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COMMISSION OF THE EUROPEAN COMMUNITIES

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**INTERPRETATIVE COMMUNICATION FROM THE COMMISSION**

**Respective powers retained by the Home Member State and the Host Member State in  
the marketing of UCITS pursuant to Section VIII of the UCITS Directive**

## INTERPRETATIVE COMMUNICATION FROM THE COMMISSION

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(Text with EEA relevance)

#### Introduction

The UCITS Directive<sup>1</sup> created the first European retail financial product. By harmonising the features of collective investment undertakings, the UCITS Directive paved the way for effective cross-border competition and uniformly high level of protection of investors in the EU. The free marketing of UCITS in a Member State other than the one in which it is situated is based on the "notification" procedure<sup>2</sup>: a UCITS complying with the common basic rules<sup>3</sup> of the Directive can be authorised by its Home Member State authority. This authorisation to market UCITS units is valid in all Member States, subject to notification to the Host Member State authority in accordance with the procedure set out in Articles 44 to 46 of the Directive. The Host Member State authority can object to such marketing if it considers that the arrangements made for the marketing of the units do not comply with the local rules in force in the Host Member State which do not fall within the field governed by the Directive.

The notification procedure has been widely availed of, with more than 29,000 notifications to date. However, difficulties have arisen in respect of its smooth functioning<sup>4</sup>. In particular, the formalities, length and complexity of the notification procedure may vary greatly from one Member State to the other. If some of these variations can be explained by different administrative practices, many of them also result from diverging interpretations of the Directive.

To remedy this situation, the Commission and the Committee of European Securities regulators (CESR)<sup>5</sup> have embarked since 2004 on a series of initiatives<sup>6</sup>. Diverging

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<sup>1</sup> Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), OJ n°L375, 31.12.1985, p. 3, as amended (the "UCITS Directive" or the "Directive").

<sup>2</sup> Sometimes referred to as the "passport procedure". This communication focuses on the notification procedure applicable to the marketing cross-border of UCITS units, not on the one applicable to management companies .

<sup>3</sup> See Recitals 4 & 5 of the Directive.

<sup>4</sup> See, notably, Commission Green paper on the enhancement of the legal framework for investment funds, COM (2005) 314, final, 14.7.2005, and European Parliament resolution on asset management (2006/2037(INI)), 27.4.2006.

<sup>5</sup> Established under Commission decision 2001/527/EC of 6 June 2001, (OJ n° L191, 13.7.2001, p.43), CESR acts as an advisory group to assist the European Commission in the securities field. It also contributes to more consistent and timely implementation of EC-legislation in Member States by securing more effective cooperation between national supervisory authorities.

<sup>6</sup> cf CESR guidelines n°04/434b of 3 February 2005 for supervisors regarding the transitional provisions of the amending UCITS Directives 2001/107/EC and 2001/108/EC, draft Commission proposal for a comitology instrument clarifying the assets eligible for investment (under discussion) or draft CESR guidelines n°06/120b of 29 June 2006 to simplify the notification procedure of UCITS..

interpretations of the respective responsibilities of the Host Member State and the Home Member State have been identified as a key factor contributing to legal uncertainty.

To remedy this situation, the Commission believes that the consequences of Article 44(1) setting out the respective responsibilities of the Home Member State and the Host Member State need to be recalled. Article 44 (1) provides that:

*"A UCITS which markets its units in another Member State must comply with the laws, regulations and administrative provisions in force in that State which do not fall within the field governed by this Directive."*

Views differ as to the implications of this provision for the residual responsibility of the Host Member State. Through this Communication, the Commission recalls in particular the contents of the fields "governed" or reserved under the Directive to the responsibility of the Home Member State. It reaffirms the consequences of Article 44(1) as regards the responsibility of the Host Member State.

**This communication does not create any right or obligation. It does not prejudice the position that the Commission might decide to take on the same matters at a later stage in the light of further developments, including rulings from the European Court of Justice or the Court of First Instance.**

