THE
INVESTMENT
ASSOCIATION
INVESTMENT MATTERS

The Investment Association
Camomile Court, 23 Camomile Street,
London, EC3A 7LL

T +44 20 7831 0898
E enquiries@theia.org
W theinvestmentassociation.org
Twitter @InvAssoc

Via email to:

fisma-cross-borders-investment-funds@ec.europa.eu

Date: 9 October 2016

Dear Mr Gentner and Team,

RE: Your Consultation: on the main barriers to the cross-borders distribution of investment funds across the EU

The Investment Association represents UK investment managers. We have over 200 members who manage more than £5.5 trillion for clients around the world, of which some 20% is for European clients. Our members operate funds across the EU, with the asset management frequently delegated back to the United Kingdom.

The success of the UCITS framework can be seen both from a European cross-border perspective and from an international perspective as a global brand. In our view, this success is based on several components:

1. A well-designed, EU legal framework that has been regularly updated since its inception in 1985 to reflect ongoing market developments and financial innovation.
2. An emphasis on consumer protection with strong oversight responsibilities via the depositary/custodian structure.
3. A fund passport allowing marketing – in principle – across all 27 EU Member States as soon as it has been authorised by the competent supervisory authority in the Member State where the UCITS is domiciled.

As a result of this, the choice of investment funds available to retail and institutional investors in each Member State is large and diverse. However, there are a number of significant practical issues that prevent a more unified market, notably:

- Direct obstacles to distribution, relating to a strong culture of vertical integration in significant parts of the European financial services market.
- Indirect obstacles to cross-border distribution imposed by varying regulatory requirements in individual national jurisdictions, such as costs of registration for cross-border funds or complex templates for registration.
- Notwithstanding the advantages of being able to use multiple share classes to serve the European market, differences in the tax treatment of savings and investments across Europe also means that there are barriers to scale, as illustrated by barriers to fund mergers. In the near term, there may not be a straightforward answer to the question of tax harmonisation, and this may prove to be a problem for initiatives such as the EPP.

Our response highlights that the following areas need to be addressed to improve cross-border distribution of funds:

- Further harmonisation, most notably with respect to: marketing definitions, national regulatory fee structures and tax regimes.
- Host state regulators should not question home state regulators' decisions, or if they do so, they should respond to requests within short and harmonized set time frames.
- Paying agents' / facility agents' requirements in UCITS / AIFMD need to be reviewed. Abolition of the requirements would be our proposed option.
- AML requirements / procedures need to be adapted to changing distribution landscape (increasing level of intermediation / use of FinTech offerings).
- Domestic rules regarding redress differ significantly. A common approach needs to be found to make it easier to access non-domestic markets.

If further harmonisation and regulatory/supervisory integration via for example rule changes or ESMA guidance could not be achieved for investment funds, creating harmonisation across different administrative notification, registration and (tax) reporting systems in the member states would be the single most effective measure to increase cross-border fund distribution. It could be implemented without taking away any of the powers of the NCAs and government / tax authorities or adding to ESMA's / the Commission's powers.

If you have any questions on the content of our submission, please do not hesitate to contact us.

Yours

Florian van Megen

Retail Markets Specialist

ABOUT THE INVESTMENT ASSOCIATION

The Investment Association is the trade body that represents UK investment managers, whose 200 members collectively manage over £5.5 trillion on behalf of clients.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs.

The UK is the second largest investment management centre in the world and manages 37% of European assets.

More information can be viewed on our website.

ANNEX I

CONSULTATION RESPONSE

The Investment Association
Camomile Court, 23 Camomile Street,
London, EC3A 7LL

T +44 20 7831 0898
E enquiries@theia.org
W theinvestmentassociation.org
Twitter @InvAssoc

QUESTION 2.1 – WHAT ARE THE REASONS FOR ANY LIMITATION ON THE CROSS-BORDER DISTRIBUTION OF YOUR FUNDS? [FOR EACH HOST MEMBER STATE - REGULATORY COSTS AND/OR MARKETING REQUIREMENTS COSTS ARE TOO HIGH, LACK OF DEMAND OUTSIDE YOUR HOME MARKET, HOST MARKET SIZE IS TOO SMALL, OPENNESS OF THE DISTRIBUTION NETWORK TO THIRD PARTIES, TAX ISSUES, OTHER]

QUESTION 2.1A – PLEASE EXPAND UPON AND PROVIDE MORE DETAIL ON YOUR RESPONSE – PLEASE EXPLAIN, WHAT THE ISSUES ARE AND HOW THEY LIMIT THE CROSS-BORDER DISTRIBUTION OF FUNDS. PLEASE CITE THE RELEVANT PROVISIONS OF THE LEGISLATION CONCERNED IF POSSIBLE.

