DANISH BANKERS ASSOCIATION

DANISH SECURITIES DEALERS ASSOCIATION

INVESTERINGS FONDS BRANCHEN

Response to Consultation document, CMU on cross-border distribution of funds (UCITS, AIF, ELTIF, EUVECA and EUSEF) across the EU

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Contact Stefan Munch Gotfredsen
Direct +45 3370 1074
smg@finansraadet.dk

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The Danish Bankers Association, the Danish Securities Association and the Danish Investment Fund Association (hereafter the Associations) welcome the fact that the European Commission is now focusing on the barriers related to cross-border distribution of funds across the EU.

Creating a deeper single market for capital calls for a more well-functioning and more aligned market cross-border. Too many national barriers are set up which leads to inefficient cross-border fund market.

Member states by applying national rules and trade barriers in a protectionist manner are hindering the free competition within the fund industry. More competition within distribution of funds would lead to a more efficient market, and allow the investor to compare more products. Further, it would lead to a more level playing field and this will ultimately ensure the investor better products.

Besides differences in national implementations (UCITS and AIFM-regime) and legal standards the national tax rules are preventing free movement within the capital market. This is one of the main challenges for a free movement of capital within the European fund industry.

Key point – what is needed

- An efficient and clear-cut passport for AIFs is needed. The best way to remove the trade barriers in the market of cross border marketing of funds would be to introduce an efficient and clear-cut passport for AIFs – not only for professional investors, but also for retail investors.

- Harmonization of general exceptions is needed. A common exemption should apply within the EU and consequently, the industry would not need to seek for marketing approvals when distributing funds to a certain segment of the retail investors. This would reduce the time to market within EU, and it would certainly lead to more competition – at least for this special segment of the investors. This approach is in line with the intention of a favorable treatment of offers of securities addressed to investors who acquire securities for a total consideration of at least EUR 100,000 per investor as stated in the Commission's proposal for a prospectus regulation.

- Removal of tax barriers is essential for a well-functioning cross-border market. This includes tax barriers for inbound and outbound distribution, tax barriers for cross-border managements of funds and discriminating withholding taxes at fund level.

General overview

On a general level, the UCITS regime is functioning much better than the AIFM-regime when it comes to cross-border marketing. This is a consequence of the passporting rules applying for both professional and retail customers within the UCITS-regime. The AIFM-regime has imposed passporting rules concerning marketing to professional investors cross-border. However, passporting rules have not been set out for the marketing to retail investors. Consequently, there is a lack of alignment when it comes to marketing approvals for retail investors.

Further, the jurisdictions within EU have adopted different approaches towards enforcing AIFMD. In addition to this, it is difficult to find the national requirements since they are not always in writing or public available.

The best way to remove the trade barriers in the market of cross-border marketing of funds would be to introduce an efficient and clear-cut passport for AIFs – not only for professional investors, but also for retail investors.

This is based on the assumption that if one EU-supervisor has determined that an AIF can be marketed to retail investors in their country this would be sufficient to market it in all EU-countries.

If it is not political feasible to accept passporting to retail investors within the AIFM-regime it could be an alternative solution to agree upon a special type of AIFs which could be passported cross-border in the EU. It could either be a specific type of AIFs (like the ELTIF-funds, but with other investment restrictions than the ELTIF-funds) or funds which already have a PRIIPs KID. The PRIIPs discloses the basics of risk and cost and further information related to the fund when marketed to retail investors.

National requirements and legal costs to external national lawyers

One of the overall challenges when trying to market cross-border is identifying local requirements. Local rules, interpretations and legal standards have to be identified and fulfilled whenever entering a new market. The lack of alignment within EU is a considerable challenge for the industry. A transparent mapping of local requirements (gold plating directive rules) would be beneficial for market participants and would probably encourage member states to reduce local requirements that are gold plating the EU rules.

Different local requirements are partly related to the *procedure* for applying for a marketing approval, but also to *identifying* and *fulfilling* the material requirements. Some countries have not yet produced a standard form for applying for marketing approval (especially AIF to retail), some countries for example require a local paying agent and a tax representative while others do not, and when it comes to accepting/rejecting the marketing applications to the retail investors, the

regulators do not have the same approach. While the same fund is rejected in some member states, it can be approved in others.

Legal costs when entering a new market often become considerable, and the lack of alignment cross-border makes it very difficult for a company to obtain and maintain knowledge on the different requirements related to the different markets. Further, it is not possible to stay updated about changes in local requirements.