#### **Executive summary**

- The respective responsibilities of the Home Member State and the Host Member State in the context of the marketing of units of UCITS cross-border are laid down by Article 44(1) of the UCITS Directive: *"A UCITS which markets its units in another Member State must comply with the laws, regulations and administrative provisions in force in that State which do not fall within the field governed by this Directive"*.
- The Home Member State field of responsibility under the UCITS Directive concerns: fund authorisation, fund structure, management and investment policies and compulsory information to be supplied to the unit holders. A UCITS complying with the Home Member State rules implementing the "basic common rules" of the Directive in this reserved field shall be entitled to market its units throughout the EU. In the "reserved field", no additional rules, requirements or information requests originating from the Host Member State on the basis of its residual responsibility can be imposed. The Host Member State retains its responsibility outside this field.
- It is not possible to establish a definitive list of the areas which fall under the responsibility of the Host Member State. However, it is possible to identify distribution infrastructure and marketing techniques and channels as falling under the responsibility of the Host Member State. Facilities for making payments, repurchase / redemption of units of UCITS and for making available compulsory investor information also fall under the review of the Host authority (Article 45 of the UCITS Directive).
- To the extent that Host Member State requirements relate to functions or activities which are not undertaken by the UCITS management company itself, but which instead are carried out by third parties situated in the Host Member State and appointed by the UCITS, compliance with those national rules is to be required in a first instance of such third parties.

## 1. RESPECTIVE POWERS OF THE HOME MEMBER STATE AND THE HOST MEMBER STATE PURSUANT TO ARTICLE 44 - GENERAL PRINCIPLES

Pursuant to Article 44 (1) of the Directive, a "UCITS which markets its units in another Member State must comply with the laws, regulations and administrative provisions in force in that State which do not fall within the field governed by [the UCITS] Directive". In the case of the notification procedure, the scope of the residual competence is reflected in Article 46 of the Directive: the Host Member State is entitled to review at notification stage the compliance of a UCITS from another Member State with the laws, regulations and administrative provisions applicable to marketing arrangements falling outside the field governed by the Directive.

If Article 44(1) provides for the exclusive responsibility of the Host Member State outside the field governed by the Directive, it should also be interpreted to mean that the Host Member State should not use its residual powers to circumvent the rules and principles set out in the Directive, and notably those falling under the exclusive responsibility of the Home Member State. This is the case even though the provisions of the Directive are no more than common basic rules. This principle is the cornerstone of the UCITS notification procedure and is widely recognized in EC internal market law<sup>7</sup>. A UCITS wishing to market its units in a Host Member State does not have to comply with Host Member States rules applicable in the field that the Directive reserves to the responsibility of the Home Member State.

### 1.1. The field reserved to the responsibility of the Home Member State

A first question is: what does the "field governed by the Directive" encompass? More specifically, what is the field reserved to the responsibility of the Home Member State under the Directive? Recital 4 of the UCITS Directive mentions that one of its objectives is to set out "*common basic rules*" for the "*authorisation, supervision, structure and activities of collective investment undertakings situated in the Member States and the information they must publish*". This can be understood as the "reserved field". In a more detailed way, this field can also be summarized as follows: (i) fund authorisation (Section II of the Directive), (ii) fund structure (obligations regarding management companies and investment companies, obligations regarding the depositary) (Sections III, III(a), IV and IV(a) of the Directive), (iii) management (operating conditions, obligations concerning investment policies and eligible assets, general obligations such as prohibition of uncovered sales or limitations on borrowing) (same sections as for (ii), Section V and Section VII of the Directive), and (iv) compulsory information to be supplied to the unit-holders by the UCITS (Section VI)<sup>8</sup>.

In each of these fields, the Host Member State should not apply to a UCITS from another Member State which markets its units in its territory, the rules that it applies to a UCITS registered on its territory. Recital 5 of the UCITS Directive makes it clear that "*...The application of these common rules is a sufficient guarantee to permit collective investment*

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<sup>7</sup> In the case of free movement of television programmes, see for instance ECJ Joined Cases C 34/95, 35/95 and 36/95, *KO vs De Agostini* and *KO vs TV-Shop* of 9 July 1997, notably paragraphs 55 to 62.

<sup>8</sup> In the case of Section VI, Article 33 and 35 of the Directive, which grant certain rights to investors as to access to compulsory information, are outside the scope of this communication, as they apply to all investors, without distinguishing between those situated in the Home Member State and those situated in the Host Member State. Accordingly they do not relate to the respective powers retained by the Home Member State and the Host Member State.