We would highlight three key areas:

1. Marketing and distribution.

Harmonisation of marketing rules, registration and paying agents is essential. We provide more detail on marketing rules and registration in answers to subsequent questions. Some countries require paying agents in the Member State, while others do not. The costs of paying agents differ from country to country. Customers may benefit little or not at all from paying agents – they are a legacy of the 1980s and of a past, paper-only distribution landscape. Further standardisation of rules around paying agent fees is necessary. Ideally, the requirement to employ paying agents, whose added benefit to the clients is questionable, should be deleted.

UCITS 4 did a lot for harmonising the different procedures for cross-border distribution, but there are some things that have been left undone. For example, while there is regulator to regulator communication regarding the KIIDs, firms are still required to file prospectuses directly with each regulator. It should be regulator to regulator notification for all regulated documents only.

2. Fees.

Some countries have fees linked to certain conditions that makes it hard to know in advance how much to pay – e.g. for AIFMD passport fees in Spain, the fee paid to the Spanish regulator is linked to the fund's assets under management in the Spanish market. This makes it very hard to predict fees and therefore is a significant barrier to market AIFs in Spain, even under AIFMD.

3. Taxation.

Firms continue to provide investors with certain types of taxation reports according to domestic requirements – these should be standardised across EU countries. If tax rules have to remain domestic, the reporting and claiming process should be harmonised. That would enable firms acting cross-border to streamline their back offices and be more efficient.

QUESTION 3.1A – ARE YOU AWARE OF MEMBER STATE INTERPRETATIONS OF MARKETING THAT YOU CONSIDER TO GO UNREASONABLY BEYOND OF WHAT SHOULD BE CONSIDERED AS MARKETING UNDER THE UCITS DIRECTIVE*?

QUESTION 3.1B – ARE YOU AWARE OF MEMBER STATE INTERPRETATIONS OF MARKETING THAT YOU CONSIDER TO GO UNREASONABLY BEYOND THE DEFINITION OF MARKETING IN AIFMD?

QUESTION 3.1C – ARE YOU AWARE OF ANY OF THE PRACTICES DESCRIBED ABOVE HAVING HAD A MATERIAL IMPACT UPON THE CROSS-BORDER DISTRIBUTION OF INVESTMENT FUNDS?

Differences in country specific marketing requirements make it difficult to produce harmonised marketing materials for use on a pan-European basis. Firms believe that local country marketing requirements should be harmonised - or home regulator's requirements should override host state's requirements.

The origin of the problem lies in the lack of a harmonised marketing definition across UCITS, AIFMD, ELTIF, EUVECA and EUSEF. IA members criticise the lack of such a harmonised definition of marketing and what can be recognised as pre marketing. ESMA guidance could provide a consistent approach to be adopted in all EU Member States.

Some countries have an obligation to lodge marketing material with their local regulators prior to publication. This causes delay and makes pan-European campaigns difficult to coordinate. The IA does not believe that such pre-approval of marketing material makes for efficient cross-border distribution. At least materials aimed at professional clients should not require pre-approval. Alternatively, post event supervision/enforcement processes could be employed as a solution. Some examples of such country-specific requirements:

- France – requirement to submit marketing materials to the regulator for review can significantly delay the fund registration. The process is unduly long with questions being raised in initial and subsequent reviews the relevance of which firms often struggle to understand.
- Belgium – requirement to submit marketing materials to regulator prior to publication. Belgium has very rigid rules around how performance can be shown with an interpretation of MiFID that differs significantly from other European regulators (i.e. 5 years of most recent performance has to be the most recent calendar year instead of rolling 12 month periods to most recent quarter-end). This means producing pan-European marketing for use in Belgium becomes impossible. An index cannot be shown in marketing for performance comparison purposes unless it is shown in the KIID (where it only appears if the fund is deemed to be managed with reference to the index).
- Italy – requirement to submit marketing materials to regulator prior to publication.
- The Netherlands – requirement to have prescribed 'GUISE' risk rating effectively means bespoke marketing materials must be used in Netherlands.

Under UCITS, notifications are communicated regulator to regulator. Ideally, host regulators would not implement additional requirements. However, in France, Italy and Belgium, the regulator does request additional (marketing) material for UCITS when marketed to retail investors. If asset managers passport UCITS into these countries, they have to deal with the host regulator and domestic requirements as well as with their home regulator. Otherwise, until the additional material is approved by host regulators, managers can't market in that jurisdiction with the KIID only.

