

## UPDATE ON THE UCITS – THE MANAGEMENT COMPANY PASSPORT

**On 16 July 2008, following a lengthy consultation period, the EU Commission issued its proposals for introducing new rules to modernise the framework applicable to UCITS. These proposals are commonly referred to as UCITS IV. The Commission's proposal provided for (i) a simplified notification procedure, (ii) merger of UCITS Funds on a cross border basis, (iii) UCITS master/feeder structures, (iv) a key investor information document replacing the simplified prospectus in addition to (v) measures to enhance cooperation between competent authorities. The Management Company passport was not included in the proposal because, during the consultation process, concerns were raised by a number of Member States and industry participants as to how responsibilities for supervision could be allocated between the competent authority of the Management Company and the competent authority of the UCITS. Some felt that the proposals for a Management Company passport would leave major legal, regulatory and tax issues unsolved, which could harm the UCITS brand. Since July 2008, the EU Council's Presidency has actively worked on and finally published a compromise to nevertheless include the Management Company passport in the UCITS IV proposals. The purpose of this contribution is to describe the main elements of the Management Company passport as proposed by the Council.**

### INTRODUCTION

1. The inclusion or not of the *Management Company passport* in the reform of the legislative framework for UCITS (commonly referred to as "UCITS IV") has been the subject of discussions at investment management industry level and EU governing bodies' level and has also been the subject of the publication on 31 October 2008 by the Committee of European Securities Regulators ("CESR") of its *Advice to the European Commission on the UCITS Management Company Passport*.

2. Whereas many market participants were more or less unconditionally in favour of a full Management Company passport, others were concerned that the proposals in the form of the drafts published by the Presidency of the European Commission, even if amended to take account of certain recommendations made by CESR in its advice, would leave unsolved major legal, regulatory and tax issues incompatible with the maintenance of high investor protection standards which to date have been the hallmark of the UCITS brand.

3. Although many of the issues raised in the aforementioned debate have not been resolved to date and will require further discussion and clarification, it seems that on 2 December 2008 the European Council obtained the support of the ECOFIN Council and the European Parliament's Economic and Monetary Affairs Committee on the Presidency compromise. By mid December 2008 the Council, the Parliament and the Commission had agreed on a common text in their so called *interinstitutional dialogues*. Upon the agreement of the Permanent Representatives Committee (COREPER), which came through on 17 December 2008, the European Parliament could vote the UCITS IV package, comprising a full Management Company passport, as early as the week of 12 January 2009 to be then formally adopted by the Council in the first half of 2009. Member-States would then be required to implement these

amendments to the UCITS Directive in their local laws and regulations by 1 July 2011 at the latest.

4. The purpose of this contribution is to briefly outline and discuss the proposal for a Management Company passport as reflected in the EU Council's Presidency compromise of 20 October 2008 (reference 14332/08) (the "Proposal"). Changes made to the Proposal after 20 October 2008 as a result of the events referred to in section 3. above could not be included in this contribution but are not significant.

### THE PRINCIPLES OF THE PASSPORT

5. A Management Company authorised by its home Member State may carry on in all EU Member States the activity for which it has been authorised, either through the establishment of a branch or under the freedom to provide services.

6. Hence, a Management Company, when carrying out activities in other EU Member States, has the choice of either setting up a branch in other Member States or providing services under the freedom to provide services without the establishment of a branch. This contribution will focus on the situation where the Management Company provides services under the freedom to provide services without the establishment of a branch.

7. With regard to collective portfolio management (i.e. management of common funds and investment companies), these activities comprise (i) the distribution in all EU Member States of the units/shares of UCITS managed by the relevant Management Company ; (ii) the collective portfolio management of UCITS including all associated functions and tasks (i.e. to be the Management Company of common funds or the designated Management Company of investment companies) and (iii) the provision of investment management, administration and /or marketing services to other Management Companies or investment companies under delegated mandates. It is

only the activities referred to under (ii) which are being discussed in this contribution.