Therefore, the industry becomes very dependent on external legal advice whenever entering a new market. In addition to being costly, the fact that the company has to rely on external advice to some extent leads to legal uncertainty for the fund provider.

Prolongation of time to market
It increases the time to market whenever a provider needs an external advice to be able to send a market application to the relevant authority.

Furthermore, it differs very much across EU how fast the national authorities can handle and assess a marketing application. In some member states the assessment is done fairly quickly, while it takes several months in other member states.

More cross-border alignment on the procedures related to marketing applications would help to shorten the time to market. Further, it would be possible to distribute funds within EU on a more level playing field, if the regulators were obliged to treat the applications the same way and with the same speed.

The term "marketing" and other terms that are not interpreted the same way
Along with special local requirements the industry has to navigate in a landscape where the member states have different interpretations of the term "marketing".

Given that, there is no guidance on a European level regarding what marketing exactly consists in, the guidance and position of the different national competent authorities may vary. Some jurisdictions, Sweden, for example, deem any contact between the AIFM and the investor – even before the fund is even created – as being marketing. Other countries, Denmark and Luxembourg, for example, have published guidance on the FSA website stating that initial contact before the creation of a fund does not constitute marketing, if it is not possible to subscribe to units/shares yet.

Consequently, the industry is dependent of a customized legal advice prior to initiating any kind of activities – even activities in other member states are considered as non-marketing activities.

An aligned approach to marketing, including determination of the activities qualified as being marketing or non-marketing activities would be welcome. Such an alignment would add to a more level-playing field. Preferably, as new guidelines within this field from ESMA. Alternatively, at least more guidance from the regula-

tors on their national interpretation of the term "marketing" should be provided across the EU.

Besides the lack of a common understanding of the term "marketing", there does not seem to be a common understanding of other distribution-related terms, including but not limited to: "distribution", "platforms" and "due diligence". A common understanding of the interpretation of these terms would be useful in order to make sure that any requirements related to the distribution are aligned. For example it is not clear whether or not distribution includes "marketing" or if marketing will always entail distribution.

Further, it is not fully clear what the services delivered by a platform are – are providing platform services (being offering fund managers/global distributors to put certain fund units/shares on their platform making these available for sale to their sales agents/end clients) considered "distribution" or even "marketing"? One could argue that the fact that the platform providers simply make the fund units/shares available for sale, but do not do any specific activity in order to marketing/enhance sale of one type of fund units/shares instead of another. Therefore, no actual marketing takes place, no advice is given and therefore MIFID does not apply.

Reverse solicitation

Further, there is an uncertainty as to reverse solicitation (also referred to as "passive marketing", i.e. activities that are generally not considered as (active) marketing under the AIFMD). The national FSAs within the member states apparently do not share the same view on whether or not an activity qualifies as reverse solicitation and consequently not a marketing activity. In some jurisdictions a certain activity will be looked upon as a marketing activity, while the same activity in other jurisdictions will be treated as reverse solicitation. The European regulators do not share the same view as to whether communication and investment at the initiative of the manager qualify as being marketing (requiring a local marketing approval), or whether this is at the initiative of the investor, qualify as reverse solicitation.

There is a need for alignment within this field, as it is difficult for the industry to navigate in a landscape where the national regulators do not share the same view when it comes to the need for a marketing approval (AIF for retail customer segment) or notification (UCITS regime and AIF regime when units/shares are offered to professional investors). A clear and common interpretation would help eliminating the legal uncertainty.

Special exemptions – no need for a marketing approval

In certain member states units/shares of an AIF can be sold to retail customers without prior marketing approval of the fund. Such distribution can be allowed if the investor invests a certain (high) minimum in the fund, and if the investor declares in writing that he/she is fully aware of the risks linked to the investment.

A common exemption should apply within the EU and consequently, the industry would not need to seek for marketing approvals when distributing funds to a cer-

tain segment of the retail investors. This would reduce the time to market within EU, and it would certainly lead to more competition – at least for this special segment of the investors. This approach is in line with the intention of a favorable treatment of offers of securities addressed to investors who acquire securities for a total consideration of at least EUR 100,000 per investor as stated in the Commission's proposal for a prospectus regulation.

Distribution agreements
Generally, a lot of time and energy are spent on negotiating distribution agreements between the various parties in the distribution channel. Drafting the distribution agreements is challenged by the many gold-plating rules in certain member states e.g. requirement for appointment of local agents, local choice of law or language etc. A common legal framework will reduce these challenges.