Such additional regulatory scrutiny of marketing materials leads to great uncertainties, particularly when firms do not have certainty that host NCAs are responding to requests within set and reasonable time periods. For example, regulators could be required to establish systems with a turn-around time of two weeks for simply translated materials that have already been approved by e.g. the home NCA.

Ideally, such approval would be coordinated at a supra-national level (i.e. ESMA). However, an alternative policy could be that the onus to comply with local rules would be put on the locally regulated distributor, who has better knowledge of the market and requirements and generally better access to the local regulator.

Timing:

Following the initial registration of a fund or the launch of a new sub-fund, the period before marketing can commence differs. In some countries (e.g. Austria but also other countries) marketing can commence once the home state regulator has confirmed the successful transition of the notification package to the host regulator. It is recommended to wait 5 days before marketing to allow the host regulator to revert in case of any comments. This shows that a simple and straightforward approach is possible. Therefore, additional lengthy approval procedures should be removed.

The consequences of not having a clear system are:

- Delays in getting attractive investment propositions to market
- Complexities for UCITS Managers managing their marketing activity, and marketing materials, on a pan European basis
- Similar complexities for distributors who operate on cross-border basis
- Inability to run effective cross-border launch campaigns for new funds thereby allowing funds to reach critical scale in terms of assets under management more quickly and therefore to the benefit of investors.

4 COSTS

General comment: The data dive as initiated by this section of the consultation misses the point of the issue firms face. They cannot easily and precisely allocate specific cost to certain aspects and barriers. Distribution costs are unnecessarily high because of the accumulation of barriers in different ways, depending on distribution channel and countries involved. The policy objective has to be to create a functioning single market without barriers and national differences. That cannot be achieved by only addressing the single most burdensome or costly barriers in some places. EU policy has to focus on promoting the common standard and limit national add-ons wherever possible. Costs would not be an issue if the requirements and administrative systems were the same, irrespective of home and host countries of the products.

QUESTION 5.2 – IN YOUR EXPERIENCE, DO ANY MEMBER STATES CHARGE HIGHER REGULATORY FEES TO THE FUNDS DOMICILED IN OTHER EU MEMBERS STATES MARKETED IN THEIR MEMBER STATE COMPARE TO DOMESTIC FUNDS?

QUESTION 5.2*A* – PLEASE EXPLAIN YOUR REPLY AND PROVIDE EVIDENCE.

Registration fees are decided at the discretion of the Member State. Fees can vary significantly across European states. IA members would welcome a harmonised model across the single market, equal treatment for all funds irrespective of domicile or whether passported or not. On the one hand, it has been suggested that these fees are either scrapped because they do not serve any purpose, once the principal of home state authorisation to be sufficient is accepted. On the other hand, they could be decided at a higher political level than individual Member State and be harmonised. This would follow the trend of harmonisation of the UCITS directive provisions across Europe (e.g. the harmonisation of sanctions under UCITS V). The € range of fees is surprisingly high.

A unified approach would stop unwarranted price hikes. For example, after 2008 Greece and Italy doubled their fees from one year to the next, which ultimately got passed onto the investors.

In some countries, fees vary significantly between domestic and foreign domicile funds. In Belgium on-going fees for a domestic fund are €500 but €2000 for an international fund. The Country used to charge an ad valorem fee for foreign funds making imports even less attractive (9.25bps). The reason given was that the Belgian regulator claimed they couldn't check if foreign firms had given them the correct figure for the calculation.

QUESTION 6.1 – WHAT ARE THE MAIN BARRIERS TO CROSS-BORDER MARKETING IN RELATION TO ADMINISTRATIVE ARRANGEMENTS AND OBLIGATIONS IN MEMBER STATES? PLEASE PROVIDE TANGIBLE EXAMPLES OF WHERE YOU CONSIDER THESE TO BE EXCESSIVE.

Chapter XI of the UCITS Directive sets out the process that needs to be followed in order for a UCITS to market its units cross-border. These include the requirement in Article 92 for UCITS to provide facilities in accordance with the laws, regulations and administrative provisions in force in the Member State in which units are to be marketed; for making payments to unit holders, repurchasing or redeeming units; and making available information which UCITS are required to provide to investors. In a number of Member States, including the UK, the requirement for providing facilities has been transposed to require UCITS to have a physical presence in the Member State, either through a branch, another firm in its corporate group or through contracting with an agent (typically referred to as the facilities agent or paying agent).