## PASSPORTING OF COLLECTIVE PORTFOLIO MANAGEMENT

8. Consequently, under the Proposal, a Management Company, once authorised in its home Member State, can set up and manage not only common funds set up and authorised in the Management Company's home Member State, but also common funds set up and managed in other EU Member States. For example, a Management Company set up and authorised in Luxembourg can create and manage common funds set up and authorised in other EU Member States. Similarly, a non-Luxembourg Management Company set up and authorised in its home Member State, can create and manage a Luxembourg common fund. It is worth noting that the Proposal defines the home Member State of a common fund as being the Member State in which the common fund is authorised. Currently, the UCITS Directive defines the home Member State of a common fund as the Member State in which the common fund's Management Company has its registered office, thus requiring that a common fund and its Management Company are both situated in the same Member State.

9. Similarly, a Management Company set up and authorised in its home Member State, can act as a designated Management Company not only for investment companies established and authorised in the Management Company's home Member State, but also investment companies established and authorised in any other EU Member State. For example, a Management Company set up and authorised in Luxembourg may be designated as a Management Company by investment companies set up and authorised in other EU Member States. Similarly, investment companies set up and authorised in Luxembourg may designate a Management Company set up and authorised in any other EU Member State. In contrast with the situation for common funds as described in the last sentence of the preceding paragraph, the text of the existing UCITS Directive already provides for the provision of cross border collective portfolio management services by management companies to investment companies, but

this was not recognised in practice by EU Member States authorities.

## NO MANAGEMENT COMPANY PRESENCE REQUIRED IN THE UCITS HOME MEMBER STATE

10. Subject to the scope for delegation arrangements as discussed under 14. below, a Management Company provides (under the freedom to provide services, i.e. when not acting through a branch) its collective portfolio management services, namely investment management functions, administration functions and marketing functions, in and from its home Member State. Consequently, where a Management Company provides cross border Management Company services to UCITS (common funds and/or investment companies) set up and authorised in other EU Member States, the collective portfolio management services, including the relevant administration functions, are performed in the Management Company home Member State and not in the UCITS home Member State. This is a significant change from the present UCITS Directive where, under the head office concept, it is implied that administration functions have to be performed in the UCITS home Member State.

11. These rules have been emphasised in the Proposal as a matter of principle as the Proposal provides that "it must not be made a condition of authorisation that UCITS be managed by a Management Company having its registered office in the UCITS home Member State or that the Management Company performs or delegates any activities in the UCITS home Member State".

## COMPETENCIES OF THE MANAGEMENT COMPANY HOME MEMBER STATE AUTHORITY

12. The Management Company's home Member State authorities are the competent authorities for authorising the Management Company and supervising its compliance with the rules and applicable provisions in the Management Company's home Member State. These rules comprise rules relating to the authorisation (authorised services; minimum capital and own funds requirements; shareholder require-

ments; authorisation of persons who conduct the business) and organisation of the Management Company (including delegation arrangements, risk management procedures, prudential rules and supervision, the requirement to have administrative, accounting and control procedures and the Management Company's reporting requirements).

## COMPETENCIES OF THE UCITS HOME MEMBER STATE AUTHORITY

13. The rules of the UCITS home Member State apply to the constitution and functioning of the UCITS and the competent authorities of the UCITS home Member State are responsible for supervising compliance with those rules. In an effort to distinguish between the scope of the Management Company home Member State rules (and consequent competence of the Management Company home State authority) and the UCITS home Member State rules (and consequent competence of the UCITS home Member State authority), the Proposal specifically lists the rules which relate to the constitution and functioning of the UCITS as those rules which cover (a) authorisation of the UCITS; (b) issue and redemption of units and shares; (c) exercise of unitholders' voting rights; (d) investment policies and limits; (e) restrictions on borrowing, lending and uncovered sales; (f) valuation of assets and accounting for the UCITS; (g) calculation of the issue price and/or redemption price; (h) distribution or reinvestment of the income; (i) disclosure and reporting requirements of the UCITS, including the prospectus, the key investor information and periodic reports; (j) marketing and distribution of the units; (k) relationship with unitholders; (l) merging and restructuring of UCITS; (m) winding-up and liquidation of the UCITS. In addition the Proposal refers to the rules set forth in the UCITS instrument of incorporation and its prospectus.