Distributing via platforms
It is unclear which obligations are put on the fund/fund manager and global distributor when appointing sub-distributors and platforms to arrange for local distribution in various specific countries. A legal framework should state/confirm that the distributor actually selling a fund unit/share to the end client has the obligations in accordance with applicable law, including MIFID requirements.

It could be argued that as long as the fund manager/global distributor does not have in place a distribution agreement with the distributor/bank the fund manager/global distributor is not obliged to do any of the abovementioned checks. However, then it becomes random in which cases the end-client (acquiring a fund unit/share from such "end"-distributor") is actually protected by the fund manager/global distributor monitoring the end-distributor.

It needs to be clearly stated that simply making fund units/shares available for sale on a platform does not entail marketing and/or advice under the MIFID rules. If it is forbidden to use platforms not providing advice ("robo-advice" etc.) most platforms would not exist, and the end-client would need to rely on various specific fund managers/global distributors to provide them with proper advice, however, not being able to offer them the flexibility of investing in any other fund unit/share that the ones actually facilitated by such fund manager/global distributor. There will be no transparency for the client in order to know which advice is the best, and which is offered at the best price – as no fund manager/global distributor would want to give advice on any fund unit/share not provided by them. Therefore, we need to support the platform services, providing flexibility to the market, transparency and easy access to many fund units/shares in one place.

Sub-distribution – monitoring obligations
It follows from the AIFMD and UCITS rules that any delegated activity needs to be monitored properly and proper due diligence needs to be performed. Further, it follows that the fund manager delegating is liable for any activity delegated in the whole chain – including delegation between e.g. third and fourth party. However, it seems "overkill" to put an obligation on the fund manager to perform due diligence etc. and require such fund manager to also make due diligence on the other levels of the distribution chain. This requires the fund distributor to put obligations

on the global distributor to perform due diligence on its counterparties (distributors) and often in accordance with the due diligence principles of the global distributor.

If a branch standard for due diligence questionnaires was set down by the regulator, this standard could be used in order to obtain similar replies to due diligence questionnaires. Consequently, it would be easier to compare them.

Solvency II reporting – different treatment of customers

Solvency II reporting – requiring fund managers to provide immediate information to insurance companies of the holdings in any fund without delay creates an advantage for them which an investor not being an insurance company does not have. It puts the insurance company in a position to front-run and copy the strategy of a certain fund, which the other investors in the same fund will not be able to do. This is a problem as it creates a favorable position for the investors being insurance companies.

Cross-border mergers

Finally, a well-functioning cross-border market also includes alignment of processes and requirements related to cross-border fund mergers. As long as the Member States are not more aligned, potential mergers may never be effected just because of hindering national "flavors". As a concrete example swing pricing is not accepted by Finansinspektionen in Sweden, while swing pricing on the other hand is accepted by the CSSF in Luxembourg. In practice such national differences can hinder cross-border activities which will hinder a more effective market. Ultimately, this will hinder a fair competition amongst fund providers cross-border, which is surely not in the interest of the European investors.

Tax barriers

Tax barriers are another main reason that the cross-border market within the fund industry is not more well-functioning. In many EU member states local tax rules are a major hurdle deterring foreign fund providers from distributing their investment funds in other EU member states. Local tax rules are also deterring international fund providers from consolidating their business activities in one or a few EU member states.

The tax barriers are more thoroughly described in the appendix attached.

Appendix – tax barriers

Tax issues are another main reason that the cross-border market within the fund industry is not more well-functioning. In many EU member states local tax rules are a major hurdle deterring foreign fund providers from distributing their investment funds in other EU member states. Local tax rules are also deterring international fund providers from consolidating their business activities in one or a few EU member states.

The tax barriers in headlines are:

1. Tax barriers for inbound distribution (local tax rules in host countries)

2. Tax barriers for outbound distribution (local tax rules in the registration countries of the fund)

3. Local tax rules are deterring fund providers from consolidating their business activities in one or a few EU member states
   - *A.* Tax barriers for cross-border managements of funds
   - *B.* Tax barriers for cross-border mergers
   - C. Tax barriers for creating master-feeder structures

4. Discriminating withholding taxes at fund level

In the following we will explain the situation in more detail for each item.