*undertakings situated in Member States...to market their units in other Member States without those Member States being able to subject these undertakings to any provision whatsoever other than provisions which, in those states, do not fall within the field covered by this Directive". As a consequence of the above, and as a general principle, there is no residual responsibility of the Host Member State in the field that the Directive reserves to the exclusive responsibility of the Home Member State<sup>9</sup>.*

## **1.2. The residual responsibility of the Host Member State**

A second question is: what are the Host Member State rules falling outside the reserved field which will be applicable to a foreign UCITS marketing its units in such Host Member State? On the basis of the general principles set out in Article 44(1), it is not possible to draw a definitive list of such rules. However, it is possible to identify the following fields as falling under the responsibility of the Host Member State:

- Distribution infrastructure which should be in place before beginning to market the UCITS units. In certain Member States, this might imply the use of a duly authorised and/or supervised intermediary.
- Techniques and channels used to ensure that the UCITS units are ultimately subscribed to by the investor, such as canvassing, cold calling, direct selling via the internet and other forms of solicitation of the investor. For instance, if a Host Member State prohibits the use of certain techniques for UCITS situated on its territory, this can also be imposed on a UCITS situated in another Member State.
- Advertising (Article 44(2)<sup>10</sup>): the Host Member State is competent to determine and enforce the rules applicable to the way a foreign UCITS is promoted to potential investors residing on its territory in view of subscription.
- Facilities for making payments to unit-holders, repurchase or redemption of units and for making available compulsory information on the UCITS to the unit-holders (Article 45).

It should be added that several Host Member State rules falling outside the field reserved under the Directive are now in any event harmonised at EU level. This includes rules applicable to marketing channels and techniques (e-commerce directive, distance marketing of financial products directive), consumer protection rules (unfair commercial practices directive, misleading and comparative advertising) and MiFID<sup>11</sup> provisions on marketing communications and other pre-contractual information.

Once marketing has started in the Host Member State, UCITS will have to be compliant with all applicable Host Member State rules not falling within the reserved field. The consequences

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<sup>9</sup> The Directive expressly acknowledges potential exceptions to this principle in relation to certain items of information to be included in the full and the simplified prospectus, (cf paragraph 2.2. below).

<sup>10</sup> The fact that Article 44(2) is not expressly referred to under Article 46 does not mean that advertising does not fall within the scope of the review to be undertaken under the notification procedure by the host Member State. Indeed, Article 44(2) is only an illustration of Article 44(1).

<sup>11</sup> Directive 2004/39/EC of 21 April 2004 on markets in financial instruments (the MiFID Directive) , OJ n° L145, 30.04.2004, p.1.

on UCITS management companies<sup>12</sup> will vary, depending on the extent of their involvement in the marketing phase.

Indeed, to the extent that Host Member State requirements relate to functions or activities which are not undertaken by the UCITS management company, but which instead are carried out by third parties situated in that Member State, and appointed by the management company for the marketing of the units, compliance with those requirements is not to be required from the UCITS management company in the first instance. Using the examples of paragraph 1.1, Host Member State compliance requirements over marketing techniques or payment and repurchase of units are to be complied with by local entities undertaking such activities.

Outside the field reserved to the responsibility of the Home Member State, the UCITS management company may still be subject to certain compliance requirements even when it entrusts a third party with the marketing of its units in a Host Member State. For instance, using the examples of paragraph 1.1, a Host Member State authority can be entitled to require the management company to comply with certain standards for the choice of its local entity (such as a duly authorised and supervised intermediary). In the case of advertising campaigns organised by a third party situated in the Host Member State, such party can rely on information provided by the management company: a Host Member State authority may require such UCITS management company to provide, say, fair, clear and not misleading information on the UCITS to the local entity.

Finally, the Directive provides expressly in Article 44(3) that the Host Member State rules governing the field falling outside the scope of the Directive should be applied without discriminating between UCITS situated in the Home Member State and in the Host Member State. In addition, it is settled case law that in a residual field of responsibility of the Host Member State, must meet certain conditions in order to be justified. Specifically, such restriction should not exceed what is “objectively necessary to this end”<sup>13</sup> and should not go beyond what is necessary in order to attain it (“proportionality test”)<sup>14</sup>. In other words, when imposing restrictions on the freedom of establishment or on the freedom to provide services on the basis of investor protection, the relevant Host Member State has to demonstrate that the restriction is objectively necessary to attain investor protection and that the latter could not be achieved by less stringent rules<sup>15</sup>. Hence the Host Member State rules falling outside the reserved field of the UCITS Directive are also subject to these general requirements<sup>16</sup>.

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<sup>12</sup> The reference in Article 44(1) to "*UCITS which markets its units...*" is legally correct but does not correspond to economic reality. An UCITS does not constitute an autonomous decision-making centre, economically speaking the UCITS will not be performing marketing itself (one exception to this are self managed UCITS). Marketing is within the remit of the UCITS management company, and, in most cases, local intermediaries acting as third party distributors.