The facilities agent requirement brings an extra third party into the payment chain. This creates extra costs (which must be indirectly passed to investors) and an additional layer of credit risk (for the fund) when transferring funds to/from investors – especially when a particular country's banking system may be under strain, of which there have been examples lately. Other markets prove that this transfer can operate satisfactorily on a cross-border basis within the EU Single Market without this intermediation and cost. We suggest that developments in digital technology allow the payment through on-line payment facilities without adverse impact on retail investors. Indeed, electronic or on-line payment benefits most retail investors.

The facilities requirements in the UCITS Directive, and the laws and regulations in most Member States requiring the physical presence of a facilities agent, date from the original UCITS Directive in 1985. Since then, significant technological advances have been made. In particular the development of the internet, mobile telephones (including more recently smartphones) and international call centres. These technologies and services delivered via them are now accessible to the wider population. The increased penetration of this technology has rendered the requirement to have a facilities agent in each Member State obsolete. Moreover, the existing situation runs contrary to the general aim of the European Commission to promote digital solutions (see, for example, the recently issued Green Paper on Retail Financial Services).

Article 92 should be revised to ensure that a UCITS can satisfy the requirement to provide facilities in a Member State remotely through a website or telephone service accessible to consumers in that Member State, in their language, conforming to the local laws of the Member State and providing payment facilities compatible with the payment systems of that Member State. However, until the directive can be changed, the IA would welcome engagement by the FCA with other EU regulators to reduce national requirements for the provision of facilities to require a facilities agent with a physical presence in the applicable jurisdiction. Ultimately, it should be a commercial decision if fund manufactures employ facilities agents to deliver additional services to their clients. The current model does not lead to better services since facilities agents have no incentive to add value. They know that the manufacturer has an obligation to have a local paying agent and will have to pay for it regardless of the service provided simply to have market access.

Most countries require the appointment of a local Representative, Information Agent and / or a Paying Agent. The requirements of these roles vary from country to country and are of dubious value to investors – as investors can receive fund documentation via the Manager's website and can transact via local platforms or via a central Transfer Agent.

In Ireland and Denmark the role is a simple Information Agent which needs to be able to make the Fund's constitutive documents available to local investors. in Austria and France the role also has to allow for investors to be able to place deals, handle dividend payments. In France and Spain they also have to act as the 'representative' to the local Regulator, which can only be done by residents. Germany mandates that a Paying Agent is required and that a legally binding contract with a Paying agent is in place before any funds can be registered.

In certain countries, firms experience has been that there are few companies prepared to fulfil this role.

The fees charged by such entities are subject to negotiation between the Fund / Manager and the entity itself. The fees vary significantly partially reflecting differences in the role to be performed, but equally as there is little competition in some markets, it is a 'sellers market'. Fees vary from €5000per annum for an umbrella of 50 funds to €35,000.

Consequences of the administrative requirement for intermediation are delays in obtaining registration due to: sourcing partners, required due diligence, and negotiating contractual agreements and additional cost to the UCITS fund / shareholders. Paying agents bring no benefits to investors. They are better served via online and more professional but economic telephone services.

QUESTION 7.1 – WHAT ARE THE MAIN ISSUES THAT SPECIFICALLY HINDER THE DIRECT DISTRIBUTION OF FUNDS BY ASSET MANAGERS? [REGULATORY REQUIREMENTS – MARKETING REQUIREMENTS, ADMINISTRATIVE ARRANGEMENTS, OTHERS: PLEASE SPECIFY / REGULATORY FEES IMPOSED BY HOST MEMBER STATES / TAX RULES (E.G. WITHHOLDING TAXES) / INCOME REPORTING REQUIREMENTS / LACK OF RESOURCES / OTHERS: PLEASE SPECIFY]

QUESTION 7.1A – PLEASE EXPAND ON YOUR REPLY.

Lack of harmonisation around marketing rules (fear of non-compliance with local requirement), KYC and AML rules, different market- and language requirements, challenges in tailoring online presentations to markets and languages, compliance with all national rules (at once), make it very difficult to build something scalable on a cross-border basis. An integrated market would mean that any retail client could access any manufacturers offering on the same platform (e.g. online) no matter where either party is domiciled.

European regulators (and ESMA specifically) should offer an engagement hub (similar to the FCA sandbox service) that helps providers to develop such offerings. In close cooperation with and support of the regulator, this could give manufacturers certainty and protection when developing the next generation of cross-border fund distribution. It would also help the regulators to get a better view of the complex net of barriers as outlined above.

QUESTION 8.1 – DO YOU HAVE DIFFICULTIES WITH THE UCITS NOTIFICATION PROCESS?

