rules, investment policies and limits, issuance or redemption of units, voting rights, distributions, assets valuation and accounting, calculations (e.g., the net asset valuation ("NAV"), issue/ redemption prices), disclosure (prospectus, key information document ("KID"), periodic reports), marketing and customer enquiries. In addition, the management company should always comply with the fund rules and the prospectus provisions. The UCITS competent authority should be responsible for supervising the management company's compliance with these requirements.

The management company should also comply with the organisational provisions and the rules of conduct applied by its own home MS (e.g., risk management and conflict of interest procedures). The UCITS competent authority should be satisfied that the management company's risk management and conflict of interest procedures are adequate for the particular UCITS.

2.1 Applicable law and allocation of responsibilities in the case of free provision of services

Home MSs should not impose on a management company which is authorised in another MS and provides cross-border UCITS management through the free provision of services any additional requirement on matters which are covered by the UCITS Directive (except as expressly permitted by it).

The management company should inform the UCITS competent authority of any delegation arrangements at the time of the UCITS authorisation as well as any subsequent changes.

MSs should make complete and up-to-date legal, regulatory and administrative information relating to the establishment and operations of the management companies and UCITS funds easily accessible by electronic means in clear and unambiguous language.

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

MSs should not impose additional requirements regarding the organisation and operation of the branch by a management company on matters which are covered by the UCITS Directive (except where permitted by it).

The competent authority of the host MS in which the branch is located should be responsible for supervising the compliance by the branch with its rules of conduct.

2.3 Cooperation between competent authorities

For the purpose of ensuring adequate supervision of the UCITS, the depositary and the management company, the competent authorities should have the power to conclude bilateral and/or multilateral cooperation agreements among themselves that may involve sharing or delegating supervisory tasks over the UCITS. The competent authorities should also have the power to institute more formal structures such as 'colleges of supervisors'.

3. Authorisation procedure for UCITS fund whose management company is established in another MS – the procedure to assess the management company's qualifications and the circumstances under which the MCP could be refused

UCITS authorisation

A key concern in introducing the MCP is that there should be a clear allocation of responsibilities between the respective competent authorities of the management company and the UCITS, in order that they may fulfil their regulatory functions without confusion or conflict. In particular, the UCITS competent authority should be able to verify that the management company, supervised by another competent authority, is suitable for the particular UCITS and complies with applicable laws.

UCITS competent authority should not be able to require UCITS to be managed by management companies having their registered office in that MS.

The UCITS competent authority should approve the choice of the management company (and issue a certification attesting that the management company fulfils the requisite conditions under the UCITS Directive)if:

(i) the management company is authorised by its home competent authority to manage the particular type of UCITS;

(ii) the management company will be able to comply with its rules and its risk management process, conflicts of interest procedures and proposed delegation arrangements are adequate for that type of UCITS; and

(iii) the choice of the management company does not prevent the effective exercise of its supervisory functions.

In addition to other relevant documents (e.g., fund rules, prospectus, KID, distribution arrangements), a management company applying for cross-border authorisation under the free provision of services should provide the UCITS competent authority with information on the risk management process, accounting, conflict of interest and other internal procedures, its relationship to the depositary, delegation arrangements, local point of contact and how it intends to comply with the legitimate supervisory requirements of the UCITS competent authority.

When applying for cross-border authorisation through a branch, the management company should include a programme of operations setting out its proposed activities and services in accordance with the applicable provisions of the UCITS Directive.

Any material changes to the information provided during the application process must be promptly updated to the UCITS competent authority.

The UCITS competent authority should be entitled to ask the management company to provide clarification and information (including documents) regarding the above insofar as necessary to verify its compliance with the rules falling within its remit (but not otherwise).

The UCITS competent authority should have the right to approve any replacement of the management company or the depositary and any amendment to the fund rules.

4. On-going supervision of the management of the fund - the conditions needed to ensure that the respective competent authorities have sufficient means and information to discharge their duties effectively

4.1 Information flow to the competent authorities

There should be arrangements to facilitate a timely and effective exchange of information between the respective competent authorities responsible for supervising the UCITS and the management company.

