Financial Products and Services Committee

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I. Brazil: Developments in the Mutual Fund Industry—Brazilian Funds Can Now Invest Abroad

The mutual fund industry in Brazil is highly regulated and subject to the control and supervision of the Brazilian Securities and Exchange Commission (CVM).1 Under the applicable regulations, an investment fund (fundo de investimento) is the gathering of capital, in the form of a condominium, aimed at the investment in shares and stock and any other kind of instrument available in the financial and capital markets.2 Previously, Brazilian funds were required to concentrate all their investments in Brazil, except foreign debt funds (fundos de dívida externa). Recent amendments provide more flexibility about the types of investments to be made by the Brazilian funds, which are expressly authorized to invest abroad too under certain conditions as outlined below.3

Foreign debt funds must invest4 at least 80 percent of their equity in instruments representing foreign debt under the responsibility of the Union,5 with the investment of up to 20 percent of their net worth in other credit instruments traded in the international mar-

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1. The current basic regulations on the incorporation, administration, operation, and disclosure of information of the investment funds in Brazil have been approved by Instrução CVM No. 409, de 18 de agosto de 2004, Diário Oficial da União [D.O.U.] de 24.08.2004, (Brazil) [hereinafter CVM Instruction No. 409], amended by: (i) Instrução CVM No. 411, de 26 de novembro de 2004, D.O.U. de 01.12.2004, (Brazil) [hereinafter CVM Instruction No. 411]; (ii) Instrução CVM No. 413, de 30 de dezembro de 2004, D.O.U. de 31.12.2004, (Brazil) [hereinafter CVM Instruction No. 413]; (iii) Instrução CVM No. 450, de 30 de março de 2007, D.O.U. de 03.04.2007, (Brazil) [hereinafter CVM Instruction No. 450]; and (iv) Instrução CVM No. 456, de 22 de junho de 2007, D.O.U. de 06.26.2007, (Brazil) [hereinafter CVM Instruction No. 456]. All these regulations, and the consolidated and updated text, are available at http://www.cvm.gov.br.

2. CVM Instrução No. 409 art. 2.

3. See CVM Instruction No. 450.

4. CVM Instrução No. 409 art. 96 (detailing the criteria for the investments to be made by foreign debt funds).

5. Pursuant to the provisions of paragraph 1 of article 96 of CVM Instruction No. 409, as amended by CVM Instruction No. 411, the securities representing the foreign debt under the responsibility of the Union must be kept overseas, in a custodian account, in the Euroclear System or in the LuxClear (Central Securities Depositary of Luxembourg (CEDEL)). Paragraph 2 of article 96 of CVM Instruction No. 409, as amended by CVM Instruction No. 411, establishes that the securities included in the fund's portfolio must be deposited in the custody of entities authorized to provide such services by the relevant local authority.
After compliance with those requirements, any remaining capital can be used in
transactions in the derivatives organized markets: (i) abroad, solely for hedging purposes
with respect to instruments in the portfolio, or in deposit account in the name of the fund,
abroad, due respect being given, in this case, to 10 percent of the respective net worth; or
(ii) in Brazil, also exclusively for hedging purposes of securities in its portfolio, provided
they are backed on instruments representing foreign debt under the responsibility of the
Union, or to be kept in deposit account in the name of the fund, within the Brazilian
territory, respect being given, in this case, to 10 percent of the respective net worth. The
transactions in organized derivative markets may occur in those managed by commodities
and futures exchanges, and on the over-the-counter market, in this case so long as those
transactions are registered with the Central of Custody and Financial Settlement of Secur-
ities (CETIP). Expenses incurred in the posting of security margins for guarantees in
cash, daily adjustments, premiums, and operating costs resulting from the maintenance of
positions on the organized derivative markets in the country should be factored in. The
acquisition of local federal public instruments is allowed for security margins in transac-
tions made in organized derivative markets in Brazil. No maintenance or investment in
Brazil of capital raised by the fund is allowed, with certain exceptions as follows: (a) trans-
actions carried out in organized derivative markets in Brazil are admitted exclusively for
hedging of securities in the portfolio that are backed on instruments representing federal
foreign debt (i.e. external indebtedness under the responsibility of the Union) or for main-
tenance of demand deposit accounts in the name of the fund, in Brazil, provided that any
such transactions altogether, do not exceed the limit of 10 percent of the respective net
worth of the fund; and (b) the acquisition of Brazilian federal public instruments to be
used for security margins in transactions made in organized derivative markets in the Bra-
zilian territory is also expressly admitted.

