



The European Commission
DG Internal Market

DIRECTOR GENERAL

10 November 2005

Danish comments to the Green Paper on the enhancement of the EU Framework for Investment Funds

Denmark supports the efforts of the European Commission to assess the need for common regulatory initiatives in order to support the fund-industry on a pan-European basis.

Denmark appreciates the Commissions intentions to look at possible future developments that would need to be addressed. Such reflections should include structural actions in order to ensure that the European investment fund industry is supported by an adequate regulation which secures the quality of the UCITS products. At the same time the European investors must enjoy a high level of protection in order to keep the investors confidence.

Denmark agrees that there is at present too little evidence to warrant a major legislative change of the UCITS-directive and that the focus should be on exhausting the possibilities offered by the current legislative framework. Denmark therefore supports the Commission's initiative to identify initiatives to facilitate the successful development of the fund industry while maintaining a high level of investor protection.

The main priority should be given to initiatives to bring such divergences between the original UCITS Directive and the amendments from February 2004 to an end. In the long run we support the change of the directive to a Lamfalussy directive.

Denmark supports the application of a very open and transparent policy making process as proposed by the Commission. We find that it is important that the Commission always tries to avoid unnecessary administrative burdens and that there is a need for thorough and comprehensive impact assessments made at an early stage before a proposal is put forward. In that context it should be analysed if there is a need for an EU-initiative in a certain field in order to avoid over-regulation. It is important to leave room for competition and innovation.

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**MINISTRY OF ECONOMIC
AND BUSINESS AFFAIRS**

In order to prepare the Danish comments Finanstilsynet – The Danish Financial Supervisory Authority - has consulted industry and users about the Green Paper. This letter therefore to a large degree also reflects the positions of the industry and the users. However, the consultation does not exclude individual comments from industry or users to the European Commission.

For detailed comments and answers to the questions posed in the Green Paper, please, see the enclosed annex.

Yours sincerely



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Annex – detailed comments from Denmark

Initiatives under the existing legislative framework

1. Priority actions

In the green paper the European Commission points out that in 2002 the original UCITS Directive was amended in several key respects. Since the entry into force of the amendments in February 2004 divergences have emerged between Member States in how some of the amending provisions should be interpreted and implemented.

Priority should be given to initiatives to bring such divergences to an end in order to create a level playing field.

In this respect, the European Commission points out the important contribution that is being made by the CESR Investment Management Expert Group to find pragmatic solutions to implementation problems.

The focus of CESR's future work will be to:

- Eliminate the uncertainty surrounding the recognition of funds launched during the transition from UCITS I to UCITS III.
- Simplify the notification procedure for pass porting funds.
- Promote implementation of Commission's Recommendations on the use of derivatives and the simplified prospectus.
- Clarify the definition of "assets" which can be acquired by UCITS.

Q1: Will the above initiatives bring sufficient legal certainty to the implementation of the Directive

Answer:

The best way to promote the internal market is probably to secure a coherent implementation of the amendments to the directives. Denmark therefore supports that priority is given to initiatives within the existing regulatory framework aimed to bring such divergences in connection with implementation of the directive and the subsequent amendments to an end. If implementation subsequently is not consistent throughout EU we think that the Commission should take action.

Denmark fully supports the initiatives mentioned above and Denmark recognises the importance of CESR's contribution to this work.

Q2: Are there additional concerns relating to day-to-day implementation of the Directive which need to be tackled as a priority?

Answer:

No.

2. The management company passport

The Commission asks if a possibility for fund managers to establish and operate UCITS domiciled in other Member States will result in significant additional commercial possibilities for the industry

Q3: Would an effective management company passport deliver significant additional economic advantages as opposed to delegation arrangements? Please indicate sources and likely scale of expected benefit.

Q4: Would the splitting of responsibility for the supervision of the management company and the fund across jurisdictions give rise to additional operational risks or supervisory concerns? Please describe sources of problems and steps that would have to be taken in order to manage such risks effectively.

Answer:

Denmark contests the interpretation that there are provisions in the Directive that include the right for fund managers to establish and operate UCITS domiciled in other Member States under the management company passport.

If such a right should be established provisions are needed to determine the competence of the jurisdictions involved in such a construction. Provisions to ensure adequate risk control and investor protection are also essential.

Furthermore Denmark is not convinced that a right for fund managers to establish and operate UCITS domiciled in other Member States would result in any significant additional economic advantages for the fund industry or the investors.

An extension of the management passport to consist of a right for fund managers to establish and operate UCITS domiciled in other Member States would be very problematic. The supervision of the fund and the management company and possibly the depositary would be split between the competent authorities in two or more Member States. This

will jeopardise the investor protection and the effectiveness of risk controls. Consequently the quality of the UCITS-product must be ensured by EU-regulation before such activity is allowed.