<sup>13</sup> Cf for instance ECJ C100/01, 26.11.2002, Oteiza Olazabal, ECJ C 192/01, 23.09.2003, Commission vs Denmark and ECJ C 496/01, 11.03.2004, Commission vs France, and ECJ C 384/93, 10.05.1995, Alpine Investment BV.

<sup>14</sup> See equivalent interpretation in the case of freedom of movement of capital, ECJ C 174/04, 02.06.2005, Commission vs Italy, para. 35. See also Commission communication on the application to financial services of Article 3(4) to 3(6) of the electronic commerce directive, paragraph 2.2., COM(2003) 259, final, 14.5.2003.

<sup>15</sup> In the case of mortgage loans, see ECJ C 222/95, 09.07.1997, Parodi vs de Bary

<sup>16</sup> Cf in the case of cold calling in relation to financial services, see Alpine Investment BV, cited above.

## 2. CONSEQUENCES OF THESE PRINCIPLES – SOME EXAMPLES

### 2.1. The full prospectus and the simplified prospectus

In the case of compulsory information to be supplied to unit-holders, (section VI of the Directive), the information provided in the full and simplified prospectus falls within the reserved field covered by the Directive. Compliance with the principles set out in the Directive shall be verified in the context of the Home Member State authorisation procedure. Such authorisation is sufficient to establish the conformity of these documents and the right to market the UCITS units in other Member States. The Host Member State should not request such information to be completed on the basis of its own rules. This general principle bears two possible exceptions expressly set out in Article 45 and 48 of the UCITS Directive (cf paragraph 2.2 below).

In the case of the simplified prospectus, the Directive has explicitly provided for this principle. The simplified prospectus has a double nature. First, compulsory pre contractual information which is necessary for the average investor to be able to make an informed judgement. Second, at the discretion of the management company, marketing tool, i.e. general information aimed at a potential customer. However, even if it is used as a marketing tool, this does not mean that the simplified prospectus falls under the residual responsibility of the Host Member State. Article 28(3) is explicit in this respect, restating the principle set out in Paragraph 1. above: the simplified prospectus can be used as a marketing tool designed to be used in all Member States "*without alteration except translation*". In case this was not sufficient, Article 28(3) adds: "*Member States may therefore not require any further documents or additional information to be added*". Article 28(3) does not exclude the applicability of this principle to the full prospectus and the other information requirements set out in Section VI of the Directive.

#### Some examples

- On the basis of local advertising rules, a Member State may impose additional investor information requirements to UCITS situated on its territory, because of certain of their features. This can be the case when a UCITS contains a guarantee or engages in certain types of investments which could be seen as entailing new or high level of investment risks by the Host Member State.

In the case of UCITS situated in other Member States and marketing their units in such Host Member State, the latter should refrain from imposing any amendment or additions to the contents of a full prospectus or a simplified prospectus drafted in accordance with the common basic principles set out in the Directive<sup>17</sup>. These disclosure documents fall within the field reserved by the Directive, i.e. compulsory information to be supplied by the UCITS to the unit-holders. The reserved field covers in particular disclosure on UCITS risks, fees and costs<sup>18</sup> (cf Annex I of the Directive). In the case of an authorised UCITS, compliance with

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<sup>17</sup> In whatever form, for instance by way of a direct amendment, request of additional information or further documents.

<sup>18</sup> A distinction should be made between disclosures of cost and fees in relation to the UCITS itself, which fall under the exclusive competence of the Home Member State and disclosure of cost and fees in relation to the provision of services by third parties, such as distributors, which are not covered by the Directive. This is reflected in Article 34 of Directive 2006/73/EC of 10 August 2006 implementing the MiFID Directive (OJ n°L241, 2.9.2006, p.26).

such requirements has already been dealt with by the Home Member State and should not be subject to a second review at Host Member State level<sup>19</sup>.

On the distinction between advertising and compulsory information, the information that the UCITS is required to provide to its unit-holders under the Directive should not be confused with the information that is supplied as part of a "marketing campaign" (e.g. leaflets, brochures, advertising campaign) and which can be characterised as "advertising". In the first case, the field of compulsory information is reserved by the Directive to the sole responsibility of the Home Member State (Article 44(1)). In the second case, the advertising field is not dealt with by the Directive and falls under the responsibility of the Host Member State. If an advertisement at the initiative of a UCITS management company from another Member State can thus be modified at the request of the Host Member State, this possibility does not extend to the compulsory information, which is subject to the Home Member State responsibility.