CVM recently announced that all the other Brazilian funds can make investments
outside Brazil. Furthermore, the Brazilian Monetary Council (Conselho Monetário Na-
cional or CMN) also decided to authorize Brazilian funds to make transfers from other
countries to Brazil and vice-versa related to their investments abroad, pursuant to the
limits and other rules set forth by the CVM and the Central Bank of Brazil (Banco Central
do Brasil or Bacen).

Multi-market funds (fundos multimercaos), which are deemed to be the Brazilian hedge
funds, must have investment policies in place that provide for various risk factors, without
any required concentration on a given factor or different factors from the other fund

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6. With respect to the credit instruments traded in the international market, total issue or co-obligation of
one single legal entity, its controller, company(s) directly or indirectly controlled thereby, and its affiliates
under common control may not exceed 10 percent of the fund’s net worth. CVM Instruction No. 409 art. 96,
§6.

7. Id. at 96, ¶4.

8. Id. art. 96, ¶ 5, item I.

9. Id. art. 96, ¶ 5, item II.

10. Id. art. 96, ¶ 5, item III.

11. Id. art. 96, ¶7, amended by CVM Instruction No. 413 (stating the restrictions and exceptions).

12. See CVM Instruction No. 450.

According to the new policy confirmed by both CVM and CMN, multi-market funds are authorized to invest their proceeds in the acquisition of financial assets abroad up to the limit of 20 percent of their respective net worth value,\textsuperscript{15} provided that: (i) this possibility has been expressly contemplated in the fund's regulations, prospectus, and marketing material; and (ii) the financial assets are admitted for negotiation at stock exchanges, commodities, and futures exchanges or registered in any system of registration, custody, and financial settlement duly authorized by a country signatory to the Asuncion Treaty or in any other jurisdiction supervised by a local regulatory authority that has entered into a mutual cooperation agreement with the CVM, allowing the exchange of information about transactions made at the supervised markets, or which may be a signatory to a multilateral memorandum of understanding with the International Organization of Securities Commission (IOSCO).\textsuperscript{16}

The applicable thresholds are slightly different for each type of investment fund. As already mentioned, the limit for multi-market funds is 20 percent. Foreign debt funds continue to be authorized to invest up to 100 percent in financial assets negotiated abroad. But all the other types of fund classes (short term funds, backed funds, fixed income funds, shares funds, and foreign exchange funds) are subject to 10 percent only.\textsuperscript{17}

These investments are considered cumulatively for purposes of the calculation of the corresponding concentration thresholds by issuer and by modality.\textsuperscript{18} The current concentration percentages permitted are: (i) 5 percent by each issuer, when the issuer is an individual or a legal entity that is not a publicly held corporation registered at the CVM and/or a financial institution duly authorized to operate in Brazil by Bacen, which is precisely the case of any person or company resident, domiciled, or headquartered outside Brazil,\textsuperscript{19} and (ii) 20 percent of each different modality of financial asset.\textsuperscript{20}

It is important to note that Bacen has indicated that it will issue a new circular in due course amending the exchange regulations, which are silent on this subject, expressly contemplating the transfers from and to the Brazilian funds in order to permit such investments abroad. This announcement is one step forward in consolidating and improving Brazilian exchange regulations.

