

# MiFID IM News

A Pan-European Newsletter

November 2007

**This is the first edition of our new MiFID IM Newsflash. Over the coming months, we will be regularly tracking the implementation status and impact of MiFID, both within and outside the EU, with a focus on the UCITS world, keeping you abreast of MiFID developments as they occur.**

## MiFID implementation status

First, a brief update on the implementation of MiFID. Poland will not satisfy the 1 November 2007 deadline for the implementation of MiFID into its national laws. Spain will have implemented the Level I Directive by end of the year but will implement the Level II Directive at a later stage.

All in all, the deadline will have been respected by most member States. Norway, Lichtenstein and Iceland, all members of EEA, have also indicated that they will adapt their legislation for the MiFID November deadline.

## MiFID and UCITS interactions – the manager exemption

We all know that according to Article 2.1(h) of the level 1 directive, MiFID is not applicable to investment funds, their managers and depositaries. Management companies (“ManCos”) are officially only caught if they provide the additional (MiFID) services as foreseen by Article 5(3) of the UCITS directive. ManCos limiting themselves to collective portfolio management (“CPM”) are off the hook.

MiFID uses the term “*manager*”. Thus, an important question is whether can we go as far as exempting from MiFID’s requirement in relation to a fund or to its ManCo, the asset manager to whom management of the fund has been delegated. This question is not straight forward as the preliminary positions of some EU countries surveyed show divergence.

Indeed, some countries make a distinction depending on whether the “delegated” asset manager is itself a UCITS management company or is a MiFID firm. If treated as the former, the relationship would be treated as a UCITS one in Belgium, Netherlands and Luxembourg. If the latter, the answer changes for Belgium and Netherlands. Germany, in the wake of the Phoenix case, has decided contrary to its first intention, to apply MiFID each time there is a portfolio management service given to third-party funds (i.e. by delegation), regardless of the delegate’s regulatory status. The same is true for Austria.

The EU Commission has set up on its internet site a Q&A facility, destined to provide some guidance to the industry around these thorny issues. In its response, the Commission has taken the view that the “manager’s exemption” concerns the fund operator only (i.e. the designated management company) and not the delegated asset manager rendering portfolio management service to the fund operator, regardless of its regulatory status. As a consequence, the asset manager will owe the fund (or its designated ManCo) all relevant MiFID obligations, including best execution. Indeed, in line with Article 24 of MiFID, the Commission has clarified that although a fund can be an eligible counterparty, this status will not apply when portfolio management or investment advice services are being rendered to it.

Germany, who is proving to be quite imaginative in its interpretation of MiFID, has already indicated that it would not follow this approach and will treat the fund as an eligible counterparty!

Another consequence of the Commission’s interpretation on the exemption is that the delegation of asset management to another UCITS management company is only possible if the latter is authorized to perform individual portfolio management service in accordance with Article 5(3) of the amended UCITS Directive. France, for example, does not follow this interpretation: delegation of asset management always falls under CPM – hence no need for an extended license.

## What about marketing?

Although an infrequent situation in most European countries, investors sometimes turns to a UCITS Management Company, directly to its head office or elsewhere in Europe if it has set up a branch office, to subscribe for fund shares directly. Although in this example of fund distribution the ManCo finds itself in a client-facing position, it would not need to apply any of the MiFID rules that another distributor would have to apply towards its clients subscribing for shares in the same fund – a rather odd result.

The explanation behind this difference in treatment stems from the different regimes applicable to the relationship. UCITS on the one hand (“marketing” of funds is one of the components of

CPM), and MiFID on the other. The Commission, in the above mentioned Q&A, clearly states also that the issuance of units by a ManCo or its TA following a subscription request is a “pure administrative task”, not an investment service. Excluding obviously the case of individual advice prior to the purchase of fund shares, such transactions, both resulting in the same outcome, (an investor purchases funds shares), will result in different levels of protection for the same investor.

This difference has seemed quite illogical to some, so much so that certain countries have wondered whether “marketing” as understood by UCITS really covers “selling”. Should one not limit it to activities such as road shows, seminars or other means to make the product known to the investor, without going the extra-step of permitting direct subscription?

The Commission has made a first attempt at clarifying the term “marketing” in its Exposure Draft of March 2007, in the context of its thoughts on the management company passport. It states that “*Marketing, for the purpose of this Annex [II], shall mean offering for sale, selling and/or delivering units in funds managed by the ManCo to investors or potential investors*”.

Unless the Commission, in its much expected Vademecum on the interactions between UCITS and MiFID, reverses this definition, this does confirm that UCITS ManCos can sell their products, even cross-border, without having to consider MiFID rules – unless obviously the host state imposes them! France and the UK are already extending some of MiFID’s conduct of business rules to their UCITS ManCos, so it would be no big surprise if they were to impose them to branches of foreign ManCos as well!

## And third-party funds?

Can a ManCo also sell third party funds? This is an interesting question. Most people thought that after CESR’s 2005 guidelines on transitory provisions for UCITS, the marketing of third-party funds by a ManCo is a given fact. For example, Luxembourg, Austria, and Germany all consider that the sale of third party funds also falls under CPM. This is so even if the actual service rendered (receiving subscription orders and transmitting them to the third party fund or its ManCo for execution) is clearly a MiFID service.

Which raises additional questions: for example, does that service really fit in the (very limited) scope of activity of a UCITS ManCo? According to the Commission’s Exposure draft mentioned above, selling third party funds does not fall under CPM. If not, then what is it? It is not DPM, not advice, certainly not administration of fund shares. Should a ManCo still be allowed to market third party funds? We heard that Belgium has recently decided to forbid it, based on the recent change of mindset of the Commission!

With many ManCos having passported their services abroad to sell their own managed funds, and also those of their group, this may become another hot and interesting issue to follow over the next few months!

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