



Commission of the European Communities  
Brussels  
[markt-consult-july-2006expertgroups@ec.europa.eu](mailto:markt-consult-july-2006expertgroups@ec.europa.eu)

London, 20 September 2006

Dear Sirs,

**Re: Report of the Expert Group on Investment Fund Market Efficiency**

Citigroup legal vehicles currently act as depositary bank or trustee (“fiduciary”) for undertakings for collective investment (UCITS and non-UCITS) in the United Kingdom, Germany, Luxembourg and Ireland, and are responsible for the oversight of 53 investment funds (834 sub-funds) for an overall asset size of approximately 180 billion Euros.

Citigroup’s EMEA Fiduciary Services (“EFS” within the Global Transaction Services organisation) is the business unit responsible for managing depositary/trustee services provided by Citigroup to undertakings for collective investment in the EMEA (Europe, Middle East and Africa) region.

**Executive summary**

Citigroup EFS agrees with the suggestions put forward by the expert group, as they will improve the current UCITS framework and facilitate the further development of the European investment fund market, for the benefit of the investor. We are of the opinion that most of the issues identified are either caused by inconsistent interpretation and application of the UCITS directive or by tax barriers, rather than by any inadequacies in the UCITS framework per se.

At the same time, we believe that should the decision be taken to introduce amendments to the UCITS directive, it would be preferable to address all outstanding issues now in order to avoid further amendments being needed in the medium term. We refer in particular to the proposed revision of the role of the depositary and harmonising its duties and responsibilities.

Finally, considering that amending the UCITS directive is an exercise requiring serious political, financial and technical effort, any revision of the existing framework should also focus on more fundamental amendments, apart from those correctly identified by the expert group. We add our suggestions.

**Detailed comments**

### *Section I – getting products to the market more quickly*

EFS agrees with the suggestions proposed by the expert group. However it is our opinion that reducing the notification time to a maximum of 20 days does not necessarily allow the home state regulator to exercise satisfactory due diligence, even if we share the expert group's opinion that a clear timeframe should be defined.

We would rather suggest that the notification process, which does not have a real *raison d'être* in a harmonised framework, should be eliminated or reduced to a pro-forma process with no impact in terms of time to market.

### *Section II – facilitating UCITS mergers*

We agree in line of principle with the suggestions of the expert group, with two caveats:

- We agree that investors should receive, prior to a merge, information comparing charges between the merging and receiving funds. However, we also believe that the result of the merge should result in best treatment being applied to all merging funds – ie the merge should never result in an increase in charges, fees or other expenses for any of the shareholders/unitholders. This principle should apply also to all those fees, that are not included in the calculation of the Total Expense Ratio (TER).
- We believe that the creation of a “Taxation of Fund Mergers Directive” would provide for a significant step forward in facilitating fund mergers, however it would eliminate distortions only for those UCITS invested only in EU securities markets. We query whether this should be coupled with the negotiation of double tax treaties between the EU, on behalf of all Member States, and non-EU countries.

### *Section III – allowing pooling techniques*

We agree with the Expert Group's view that barriers to pooling techniques should be addressed. However, we also consider that legal pooling techniques (as opposed to “virtual pooling” techniques, which relate to effective portfolio management) are required only if the regulatory and fiscal regime is inadequate; in a fully functioning, ideal European market, pooling techniques should not be required because of the absence of tax barriers and because of the industry's consolidation (in terms of both asset managers and other service providers).

### *Section IV – making the management company passport work*

We agree with the suggestions put forward by the Expert Group. We would also argue that regulatory concerns relating to dual supervision (the UCITS being regulated by the home state, the management company being regulated by another member state) can be readily addressed. We would recommend increasing the scope of the oversight role of the depositary and the responsibilities and independence of UCITS' directors, in particular for those UCITS established in corporate form.

#### *Section IV – more freedoms for the depositary*

While we agree in general with the suggestions of the Expert Group, we question the rationale for introducing discrimination between short-term and long-term measures/actions. Any major inefficiency in the UCITS framework should be addressed as a matter of priority.

#### **Additional Suggestions**

The Expert Group has correctly identified what we would consider the “macro inefficiencies” of the current UCITS framework. Addressing these inefficiencies would certainly improve the situation considerably. However, all the minor inefficiencies or uncertainties appear to be left to persist. If they are not addressed as part of this consultation process, which has been unique in the twenty years’ history of the UCITS framework, when will they be? One could argue that CESR will be driving this process, however CESR’s approach until now has always been to clarify the existing UCITS regime on a voluntary basis, as the non-Lamfalussy nature of the directive does not allow for Level 4 enforcement. As one of the few pan-European providers of Depositary and Trustee services, Citigroup’s opinion is that much greater convergence is needed, not only for the purpose of improving markets’ efficiency, but also for ensuring the fair and equitable treatment of European investors, on issues such as:

- Definition of sophisticated/non sophisticated UCITS: the EC Recommendation 2004/383/EC has introduced a distinction within the UCITS framework, but has not provided the tools or guidelines to ensure this distinction is consistently applied and enforced. There is the risk that two UCITS with virtually the same characteristics apply different degrees of due diligence in respect of the risk management process, eventually introducing potential for a disparity of investor treatment.
- Independent boards/directors and corporate governance: UCITS’ corporate governance standards do not readily ensure adequate protection for investors, most of all for those UCITS established in contractual form.
- Errors and compensations, and their transparency: rules relating to Net Asset Value calculation errors, investment and borrowing breaches and de minimis payments are not consistent. Similarly to that described in terms of sophisticated/non sophisticated UCITS, investors’ treatment is not consistent across all jurisdictions.
- Best execution by service providers: we believe that consideration should be given to implementing best execution rules on services provided to UCITS (including, but not limited to, asset management, depositary, fund administration, custody and transfer agency services). This would improve competition and probably encourage consolidation within the industry, most importantly if suggested improvements to passporting rules are implemented.

- Anti money-laundering rules for UCITS: until now, the investment fund industry has been forced to operate within the constraints of legislation that is designed for retail banking. A dedicated framework should be implemented to cope with the specific characteristics of this investment product.

## **Conclusion**

Citigroup EFS stated on occasion of the consultation on the European Commission's Green Paper in November 2005, that there is great need for an increased harmonisation of the fiscal, corporate governance and financial services regulatory framework (including a consistent application of the principle of freedom of provision of services).

Citigroup EFS substantially agrees with the results of the expert group's work and the contents of the report, but would have welcomed a more innovative approach if the expert group's proposals implementation will require amendments to the UCITS directive (and so, a UCITS IV directive of some sort).

If you wish to discuss any of the points raised in our response please do not hesitate to contact me.

Yours faithfully,

Sean Quinn  
European Fiduciary Manager  
Citigroup EMEA Fiduciary Services  
Tel.: +44 (0) 207 500 5619  
E-mail: sean.quinn@citigroup.com