QUESTION 8.2 – IF YES, PLEASE DESCRIBE THOSE DIFFICULTIES.

Once an NCA has authorised a registration, the UCITS host countries have a 30 day grace period in which they can ask questions – this is something which the Commission should reduce or remove completely because if the UCITS home state has granted authorisation this should be sufficient. In a single market we should be able to move from pre-approval systems throughout the EU to a post event supervision/enforcement process as a solution. In such a scenario the Home State NCA authorises UCITS (fees paid to home state only) and informs ESMA (solely where it is a UCITS that intends to market cross-border). ESMA puts the UCITS on central register (including provider contact details), the Man Co tells ESMA where in the EU it intends to market the UCITS (this would delete the requirement to pay the multiple layers of fees to any national regulator where the UCITS should be marketed. The UCITS updates the central register within a few working days (e.g. three) and the Manager can start marketing immediately after EMSA notification. The obligation to inform ESMA register correctly lies with the Man Co. Host State NCAs have the obligation to check the ESMA register to see who is marketing in their jurisdiction and then carry out the usual Home/Host State supervision.

QUESTION 8.4 – DO YOU HAVE DIFFICULTIES WITH THE AIFMD NOTIFICATION PROCESS?

QUESTION 8.4A – IF YES, PLEASE DESCRIBE THESE DIFFICULTIES.

For AIFs with a passport the Swedish, the French and the Germans still comment on details of the prospectus and come up with different requirements even though it's been authorised in the home state. They are therefore overstepping their jurisdiction.

QUESTION 8.6 – WHAT SHOULD BE IMPROVED IN ORDER TO BOOST THE DEVELOPMENT OF CROSS-BORDER DISTRIBUTION OF FUNDS ACROSS THE EU?

Method of notification to existing investors in receiving scheme

UCITS IV was also meant to enable a reduction of the number of sub-optimal and inefficient UCITS throughout the EU. But under the Directive, notice of a prospective merger has to be given in writing to unit holders in the receiving UCITS, regardless of the size of the merging UCITS.

In practice it is very costly to meet these requirements, to the extent that the merger may no longer be cost-effective. There is a real risk that this efficiency could falter at the outset, if it is not recognised that the benefits of a merger could be outweighed by the costs of undertaking the merger in certain circumstances. Indeed, the notification requirements could have the unintended consequence of endangering domestic mergers in the future.

If, for instance, the merging fund has 100 investors and £1m in assets and the receiving fund has 50,000 investors and £10bn, then there will be no material impact on the unit holders in the receiving fund. However, the costs of informing them would be so prohibitive that the merger would not be viable. By way of example, one of our members has told us that it could cost an additional £54,000 - 71,000 (€60,000 - 78,000) to provide information to 10,000 shareholders in a receiving UCITS (i.e. the costs of preparation, printing, posting and additional resource time). Typically, this could increase overall project costs by some 25-50% and would put into question the viability of a merger.

This could result in significant costs across the industry. Taking the UK as an example, according to Investment Association statistics, there were 48 UK domestic mergers during 2009, and the average number of unit holders in a fund was 6,240. Using these figures and scaling up the above example, the incremental costs of having to provide information in a durable medium for that number of mergers (i.e. over and above the other merger costs) would have been in excess of £4 million for

2009, just within the UK. If one extrapolates these figures across the EU, then clearly such a requirement would result in material costs to the industry - and therefore investors - of tens of millions of euros per annum.

The same issue arises in relation to liquidations, mergers or divisions of master-feeders. Given that master-feeder structures were not permitted in some EU jurisdictions prior to 1 July 2011, it is difficult to quantify the incremental costs of this requirement in this context; but it is certainly the case that the flexibility of the master-feeder structure is seen as one of the main ways in which UCITS managers can achieve economies of scale across the Union.

The problem is the method by which this information has to be provided. The CESR consultation paper and technical advice on this topic were silent on this point. In its technical advice to the Commission, CESR concluded that "it does not consider that the benefits of legislation to harmonise the way in which information should be provided in the particular case of a merger, are likely to justify the costs of implementing and maintaining it, and therefore does not intend to provide advice on how this might be done" (page 11, item 20 of CESR's technical advice). The Investment Association agrees with this approach.

Notwithstanding this, when the Commission produced the draft Directive, it introduced the requirement that the information had to be provided on paper or (where certain conditions are met) another durable medium. We do not see why the information requirements here should be provided in a different manner than any other information to the unit holders (invitation to a General Meeting, change in the name of the fund, etc.), for which there is currently no harmonisation at EU level.