3. Distribution, sales and promotion of funds

The Commission states that the way in which UCITS are offered, sold or promoted to individual investors is in need of clarification.

In a first stage, the Commission will reflect on the boundary between marketing of UCITS and sales/advisory services provided to fund investors. In a second stage, a 'gap analysis' will examine whether level 2 legislation implementing the conduct of business principles and other relevant provisions of MiFID represent a sufficient and effective basis governing intermediation activities in respect of investment funds. This, however, will have to wait until these level 2 rules are finalised.

Q5: Will greater transparency, comparability and attention to investor needs in fund distribution materially enhance the functioning of European investment fund markets and the level of investor protection? Should this be a priority?

Q6: Will clarification of 'conduct of business' rules applying to firms which distribute retail funds to investors contribute significantly to this objective? Should other steps (enhanced disclosure) be considered?

Q7: Are there particular fund-specific issues that are not covered by ongoing work on detailed implementation of MiFID conduct of business rules?

Answer:

Denmark agrees that competition and transparency in fund distribution are very important issues. Denmark would welcome and support initiatives to increase the competition and transparency in fund distribution. However Denmark will also point out that the benefit of such initiatives must be carefully balanced with the negative effect they may have on the fund industry. The reason is that investment funds are competing with many other savings products with far less requirements regarding regulation, supervision and disclosure. It is important to ensure a level playing field at the point of sale.

Initiatives beyond the existing legislative framework

The Commission points out that the European fund business is undergoing profound structural changes. It is therefore of great importance that Europe ensures that the UCITS framework is a viable basis for the successful development of the European fund industry over the longer-term while at the same time assuring a high level of investor protection.

The Commission envisages a European legislative framework that supports exploitation of cost-efficiencies and synergies on a cross-border basis; sustains investor confidence; avoids unnecessary distortion of the competition between substitute investment products and encourages healthy development of onshore alternative investments.

The Commission is convinced that, further progress towards these objectives cannot be delivered within the existing framework. It will require, in some cases, potentially far-reaching adjustments or extensions to existing UCITS legislation. The UCITS review is therefore an opportunity to begin reflections on whether and how some of these broader issues will need to be accommodated by the EU legislative framework in a longer-term.

4. Towards a cost-efficient industry

The Commission states that the existence of too many small funds impedes the EU industry from fully benefiting from economies of scale. The fund industry must be rationalised and the costs reduced. These goals may be achieved by various initiatives. The Commission points at initiatives such as cross-border fund mergers, fund pooling, the creation of possibility for the management company and the depositary to be located in different Member States and improvements in the European infrastructure for processing subscription/redemption of fund units.

Q8: Is there a commercial or economic logic (net benefits) for cross-border fund mergers?
Could those benefits be largely achieved by rationalisation within national borders?

Answer:

Denmark fully supports the analysis of the Commission in the field of cross-border mergers. However, Denmark finds that the obstacles to cross-border of UCITS mergers by far outweigh the economic benefits. To pave the way for cross-border fund mergers an extensive revision of the UCITS Directive will be necessary in order to create rules that supports the existence of a fund in more than one jurisdiction. A precondition to facilitate cross-border fund mergers could be to split the authorisation and supervision of the fund, its management company and

depository between two or more jurisdictions. This will compromise the effectiveness of supervision and investor protection. Furthermore difficulties caused by differences in national corporate laws and tax regimes will have to be solved. Finally it could be difficult to make sure that the investors enjoy the same level of protection in order to keep the investors confidence.

Denmark is of the opinion that most of the benefits to the funds that should come through cross-border mergers can be realised through facilitating the cross-border marketing of units of funds. This is a better route to growth and achieving economies of scale.

Q9: Could the desired benefits be achieved through pooling?

Answer:

Pooling is not a technique known under Danish law however; Denmark is prepared to participate in a closer analysis of the possible benefits of pooling and the obstacles in national laws.

Q10: Is competition at the level of fund management and/or distribution sufficient to ensure that investors will benefit from greater efficiency?

Answer:

No, the competition is not efficient enough. As an example it is quite common that there are very close ties between the fund and its management company, its depository, its distributor and the fund's broker. These often belong to the same group of companies. These relations impede the fund's ability to choose the best and cost-efficient offers of services.

Q11: Which are the advantages and disadvantages (supervisory or commercial risk) stemming from the possibility to choose a depository in another Member State? To what extent does delegation or other arrangements obviate the need for legislative action on these issues?

Answer:

The problem with introducing passports for depositaries is that harmonization has not reached a satisfactory level in the following areas:

- definitions of responsibilities/standards/core functions
- rules regarding who can be chosen as the depository

However the biggest problem is that investor protection can not be kept sufficiently high. Please see the answer to Q 4.