\textsuperscript{14} CVM Instruction No. 409 art. 97. The other fund classes are listed in article 92 of CVM Instruction No. 409, as amended by CVM Instruction No. 450 and comprise: short term funds (fundos de curto prazo), backed funds (fundos referenciados), fixed income funds (fundos de renda fixa), shares funds (fundos de ações), foreign exchange funds or FX funds (fundos cambiais), and foreign debt funds (fundos de dívida externa).

\textsuperscript{15} CVM Instruction No. 450 (introducing a new paragraph 1 in article 97 of CVM Instruction No. 409).

\textsuperscript{16} CVM Instruction No. 409 art. 2, \textsuperscript{5},\textsuperscript{6}, amended by CVM Instruction No. 456.

\textsuperscript{17} These thresholds are contemplated in paragraph 1 of article 85 of CVM Instruction No. 409 art. 85, \textsuperscript{1}, amended by CVM Instruction No. 450.

\textsuperscript{18} CVM Instruction No. 409 art. 85, \textsuperscript{1}, with the wording introduced by CVM Instruction No. 450.

\textsuperscript{19} Id. at art. 86, item IV, amended by CVM Instruction No. 450.

\textsuperscript{20} Id. at art. 87, item I.
II. Brazil: The Over-the-Counter Derivative Markets—The CVM Releases Proposed Rules for Public Comment*

A. INTRODUCTION

Recent years have seen substantial changes in the regulatory landscape in Brazil, fostered by federal government initiatives to develop local financial and capital markets. The derivatives market has been no exception. The spectacular growth of these markets led to a need to modernize the prevailing regulatory framework. The Comissão de Valores Mobiliários (CVM) in 2007 released for public comment proposed rules (the Proposal) to govern both exchange listed and over-the-counter derivatives transactions (OTC Transactions). This section provides a brief summary of the regulatory environment applicable to derivatives and the key aspects of the Proposal as it relates to OTC Transactions. This section does not, however, discuss exchange-related requirements. These follow, in general terms, the suggestions made by international regulators in the context of exchange demutualization.23

B. REGULATORY FRAMEWORK AND BACKGROUND

The key law governing capital markets in Brazil is Law 6.385, enacted in 1976. This legislation granted regulatory authority over exchanges to the Conselho Monetário Nacional (CMN) which over time issued regulations on the topic. The CVM opted for a cautious de facto approach, regulating and supervising the markets in conjunction with the Central Bank.

* Article submitted by Fernando Q. Merino, Brazil General Counsel for Merrill Lynch in São Paulo, Brazil.


As a statutory matter, valores mobiliários (Brazilian Securities) can only be traded in "organized over-the-counter markets" (mercado de balcão organizado) (MBO); however, Law 6.385 does not contain an express definition about what constitutes an MBO. OTC derivatives are currently characterized as Brazilian Securities.

Since its implementation, Law 6.385 has provided the CVM with authority to regulate over-the-counter markets in Brazilian Securities; however, regulations on the topic have been scattered. Most of these regulations do not reflect the current market environment or practices. OTC Transactions are also governed by regulations issued by the CMN, detailing permissible transactions for financial institutions. The regulations provide a broad range of types of transactions and underlying assets, but certain restrictions are still applicable. These regulations remain as the backbone for the types of OTC Transactions conducted in the market.