We suggest that it should be left to existing national laws of Member States to provide for how documents and other information may be notified to existing investors. A pragmatic solution is to only notify receiving fund shareholders where it is material.

QUESTION 9.1 – HAVE YOU EXPERIENCED ANY DIFFICULTIES WHEREBY TAX RULES ACROSS MEMBER STATES IMPAIR THE CROSS-BORDER DISTRIBUTION AND TAKE-UP OF YOUR UCITS OR AIF OR ELTIF OR EUVECA OR EUSEF?

QUESTION 9.1A – PLEASE DESCRIBE THE DIFFICULTIES, INCLUDING WHETHER THEY RELATE TO DISCRIMINATION AGAINST UCITS OR AIF (INCLUDING ELTIF, EUVECA OR EUSEF) SOLD ON A CROSS-BORDER, AND PROVIDE EXAMPLES. PLEASE CITE THE RELEVANT PROVISIONS OF THE LEGISLATION CONCERNED.

A single reporting standard for tax reporting across member states would be helpful. Requirements vary greatly across different states.

Outstanding tax re-claims: experience shows that double tax treaties cannot be relied on. Often standing claims are not paid out for a very long time. In some cases outstanding tax reclaims do hinder the merging of funds.

Tax Transparency

- Tax transparency is required for Belgium/Italy/Germany/Austria/UK reporting status
- The Tax calculation methodology and reporting requirements differs from country to country. As a result, the fund needs to prepare several sets of data and engage with numerous local tax certifiers which generates additional costs for the Shareholders.

Other examples:

Belgian NAT requires identification of Belgian investors. It can be time consuming to identify them if the orders come from platforms such as Fundsettle. In addition, the tax is paid by the fund which means that any non-Belgian investor bears part of the cost (unless the fund/share class is sold exclusively to Belgian investors).

The cost of preparing and publishing the necessary calculations by third party suppliers and tax advisors varies from country to country, but for instance some firms estimate the total cost is in the region of €250k. This may be borne by shareholders, the Manager or a combination of the two

QUESTION 9.2 – HAVE YOU EXPERIENCED ANY SPECIFIC DIFFICULTIES DUE EITHER TO THE ABSENCE OF DOUBLE TAXATION TREATIES OR TO THE NON-APPLICATION OF TREATIES OR TO TERMS WITHIN THOSE TREATIES WHICH IMPEDE YOUR ABILITY TO MARKET ACROSS BORDERS? FOR EXAMPLE: DIFFICULTIES IN DETERMINING THE NATIONALITY OF YOUR INVESTORS OR DIFFICULTIES IN CLAIMING, OR INABILITY TO CLAIM, DOUBLE TAX RELIEF ON BEHALF OF YOUR INVESTORS.

QUESTION 9.2A – PLEASE, DESCRIBE THOSE DIFFICULTIES, AND IF APPLICABLE, HOW THESE CAN BEST BE RESOLVED – FOR EXAMPLE THROUGH AMENDMENTS TO DOUBLE TAXATION TREATIES. PLEASE SHARE ANY EXAMPLES OF BEST PRACTICE THAT COULD HELP TO ADDRESS THESE ISSUES.

Legal status of intra-EU withholding tax

In recent years, the Court of Justice of the European Union has found consistently that it breaches EU Treaty principles of discrimination and free movement of capital if one Member State levies withholding tax on dividend payments to a recipient in another Member State, where no dividend withholding tax is levied domestically. However, most Member States have not introduced domestic legislation compatible with the findings of these cases and continue to levy withholding tax on dividends paid to investors in other Member States.

In plain terms, the application of withholdings where there is no basis to do so impairs the operation of the Single Market and we believe there are grounds for the intervention by the EU to address inconsistent application of EU law related to levying withholding taxes.

QUESTION 9.3 – FEEDBACK TO EARLIER CONSULTATIONS HAS SUGGESTED THAT THE LEVYING OF WITHHOLDING TAXES BY MEMBER STATES HAS IMPEDED THE CROSS-BORDER DISTRIBUTION OF UCITS OR AIFS (INCLUDING ELTIF, EUVECA AND EUSEF). WITHHOLDING TAXES ARE USUALLY REDUCED OR EVEN ELIMINATED UNDER DOUBLE TAXATION TREATIES. BUT IN PRACTICE IT HAS BEEN CLAIMED THAT IT IS DIFFICULT FOR NON-RESIDENT INVESTORS TO COLLECT ANY SUCH WITHHOLDING TAX REDUCTIONS OR EXEMPTIONS DUE UNDER DOUBLE TAXATION TREATIES. HAVE YOU EXPERIENCED SUCH DIFFICULTIES?