- A simplified prospectus drafted in accordance with the common basic principles of the Directive from a UCITS authorised by its Home Member State authority cannot be reviewed, challenged or questioned by the Host Member State, even where it has not been subject to a formal approval procedure by the Home Member State authority. The attestation from the Home Member State that the UCITS fulfils the conditions imposed by the Directive, is sufficient in this respect.
- On the basis of Article 47 paragraph 2, a Host Member State may check the translation of the full and simplified prospectuses, the annual and half yearly reports and of the other information provided for in Article 29 and 30.

## **2.2. Exceptions to the principle of the reserved field in relation to the full and simplified prospectuses**

- The Directive expressly states in its Article 45 that a UCITS wishing to market its units in another Member State shall take in accordance with the laws, regulations and administrative provisions in force in the Host Member State "*the measures necessary to ensure that facilities are available in that State for making payments to unit-holders, repurchasing or redeeming units and making available the information*"<sup>20</sup> which UCITS are obliged to provide ". On the other hand, Schedule A, point 4 of the Directive states that the full prospectus should contain "*information concerning the arrangements for making payment to unit-holders, repurchasing or redeeming units and making information available concerning the UCITS*". Similarly, Schedule C of the Directive states that the simplified prospectus should provide information on "*how to sell the units*", "*when and how dividends on units or shares of the UCITS are to be distributed*". As acknowledged in Article 45 and 46 of the Directive, a Host Member State would be competent to review the compliance of such information with its local rules as far as it is addressed to investors located on its territory.
- Similarly, article 48 of the Directive entitles the UCITS to use the same generic name (such as "investment company" or "investment trust") in the Host Member State as in its

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<sup>19</sup> Cf in a comparable situation ECJ Joined Cases C 34/95, 35/95 and 36/95, *KO vs De Agostini* and *KO vs TV-Shop* of 9 July 1997, cited above.

<sup>20</sup> On the respective competence of the Home and the Host Member State on the provision of compulsory information to investors, see paragraph 2.4 below.

Home Member State. Article 48 expressly entitles the Host Member State to impose on the UCITS to add to its generic name certain explanatory particulars for the purpose of clarification. This is allowed only if there is a risk of confusion, but by no means does this imply a faculty to challenge its generic name.

### **2.3. Possible restrictions on the marketing of certain products**

On the basis of the principle set out in paragraph 1 above, it would not be possible for a Host Member State to use its residual responsibility to prevent the marketing of units of an UCITS originating from other Member States because its features would be deemed not compliant with the requirements of the Directive, which designs an investment product for the retail investor (for instance by deciding that such UCITS is not appropriate for retail investors). For the Host Member State, this would amount to challenge the authorisation granted by the Home Member State, which falls under the reserved field. The Home Member State is sole responsible to determine whether a product complies or not with the requirements of the UCITS Directive. Once such compliance has been established, the Host Member State cannot review its merits on the basis of its residual responsibility.

### **2.4. Notification procedure**

The notification procedure and in particular the information to be provided by the UCITS to the Host Member State authority pursuant to Article 46 is part of the "reserved field" of the Directive. Accordingly, a UCITS providing the information requested under Article 46 (attestation, fund rules or instruments of incorporation, full and simplified prospectus, latest annual report and subsequent half yearly report, as the case may be and details of the marketing arrangements) should not be asked for additional documents or information by the Host Member State authority on the basis of rules applicable in the Host Member State. However, there is an exception provided for in Article 46, as the Host Member State is expressly entitled under the Directive to check the compliance of the arrangements for the marketing of the units with applicable Host Member State rules pursuant to Articles 44(1) and 45, within the limits set out in paragraph 1 above.

## **Conclusion**

The residual responsibility of the Host Member State over the rules applicable to the fields falling outside the scope of the UCITS Directive does not mean that the Host Member State has a "licence" to impose additional rules on UCITS from other Member States notified to market its units on its territory. A key principle is that such rules should not encroach on the exclusive responsibility of the Home Member State as established under the terms of the Directive.

The impact of any residual responsibility of the Host Member State relating to the UCITS management company must also be assessed with regard to the way the UCITS actually markets its units. Management companies often use third parties to carry out the distribution of their UCITS in Host Member States. In addition, the residual responsibility of the Host Member State is also circumscribed by the fact that rules falling outside the reserved field are more and more harmonised at EU level.

Notwithstanding that a Host State does not have the right to impose additional disclosures on the risk profile of an UCITS under the Directive, a possible common approach on strengthened disclosures is currently under review following the issuance of the Commission White Paper on the enhancement of the EU framework for investment funds. In the meantime,

the Commission recalls the need to comply with and respect the principles set out in the UCITS Directive.