The development of the OTC market was also influenced by the need to register transactions with clearing systems. Starting in the mid-1980s, Brazilian regulators expressed a concern with bilateral transactions that were not subject to registration on the basis that it was difficult to ascertain the execution dates and whether such transactions reflected market prices. Eventually, the government required all transactions to be registered with clearing and/or payment systems. These include the Câmara de Liquidação e Custódia (CETIP), where most of the OTC derivative and fixed income transactions are registered, and Sistema Especial de Liquidação e Custódia (SELIC), for government bonds and repo style transactions over such securities. In addition, the exchanges developed clearing companies that are managed independently: Companhia Brasileira de Liquidação e Custódia (CBLC) and Clearing de Ativos e Mercadorias (BM&F). Although the regulations commonly refer to CETIP and SELIC as "clearings", these entities in fact only provide registration, delivery, and settlement services without interposing themselves between counterparties (i.e., no finality). For certain transactions, CETIP and SELIC act as calcul-

26. Law 6.385 art. 21, §§4-5.
29. Resolution 2.873 limits OTC swap and option transactions to currencies, interest rates, commodities, listed securities, and certain other specific financial assets. Weather derivatives, for instance, would not be permitted in the current regulatory environment.
30. CETIP and SELIC also provide a number of products and services to market participants. In addition, each provides key regulatory functions in their roles as pillars of the Brazilian settlement system.
lation agents based on a pre-agreed pricing criteria. For certain more complex transactions, CETIP and SELIC do not act as independent calculation agents. The CBLC and BM&F clearings, however, act as final counterparties and guarantee settlement.

Among other practical implications deriving from this framework is the fact that OTC Transactions in Brazil are generally transacted between financial institutions, with a limited number of transactions between end-users or non-financial institutions. Although a local form of the International Swaps and Derivatives Master Agreement was developed and implemented in the local market, the need to follow CMN regulations and “clearing registration” requirements limit the flexibility the market has to develop new products in the same manner that this market developed in the United States.

The Proposal seeks to rationalize the existing regulatory framework by removing regulatory anachronisms and increasing OTC market flexibility. It also demonstrates that the CVM is likely to take a more pro-active role in regulating derivative markets. The Proposal is welcomed, and the CVM’s staff should be praised for the timing and reach of the proposed regulations. Although the success of the Proposal in assisting the development of the OTC Transactions in Brazil, when and if enacted, remains to be evaluated, it certainly represents a good start.

C. KEY CONCEPTS

The Proposal follows the dichotomy between MBO and “non-organized over-the-counter markets” (mercado de baldo não organizado) established by Law 6.385. A market in OTC Transactions can only be made in an MBO.

The first section of the Proposal contains rules applicable to both “organized markets” (i.e., the exchanges and the MBO), mostly related to governance, self-regulation, and transparency, while the second section focuses solely on the specific rules applicable to the MBO. Clearly, the exchange business faces a greater amount of regulation and potential liability. The Proposal, however, does not differentiate conceptually between exchange and MBO markets, an express acknowledgment by the CVM that drawing a line between these markets is a tricky issue. In order to determine if a particular type of activity should be construed as exchange business, the CVM will consider, among others, the following factors: (i) that prices are “publicly” established via (a) an actual price negotiation in a floor or trading system or (b) regulated market-makers; (ii) large transaction volumes; and/or (iii) engagement in transactions directed at retail investors. Exchange markets will need to establish specific and detailed rules on price formation and client order execution.

The key concept behind the Proposal is the idea of fostering competition between exchange and MBO markets. The CVM proposes an “open architecture” encompassing existing platforms (i.e., CETIP, SELIC), while also allowing other MBOs to be created by “sponsors.” In the future, these could include the exchanges themselves. The CVM, however, did not go all the way as to allow “internalization” and expressly excluded that

31. See Proposal, supra note 22.
32. The CVM thought the Brazilian market was not yet developed to a degree that would allow “internalization”. The “systematic internalization of orders” is a product offered by financial institutions in which there is an internal matching of orders without the need for the client to face the market. These structures are recognized in the MiFID - the Markets in Financial Instruments Directive in the European Union. Council and Parliament Directive 2008/10/EC, 2008 O.J. (L 76) 33 (EC), available at http://eur-lex.europa.
possibility. With the exception of equity securities, Brazilian Securities may be traded both in an exchange and/or other MBOs.