Unless and until all Member States abolish dividend withholding tax on payments within the EU (which we would support), it is important that investors should be able to obtain bilateral treaty benefits. Claiming withholding tax relief under Double Taxation Agreements and/or a country's domestic tax laws is often cumbersome and time- and resource-intensive for governments, financial institutions and investors. As a result, end-investors often are effectively forced to forgo the tax relief due them and this has adverse effects on capital markets.

In our experience, the process for claiming withholding tax relief across the EU has deteriorated over recent years, resulting in increased costs and protracted delays for cross-border portfolio investors to collect the tax relief due them. Without a harmonised and streamlined system for tax relief at source (such as that envisaged under the OECD's TRACE proposals), investors and intermediaries will continue to face the increasingly costly administrative burdens of varying domestic procedures; tax will often not only be inappropriately withheld but withheld in amounts exceeding the rate that would ever be applicable.

The end result is that cross-border investment will be less attractive. Members States that continue to operate tax-reclaim systems will also continue to bear the costs associated with such a system, such as the stamping and certification of tax-reclaim forms and the processing of refund payments.

QUESTION 9.3A – PLEASE PROVIDE EXAMPLES OF THE DIFFICULTIES WITH CLAIMING WITHHOLDING TAX RELIEF SUGGEST POSSIBLE IMPROVEMENTS AND PROVIDE INFORMATION ON ANY BEST PRACTICES EXISTING IN ANY MEMBER STATES. PLEASE CITE THE RELEVANT PROVISIONS OF THE LEGISLATION CONCERNED.

There are currently a number of Member States that operate regimes that are designed to prevent investors from being able to accumulate income in offshore funds. The multiplicity of reporting regimes is complex and costly to operate for funds that are distributed internationally.

We would welcome an approach that could serve to harmonise all such reporting regimes. Harmonisation would be of great benefit to the funds industry and would serve to protect and promote the Single Market for funds.

QUESTION 10.1 – ARE THERE ANY OTHER COMMENTS OR OTHER EVIDENCE YOU WISH TO PROVIDE WHICH YOU CONSIDER WOULD BE HELPFUL IN INFORMING WORK TO ELIMINATE BARRIERS TO THE CROSS-BORDER DISTRIBUTION OF UCITS OR AIFS (INCLUDING ELTIF, EUVECA AND EUSEF)?

Master Feeder Structures

Currently feeder funds are not eligible investments for UCITS. This has limited the uptake of feeder funds, which master-feeder arrangements should allow the following benefits to be realised:

- Economies of scale
- Reduction of charges or better performance for the investor as a result of scale savings
- Centralisation of core management in a single high performing team
- Allowing a financial group to commingle similar funds for different types of investors
- Local presence of the feeder providing advantages in terms of servicing client needs, and greater tax-efficiency for the end investor
- Two merging financial groups may pool similar funds of both groups in one master fund (and thereby reduce management costs) while preserving different fund labels
- Complementary economies of scale alternative to fund mergers

Unfortunately the development of master-feeders in Europe has been seriously hampered by a provision elsewhere in the UCITS Directive (the "10% rule"), which was not amended when the master-feeder provisions were added to the Directive. There was no intention to restrict the development of feeders in this way. If this issue is not addressed, the Commission's goal in proposing master-feeder arrangements will not be met as the benefits outlined above will not be realised.

The whole thrust of introducing master-feeder arrangements was to address the proliferation of small funds and to enable pooling, with the economies of scale that arise therefrom. Managers seek to provide funds that will appeal to a wide range of investors, including those making decisions on behalf of CIS, as this enables funds to achieve significant scale, with the benefits that that brings. This is one of the reasons, for example, why managers of non-UCITS retail funds often choose to restrict the funds' investment powers so that UCITS may invest in them.

Also, managers are unlikely to consider pooling using master-feeder arrangements as it would make their range un-saleable in the discretionary wealth management market place. Wealth managers operate a range of investment mandates and will not want to use two separate funds for their asset allocations.

In addition, a number of scaled European and global intermediaries, who have broad discretionary and advisory businesses, make use of substantially similar buy lists. So, if the discretionary team cannot use a manager's fund, the manager will not get it onto the single buy list.

Furthermore, even if a manager wishes to convert an existing fund into a feeder, investors that are UCITS are not likely to approve such a change, as they could not continue to maintain their investment in the fund. Conversions may therefore be impossible.