## DELEGATION OF FUNCTIONS BY THE MANAGEMENT COMPANY

14. In the same way as is presently provided for in the UCITS Directive, the Proposal allows Member States to permit Management Companies established in their juris-

dition to delegate to third parties one or more of their functions on certain conditions which remain substantially unchanged from the current UCITS rules. It should be noted that it is therefore the Management Company's home Member States rules which determine the extent to which the Management Company may delegate functions and it is the Management Company's home Member State authority which must authorise any proposed delegation within the scope of the applicable rules. The UCITS home Member State rules are not applicable and the UCITS' home Member State authority has no authority in this regard, except for a right to information from both the Management Company (see 16. below) and the Management Company's home Member State authority.

## ADDITIONAL ROLE OF THE DEPOSITARY IN THE CASE OF CROSS BORDER MANAGEMENT COMPANY SERVICES

15. In the case of cross border Management Company services, the depositary of the UCITS must sign a written agreement with the Management Company regulating the flow of information deemed necessary to allow it to perform its depositary functions. In addition, the depositary must establish procedures that enable the UCITS home Member State authority to obtain on request all information which the depositary has obtained while discharging its duties. These specific requirements do not apply where a UCITS is managed by a Management Company set up and authorised in the same EU Member State as the UCITS.

## AUTHORISATION OF THE MANAGEMENT COMPANY FOR THE UCITS BY THE UCITS HOME MEMBER STATE AUTHORITY

16. When authorising a UCITS, the UCITS home Member State authority must

approve the Management Company, the choice of depositary and the UCITS rules (constitutional documents). If the Management Company is authorised in a Member State other than the UCITS home Member State, the UCITS home Member State must also receive from the Management Company its written agreement with the depositary (see 15. above) and information on delegation arrangements (see 14. above).

17. The UCITS home Member State authority may refuse the approval of the application of the Management Company only in specific circumstances set forth in the Proposal and after requests for clarification and information from and consultation with the Management Company's home Member State. Similarly, if a Management Company is in persistent breach of the legal and regulatory provisions applicable in the UCITS home Member State, the authorities of the UCITS home Member State may, after certain procedures involving the Management Company home Member State authority, prevent the Management Company from providing services in the UCITS home Member State territory.

18. It should be noted that a Management Company, prior to the first filing of an application for authorisation of a UCITS in a specific EU Member State, must inform its own home Member State of the application proposed to be made in the other Member State and provide a programme of operations stating the activities it envisages it will undertake whereupon its home Member State authority will forward this information to the Member State in which the proposed UCITS is to be authorised.

## IMPLEMENTATION MEASURES TO BE ADOPTED BY THE COMMISSION

19. In a number of areas, the Proposal provides that the Commission may adopt implementing measures to amend non-essential elements of the Directive by supplementing it which must be adopted in accordance with the regulatory procedure

[provided for in article 5 a) (1) to (4) of article 7 of Decision 1999/468/EEC, having regard to the provisions of article 8 thereof.

## POTENTIAL IMPLICATIONS/OPPORTUNITIES FOR LUXEMBOURG

20. Although the Management Company Passport will provide more flexibility for non-Luxembourg Management Companies to provide administrative services to Luxembourg UCITS from abroad, we believe that the qualification and professionalism of the Luxembourg service providers will result in such foreign Management Companies still outsourcing administrative functions to the Luxembourg service providers and is also likely to afford new opportunities to Luxembourg service providers to provide administrative services to non-Luxembourg UCITS. In addition, tax and regulatory considerations of supervisory authorities in non-EU Member States might continue to favour the establishment of the Management Company and UCITS in the same Member State. ■

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