The Proposal seems to establish two types of MBOs. The first type is where participants will access the market directly, without the need for intermediation via a brokerage house (what has typically been an attribute of the exchange markets). This would be allowed if the “sponsor” acts as a principal in the transaction, guaranteeing final payment, or if the MBO provides for set-off between transactions. The second type is where an MBO is established, and its “sponsor” does not take principal risk, but in that case there will be a need for intermediation via a broker.

There will be no requirement in an MBO for “public price formation,” and as such parties will be able to negotiate directly the pricing of the transaction, using the services provided by the MBO solely for purposes of registering and liquidating its transactions. Such pricing may also be established on a “passive” basis, i.e., derived from other markets or screens not available in a particular MBO.

Finally, an MBO does not need to provide continuous and timely price information about underlying transactions conducted within its environment—i.e., there would be no need to provide quotes or pricing on a real time basis.

An MBO must be “sponsored” by a person or group of persons—for instance, a group of investment banks could sponsor the establishment of an MBO. This sponsor will be responsible for the management of the MBO, including the development of facilities allowing for adequate performance. Establishing an MBO requires prior approval from the CVM. Requirements for approval include appropriate corporate governance rules based on the parameters set out in the Proposal, such as an independent board, appropriate self-regulation provisions, and restrictions for a broker or participant to acquire an interest greater than 20 percent in the market it operates. If such broker owns an interest greater than 1 percent, it will be deemed an affiliate of the “sponsor” for purposes of determining its independence in connection with a board nomination.

The “sponsor” should also establish adequate control procedures that should be reasonably designed to avoid fraud and market manipulation. Finally, the CVM will look into the form and timing of pricing information.

D. CONCLUSION

If the Proposal is adopted as released, it will certainly assist in the development of OTC Transactions in Brazil. In addition, it is reasonable to expect that the Central Bank and the CVM will continue to revisit the regulations applicable to OTC Transactions. All these efforts should lead to increased competition and availability of products to end-investors.

33. Historically, the need for transaction intermediation by a financial institution, a regulated business, has been perceived as required for adequate investor protection.
III. Ireland: Towards an Integrated European Market for Fund Managers*

2007 has seen significant dialogue between industry stakeholders and the European Commission regarding the management company passport (MCP) and the ability of fund managers to provide certain management services on a true cross-border basis throughout the member states of the European Union (EU). The backdrop to this consultation process has been that, despite significant legislative initiatives taken by the European Council and Parliament in 2002, the regulatory framework for investment funds which operates throughout the EU has not resulted in the successful incorporation of an integrated European market for the services of fund management companies. This piece examines the current state of play in relation to closing the gap between the reality and the ideal, and developments in the past 12 months regarding this area of proposed harmonization within the European investment funds industry.

A. The UCITS Framework

The cornerstone of EU funds integration is Council Directive 85/611/EEC (UCITS Directive). A primary objective of the UCITS Directive was to facilitate the harmonization of financial services across EU member states by introducing an investment vehicle which could be established and regulated in one EU member state and which would have an “EU passport” enabling its units or shares to be marketed and sold in all other EU member states. The term UCITS (Undertakings for Collective Investment in Transferable Securities) refers to collective investment schemes established and authorized pursuant to the UCITS Directive that comply with requirements for organization, management, oversight, fund diversification, liquidity, use of leverage, and eligible assets—all with the aim of reaching a defined level of investor protection. Once authorized, a UCITS can be marketed and sold on a cross-border basis to the public across the EU subject to notification in each member state where it is sold and compliance with local marketing and advertising rules. The availability of the UCITS passport is a significant advantage in selecting the UCITS regulatory framework over a non-UCITS vehicle.

* Article submitted by Michael Jackson, Partner, and Elizabeth Grace, Consultant, Asset Management and Investment Funds Group, of Matheson Ormsby Prentice, Solicitors, in Dublin, Ireland.