Fund Mergers/Closures

There are key barriers to the merger and closure of funds:

- UCITS cross-border merger requirements, in particular the requirement to issue a notice in a durable medium to investors in the continuing fund
- Taxation – realisation of assets from a fund closure is likely to be a taxable event for many investors

Application process

a) UCITS Cross-border Merger requirements:

The problem is the method by which the information regarding a prospective merger has to be provided. The CESR consultation paper and technical advice on this topic were silent on this point. In its technical advice to the Commission, CESR concluded that "it does not consider that the benefits of legislation to harmonise the way in which information should be provided in the particular case of a merger, are likely to justify the costs of implementing and maintaining it, and therefore does not intend to provide advice on how this might be done" (page 11, item 20 of CESR's technical advice). The Investment Association agrees with this approach.

Notwithstanding this, when the Commission produced the draft Directive, it introduced the requirement that the information had to be provided on paper or (where certain conditions are met) another durable medium. We do not see why the information requirements here should be provided in a different manner than any other information to the unit holders (invitation to a General Meeting, change in the name of the fund, etc.), for which there is currently no harmonisation at EU level.

We suggest that it should be left to existing national laws of Member States to provide for how documents and other information may be notified to existing investors.

b) Taxation of investors

Both cross-border and domestic merger events are still treated as taxable in many jurisdictions. While tax relief is potentially available to UK investors in the event of a merger or reorganisation, this may not apply to all investors, in particular overseas investors in the merging fund who may be subject to different tax regimes.

At present, managers who wish to merge or reorganise funds (both domestically or cross-border between EU Member States) are faced with a complex range of differing tax consequences. A merger or reorganisation of funds within the EU is more likely than not to result in a tax event, and this is most prevalent at the investor level. A manager may decide to merge if he is seeking greater efficiencies and cost savings, but if that merger will trigger a tax event, it is less likely to happen.

Most Member States impose a tax charge on at least one of the merger types but there are exceptions, most notably in the United Kingdom and France. Tax legislation in the UK provides for a capital gains tax rollover relief for funds where a merger occurs or where there is a reorganisation of the share capital in the fund, provided certain conditions are met. The result is that the 'new' assets are deemed to have been acquired at the same date and the same cost of the 'old' assets, and does not trigger a taxable event for the investor. This applies to domestic, foreign and cross-border mergers – in effect, tax neutrality is achieved.

At the other end of the spectrum, at least two Member States consider all kind of mergers and reorganisations (domestic, foreign and cross-border) as a taxable exchange of units, or as a sale of units followed by an acquisition of new units. Other Member States provide for tax neutral domestic reorganisations, but impose a tax charge on foreign or cross-border mergers. Some Member States simply lack the certainty in domestic law to be able to exclude the possibility of taxation.

c) Application process

There are inefficiencies in the process for applying for a merger and/or a termination/wind-up, which increase the cost and time taken to merge and/or terminate/wind-up a fund:

- Mergers – an application to the FCA is required for a merger. Once the merger is complete, the merging fund will need to be terminated or wound up. A separate application to the FCA is required for this process, despite this being the logical outcome of a merger. The requirement for an additional application, accompanied by a solvency statement, adds an additional timescale of around two months after the scheme of arrangement has taken place before the termination or wind-up of the scheme can commence. This also results in the manager of the fund incurring additional costs (the costs of a merger and subsequent termination will vary significantly depending on its complexity, but we estimate that having to prepare a separate application for termination increases legal and audit fees by around 20-30%). It would be more efficient and cost effective if both the application for the merger (by way of a scheme of arrangement) and the subsequent termination could be completed on the same application for approval. A separate application to receive the assets also has to be made by the receiving fund if it is an OEIC, again it would be more efficient if this could be covered on the same application for approval.

- Wind-up of an umbrella with more than one sub-fund – the manager is required to wind up an umbrella if all sub-funds in the umbrella have been terminated. However, if an umbrella has more than one sub-fund, and all sub-funds are being terminated, an application must first be made to terminate each sub-fund, then a separate application be made to wind up the umbrella. This adds additional costs and inefficiencies to the process for terminating and winding up the sub-funds and the umbrella – not only are two separate applications required (incurring legal costs for each wind-up), each must be accompanied by an audited solvency statement and separate termination and wind-up accounts completed. (The costs of winding up umbrellas with more than one sub-fund will vary significantly depending on the complexities involved, but we estimate that having to prepare a separate application for winding up the umbrella will increase legal, audit and administration fees by around 20-30%). In such cases, if a single application could be made to wind-up both the sub-funds and the umbrella, this would reduce the legal and audit fees required to wind up the sub-funds and the umbrella.