The initiative is not given high priority since the most important economies of scale probably lie with functions that can already be delegated under the current framework.

Q12: Do you think that on-going industry-driven standardisation will deliver fruit within reasonable time-frames? Is there any need for public sector involvement?

Answer:

Denmark supports industry-driven standardisation as an important contributor to rationalise the fund industry and to reduce costs. Denmark agrees with the Commission that the industry should continue to take the lead in this respect and that EU policy-makers should only become involved in the event of manifest 'co-ordination' problems or insurmountable regulatory or policy barriers.

5. Maintaining high levels of investor protection

The Commission states that the revised investor protection safeguards provided by UCITS III should be given time to prove themselves.

However, the Commission feels that, with its reliance on formal investment limits in the UCITS-Directive the funds may not be able to keep pace in the longer term with financial innovation and more complex distribution systems. Given the stated ambition of the industry to become the investment vehicle of choice for the retail investor, the Commission will work continuously to reinforce investor protection safeguards.

Q13: Does heavy reliance on formal investment limits represent a sustainable approach to delivering high levels of investor protection?

Q14: Do you think that safeguards – at the level of the Management Company and depositary - are sufficiently robust to address emerging risks in UCITS management and administration? What other measures for maintaining a high level of investor protection would you consider appropriate?

Answer:

Denmark fully agrees with the Commission that the revised investor protection safeguards provided by UCITS III should be given time to prove themselves.

Denmark puts a very high emphasis on investor protection. Denmark therefore also supports the Commission's efforts to assess the investor protection on a continuous basis and to reinforce investor protection

safeguards if needed. Denmark agrees in principle that with the heavy reliance on formal investment limits in the Directive the funds may not be able to keep pace with financial innovation in the future, and we are prepared to discuss other approaches that can ensure the same level of investor protection.

6. Competition from substitute products

The Commission points out that UCITS compete with many other products for the private savings of European investors. Products, such as unit-linked life insurance or certain structured products, replicate some UCITS features. They are, however, subject to different regulatory or tax treatment and are sold through different sales processes. In some Member States such competing products enjoy wide acceptance. The Commission is concerned that this different regulatory treatment may distort investment decisions. It believes that it would be a retrograde step for investors if UCITS disclosures were scaled back as a result of regulatory competition.

Q15: Are there instances resulting in a distortion of investor's choice that call for particular attention from European and/or national policy-makers?

Answer:

Denmark's assessment of the distortions caused by different regulatory treatment of UCITS and competing products is that for the time being the distortions are not important enough to justify regulatory actions.

7. Europe's alternative investment market

The Commission will establish a working group to study whether a common regulatory approach can facilitate the further development of European markets for hedge funds and private equity funds. This could also look at the types of action that could be most helpful in overcoming barriers to their cross-border development. This work could consider the extent to which a common understanding of 'private placement' could facilitate their cross-border offer to qualified investors.

Q16: To what extent do problems of regulatory fragmentation give rise to market access problems which might call for a common EU approach to a) private equity funds; b) hedge funds and funds of hedge funds?

Q17: Are there particular risks (from an investor protection or a market stability perspective) associated with the activities of either private equity or hedge funds which might warrant particular attention?

Answer:

Denmark is of the opinion that there is currently no need for common European regulation of hedge funds or private equity funds. The national regulations are sufficient for the time being.

Q18: To what extent could a common private placement regime help to overcome barriers to cross-border offer of alternative investments to qualified investors? Can this clarification of marketing and sales process be implemented independently of flanking measures at the level of fund manager etc.?

Answer:

Denmark is of the opinion that a common private placement regime would be a great help to overcome barriers to cross-border offer of alternative investments to qualified investors. Denmark will contribute to a closer study of how such a common regime may be established.

8. Modernising UCITS law?

The Commission points out that the UCITS Directive is regulating highly technical issues through first level EU legislation. The Commission asks whether there is a need for a recasting of the Directive along the lines of recent EU securities legislation – namely functional and principle-based first-level legislation supplemented by scope for detailed implemented law and reinforced supervisory cooperation (Lamfalussy approach)

Q19: Does the current product-based prescriptive UCITS law represent a viable long-term basis for a well-supervised and integrated European investment fund market? Under what conditions, or at what stage, should a move toward principle-driven, risk-based regulation be contemplated?

Answer:

The UCITS III Directive has entered into force only recently. The relatively short time that has elapsed since the entering into force has not been sufficient for the effects of these changes of the UCITS regulation to show them yet. Denmark therefore does not see sufficient reasons to undertake such a massive reform of the regulation of UCITS as a change from a product-based Directive to a Lamfalussy- Directive represents.

For the same reasons Denmark supports a reform-break in the UCITS regulation while the effects of the UCITS III Directive are materialising but in the long run it will be a natural development to change the current directive to a Lamfalussy-Directive.