34. The European Commission is a politically independent collegial institution of the European Union which embodies and defends the general interest of the EU. Its virtually exclusive right of initiative in the field of legislation makes it the driving force of European integration. The European Commission prepares and then implements the legislative instruments adopted by the European Council and the European Parliament in connection with EU policies.

35. The member states of the EU are Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.


B. PAssport for Fund Management Companies—Proposed Developments to the UCITS Framework

In its Green Paper (2005) entitled "The Enhancement of the EU Framework for Investment Funds," the Commission assessed the success of the UCITS Directive as an important first step towards an integrated and competitive European market for investment funds. The Green Paper noted that 28,830 UCITS funds manage €4 trillion, representing 70 percent of the assets under management of the EU investment fund industry as a whole. One of two key areas highlighted in the Green Paper with a view to enhancement and expansion of the existing UCITS framework was the Management Company Passport (MCP).

The Green Paper noted that whilst the Management Company Directive published in 2002 had invoked certain structural changes to enhance the role of management companies of UCITS and extended the general principles of "home state control" and "host state accommodation" to enable management companies to provide their services throughout the EU, the ability of fund managers to be appointed manager of a UCITS domiciled in a different member state did not materialize due to concerns relating to the splitting of supervisory responsibilities and the perceived ambiguities and lack of completeness within the Management Company Directive.

The current status quo applying to UCITS and their managers, therefore, is that whereas a UCITS that has been established and domiciled in one member state may sell and market its shares throughout the EU (subject to the notification procedure and local marketing requirements), fund managers do not have parallel economic and cross-border freedoms, and the management company of a UCITS must be domiciled in the same member state as the UCITS that it manages.


The Commission presented its White Paper on Enhancing the Single Market Framework for Investment Funds in November 2006. This White Paper was drafted on the basis of extensive consultation and debate with consumers, industry practitioners, and

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39. Id. at 3.
40. Id. at 5. The MCP is regarded as the possibility (a) for a UCITS to appoint a management company in another member state and (b) for a management company to establish a UCITS in another member state. The second area identified in the Green Paper as benefiting from making better use of the existing European regulatory framework for investment funds was the area of distribution, sales, and promotion of funds. Long-term challenges beyond the existing legislative framework were also reviewed in the Green Paper.
41. Id.
policymakers over a period of two years and took into account responses to the Green Paper. The UCITS model was identified by the Commission in its impact assessment as a "gold standard" both inside and outside the EU, and as representing about 75 percent of the investment funds market in Europe.\textsuperscript{43} The White Paper concluded that there were no grounds to revise the scope of the UCITS Directive or overhaul rules on investment policy and that the short-term focus should be on boosting efficiency and facilitating market-driven restructuring of the investment fund market through targeted amendments to the UCITS Directive.\textsuperscript{44} The White Paper impact assessment estimated possible savings of up to €381 million to €762 million each year if each asset management group would be allowed to operate from only one location.\textsuperscript{45} The Commission concluded in its White Paper that the MCP was a worthwhile objective and that the UCITS Directive should be amended to permit an authorized management company to manage corporate and contractual funds in other member states.\textsuperscript{46}

Following the White Paper, unresolved questions still remained, such as the precise scope of the "management" services that would be covered by the proposed passport, the difficulties in ensuring effective supervision of the proposed new regime, and the possibility of negative tax implications.\textsuperscript{47} On that basis, and as an exercise in further consultation, the Internal Market and Services Directorate General of the Commission (DG MARKT)\textsuperscript{48} conducted additional research regarding possible changes to the UCITS Directive. The result was a working document titled Initial Orientations of Possible Adjustments to the UCITS Directive (the Exposure Draft) in March 2007.\textsuperscript{49} Consistent with the approach taken in the Green Paper and the White Paper, the Exposure Draft put forward all sides of the arguments. Its premise was to prepare an extensive body of material for range of ideas presented for public discussion and debate, white papers contain an official set of proposals in specific policy areas and are used as vehicles for their development.