The management company competent authority should be provided with reports of the activities performed pursuant to a MCP by a management company under applicable domestic laws. Likewise, the UCITS competent authority should be provided with the reports required of UCITS under applicable laws and access to such reports given to the management company competent authority.

There should be mechanisms and procedures enabling the UCITS competent authority to request and receive from the management company competent authority cooperation for on-the-spot verification or investigations of the management company in the management company's home MS. Similarly, the management company competent authority should be able to request and receive from the UCITS competent authority and the depositary's competent authority cooperation for on-the-spot verification or investigations of the depositary in the depositary's home MS.

The UCITS competent authority should only be allowed to request information from the management company directly where necessary to verify compliance with the rules within its own remit of competence according to the applicable law and the allocation of supervisory responsibilities.

The respective competent authorities should immediately notify each other of all material adverse information which could impact on the management company's ability to perform its duties and comply with applicable legislation (to be notified by the UCITS competent authority to the management company competent authority), or on the management company's ability to manage the UCITS or the protection of the unit-holders (to be notified by the management company competent authority to the UCITS competent authority).

4.2 Information flow between management company, UCITS and depositary

There should be adequate arrangements in place to ensure the flow of information necessary for the management company, the UCITS and the depositary to perform their respective functions.

For example, the management company should provide the UCITS and the depositary with information regarding the investment management activities performed on behalf of the UCITS, the depositary should have access to the books and records maintained by the management company, the UCITS and/ or the depositary should advise the management company of subscriptions and redemptions and the management company and the depositary should provide the local point of contact with relevant information.

4.3 Auditors

The audits of the UCITS and the management company should be carried out by one or more independent auditors empowered to perform public interest functions under the Statutory Audit Directive (Directive 2006/43/EC). Where the UCITS and the management company have different auditors, their respective auditors should enter into an information-sharing agreement in order to assist in fulfilling their duties.

The respective auditors of the management company and the UCITS should have a duty to report promptly to the competent authorities of both the management company and the UCITS if it becomes aware of facts which could have serious financial, administrative or accounting consequences for the management company or the UCITS.

Competent authorities should be able to obtain information and documents from the auditors of the UCITS and the management company for the purpose of monitoring compliance with the rules which fall within their remit of competence according to the applicable law and the allocation of supervisory responsibilities.

5. Dealing with breaches of rules governing the management of the fund - the conditions under which effective enforcement actions can be undertaken by the respective competent authorities

5.1 Enforcement actions

Where UCITS are managed pursuant to an MCP, either through branches or under the freedom to provide services, the UCITS competent authority should be able to impose directly appropriate administrative sanctions (including financial penalties) for the management company's violation of the rules within its exclusive remit. The UCITS competent authority should inform the management company competent authority, which should be allowed to make representations on the type or level of sanction and to serve legal documents necessary to enforce the sanction against the relevant entity (or person).

If the conditions under which the management company was approved are no longer fulfilled and the unit-holders' interests are prejudiced, or if the management company has seriously and/or systematically infringed the applicable rules, the UCITS competent authority should have the ultimate power to withdraw the approval. In such event, the UCITS competent authority should be able to make the necessary arrangements for the orderly management and/or liquidation of the UCITS. The UCITS competent authority should also have the power to require the management company to suspend the issue and repurchase or redeem units in the interests of the unit-holders or of the public.

5.2 Right of unit-holder to damages

In no case should the management company's or the depositary's liability be affected by the fact that the UCITS was set up or is managed by a management company in another MS. Nor should the right of a unit-holder to claim for damages for infringement be treated differently on that ground.

Investors should file their claims against a UCITS and the management company concerning the management of the UCITS with the relevant judicial authority in the UCITS home MS. MSs should also develop out-of-court mechanisms to redress or settle investor disputes, and where existing bodies are used, ensure that the they are not prevent from cooperating effectively to resolve cross-border disputes. Investors should be advised of the availability of out-of-court mechanisms and how to access them before an investment is made in the units.

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Fund managers have been actively lobbying for the MCP, which would enable them to remote-manage funds across multiple EEA countries and increase cross-border business opportunities.

In light of the detailed proposals contained in the consultation paper, the adoption of the MCP now appears to be distinctly feasible. There will naturally be a great deal of attention focused on the final advice which CESR provides to the Commission by 1st November 2008.

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