\textsuperscript{44} White Paper, supra note 42, at 4. The proposed amendments were identified as: simplify the UCITS notification procedure; create a framework for the cross-border merger of funds; create a framework for asset pooling; enable fund managers to manage funds domiciled in other member states; improve the quality and relevance of the key disclosure documents to the end investor; and strengthen supervisory cooperation to monitor and reduce risk of cross-border investor abuse.

\textsuperscript{45} Impact Assessment, supra note 43, at 78.

\textsuperscript{46} White Paper, supra note 42, at 15.

\textsuperscript{47} It may be possible that if a fund domiciled in member State A is managed by an entity in member state B, the tax authorities of member state B could consider that all of the fund's activities take place in member state B, and the concern therefore is that the fund could potentially be taxed twice as a result.

\textsuperscript{48} The Internal Market and Services Directorate General (DG MARKT) is one of thirty-seven Directorates General and specialized services which make up the European Commission. Its main role is to coordinate the Commission's policy on the European Single Market, which aims to ensure the free movement of people, goods, services, and capital within the EU. DG MARKT is based in Brussels and has a staff of approximately 500, working under the political authority of Commissioner Charlie McCreevy and managed by Director General Jorgen Holmquist.

consultation with stakeholders as to the form and shape of future possible adjustments to the UCITS Directive, colloquially referred to as UCITS IV initiatives, based on the case made in the White Paper for introducing these changes, and to present draft text amending the Management Company Directive.

D. Scope of MCP – Partial or Full Freedom to Passport?

Regarding the critical question as to the permitted scope of the proposed MCP, the Exposure Draft put forward two options. Option one is to permit a “full” passport. This option would allow a management company authorized in member state A, pursuant to the Management Company Directive, to manage, administer, and market corporate and contractual funds in member state B either through the establishment of a branch or under the freedom to provide services, without restriction on the scope of management company functions permitted by the Management Company Directive. The second option is to allow a partial passport, which would enable a management company of a corporate or contractual fund domiciled in member state B to perform some of its authorized management functions from member state A, where the management company is authorized, with certain core administration services being excluded and reserved to the fund domicile.

On the basis of the arguments and justifications elaborated in the Exposure Draft, DG MARKT concluded that the partial passport would be the preferable solution and would best serve the single market. A very recent publication demonstrates, however, that this determination has certainly not received a consensus of support. On September 7, 2007, DG MARKT published a summary of stakeholder responses to the Exposure Draft. Sixty-three contributions from seventeen different countries were received, as well as submissions from some international organizations. “61 [percent] of responses were received from industry sources, 30 [percent] from national authorities, and 9 [percent] from investors’ associations. Regarding DG MARKT’s recommended proposals, the results of the consultation process revealed significant divergences of opinion not only on the partial nature of the proposed MCP, but also relating to the usefulness of the MCP at all.

E. Stakeholder Response

In terms of arguments in favour of the full passport option described above, DG MARKT received submissions to the effect that management companies should be able to provide a full range of portfolio management and fund administration activities on a cross-

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51. Id. at 3.
54. Id. at 2.
55. Id.
border basis in order to maximize economies of scale, and that requiring the location of certain reserved functions in the fund domicile is not necessary to ensure that the fund complies with the laws of the fund domicile.\textsuperscript{56} On the other hand, concern persisted in other submissions that to allow all management and administration services on a cross-border basis could rob the authority responsible for the fund of the means to monitor and to ensure compliance with the regulatory provisions in force in the fund domiciled,\textsuperscript{57} and that it could also result in unworkable difficulties for the fund depository to ensure that the fund operated in accordance with the rules under which it is constituted. In addition, there were concerns regarding the detection and rectification of material breaches of those rules.\textsuperscript{58}

With respect to cost savings, other contributions asserted that the MCP would only offer limited savings, if any at all, compared to the current possibilities for delegating fund management and other fund services to entities in other EU member states and that the MCP would merely increase legal complexity and supervisory uncertainty without generating any costs, savings, or improvements for fund investors.\textsuperscript{59} A further finding from the survey of responses which is worth noting, is that most regulators who responded to the consultation expressed the concern that the envisaged solutions in the Exposure Draft did not sufficiently address the supervisory challenge that would arise if funds were to be managed and administered on a cross-border basis.

F. Analysis

The ability for fund managers to provide management services on a cross-border basis throughout EU member states is a worthwhile objective in terms of the integration of the European market in financial services. Such harmonization would enable greater efficiency and specialization in portfolio management and fund administration, allowing management groups to benefit from economies of scale and to create greater cost efficiencies. The delicate balance which has generated difficulties to date in terms of legislative initiatives in this area relates to the ability of fund managers to manage funds domiciled in other member states, without generating levels of fiscal or supervisory uncertainty which could undermine regulatory and depositary oversight, or impact upon the tax efficiency of the management company and fund chain. Pitting the full passport against the partial passport option essentially begs the question whether a management company should be permitted to provide the full range of collective portfolio management services on a remote basis and thereby maximize economies of scale and specialization, or alternatively whether some functions should be reserved to the fund domicile and remain non-passportable as a means of providing an increased, but not the optimal level of integration, whilst at the same time endeavouring to reduce the risk of adverse tax implications. In this regard, the core services to be reserved to the fund domicile as envisaged by DG MARKT in its Exposure Draft were performance of activities related to maintenance of shareholder register and verification of fund valuation and pricing reports. As noted by DG MARKT,

\textsuperscript{56} Id. at 12.
\textsuperscript{57} Id.
\textsuperscript{58} With respect to the fund depository, it should be noted that DG MARKT’s proposals envisage that the depository would be domiciled in the member state where the UCITS is domiciled, as is currently the case.
\textsuperscript{59} Summary of Stakeholder Responses, supra note 53, at 12.
however, it would still be the case that these activities could be undertaken in a different member state through the establishment of a local branch (this is the exercise of the freedom of establishment under the MCP) or delegation arrangements.

Concerns regarding split supervision of a fund and its manager between two jurisdictions, and the contingent potential to compromise the effectiveness of risk controls and investor protections, are legitimate. As such, whether the final legislation incorporates a full or partial management passport, it is imperative that there are detailed provisions which enable effective regulatory supervision, including comprehensive guidelines and requirements in terms of supervisory co-operation, in order to ensure effective and seamless oversight of situations where a fund and its manager are located in different member states. The UCITS product itself as an investment vehicle with passporting rights has demonstrated the difficulties inherent in a cross-border legal framework and serves as a reminder that the MCP must meet the objectives of commerciality and workability without detracting from the sound regulatory environment that is associated with the UCITS product. In terms of taxation, in the absence of legislative clarification, the concerns regarding double tax are valid and need to be resolved conclusively. Conflict of laws issues will arise in practice as a result of the MCP and there will be challenges arising from the differences in local fund authorization processes and interpretation of local laws, both of which may have been underplayed in dialogue to date, in terms of a functioning, workable passport.

The Commission Green Paper set in motion a lengthy and extensive process of consultation, with many stages and aspects to it, and it is fair to say that the degree to which opinion is still split on the issue of the MCP belies the commitment of the Commission and stakeholders to achieving an effective solution. It may be said that there are lessons to be learned from the consultation experience, insofar as the stark presentation of two competing options, such as the full versus the partial MCP, may well have contributed to the degree of polarized opinion on this issue.

The Commission's legislative proposal has been scheduled for publication at the end of April 2008 with the intention that the proposal would then be transmitted as the basis for negotiation to the European Parliament and Council of Ministers. Time will tell whether the April deadline will be met. Our view is that finding a compromise between the competing arguments for the full and partial MCP options will be challenging. It will indeed be a case of wait and see.