Re. 1. Tax barriers for inbound distribution (local tax rules in host countries)
The main tax barrier for inbound distribution is local tax reporting rules that prescribe that certain collective investment vehicles should annually or daily calculate tax figures which is subject to tax on the level of the investors. Although such rules apply to both local and foreign funds they are often still regarded as discriminatory, since in practice it will often be easier to comply with the rules for domestic funds than for foreign funds. Moreover, all though the fund complies with the local tax reporting obligations, there might still be some negative tax consequences for the foreign fund compared to a local fund, since the local tax in other matters makes it easier to buy a local fund than a foreign fund in relation to tax return obligations, cf. below.

The European Court of Justice ruled in 2014 that the German tax reporting rules were an infringement of the free movement of capital in the "*van Caster*" case (C-326/12). However, Germany abolishes the current tax reporting rules and introduces a new tax regime for investment funds as from January 2018. At the moment several other EU countries also have local tax reporting rules, e.g. Austria, Belgium, Denmark and UK.

There are also other examples where local tax rules makes it much easier for the investors to buy domestic funds compared to foreign funds and which is not related to specific tax reporting requirements. Different tax treatment of the investors depending on whether the fund is domestic or foreign is discriminatory and will

generally be an infringement of the freedom of free movement of capital a, cf. TFEU art. 63 and 66.

In some countries, e.g. in Ireland, local income tax on distributions/redemptions is to be collected at source by imposing a final withholding tax on any distributions, reportable income or capital gains. However, such rules do in many cases only apply for local funds and not foreign funds, because the latter are outside the jurisdiction of the relevant country. If the investors in such cases buy units in foreign funds the result might be that the investors must annually file a special tax return for investments in foreign funds etc.

Accordingly, the investors prefer to buy local funds where such administrative burdens do not exist. High net worth individuals and institutional investors may be able to overcome this hurdle, but if the relevant fund is to be marketed to all types of investors this might in practice create a barrier for cross-border distribution. A way to solve this problem in practice could be to grant foreign funds the same possibility to withhold local income taxes on dividends/redemptions on behalf of the local investors.

Also different tax treatment in the country of registration and the host country may exclude investment funds from being distributed cross-border. In some countries for example, UCITS and AIFs only exist in the form of the contractual fund type (FCP). In other countries, e.g. UK and Ireland, such funds are deemed to be transparent for tax purposes, i.e. that the investors are taxed on interest, dividends and capital gains on the underlying investments as if they had invested directly. In practice such tax treatment in the host country often prevents cross-border distribution, since it is not possible for the fund providers to provide the necessary information that makes investors able to file their tax returns.

Examples like those listed above often imply that the fund providers must launch several copies of the same products in each of the jurisdictions in order to become tax efficient for investors in the different markets. This prevents the fund providers from economics of scale to the benefit of their investors. In the next step this leads to competition barriers because some institutional investors do not invest in funds whose AUM are below certain levels.

Re. 2. Tax barriers for outbound distribution (local tax rules in the registration countries of the fund)

In other cases local tax rules prevent local funds providers from distributing their investment funds in other EU member states. An example is when local dividend taxes are levied foreign investors on any distributions/reportable income or capital gains. That is e.g. the situation in Denmark and many other European countries. The problems arising in relation to investment funds are very similar to the problems arising on portfolio investments in general, cf. the EU Commission public consultation from April 30, 2011, on Withholding taxes on cross-border dividends–Problems and possible solutions.[1]

[1] https://ec.europa.eu/taxation_customs/consultations-get-involved/tax-consultations/taxation-problems-that-arise-when-dividends-are-distributed-across-borders-portfolio-individual-investors-possible-solutions_en

If the relevant foreign investor is a pension fund exempt from tax in the country of residence such foreign withholding taxes will be an extra expense, since the pension fund does not have a local tax to credit the withholding tax against. However, even if the relevant foreign investor can credit the local withholding taxes on distributions, reportable income and capital gains derived from the fund units against a local tax in the country of residence, such withholding taxes will in many cases prevent that investment funds are distributed cross-border. The reason is that the investors have to ask for a tax recover/relief at source in order to reduce the withholding tax in the source country and secondly they should ask for a tax credit against the local tax in the country of residence in order to avoid any double taxation.

At the end of the day the investors will prefer to buy domestic funds or funds from other EU countries, e.g. Luxembourg and Ireland, where such withholding taxes are generally not imposed.

Re. 3. Local tax rules are deterring fund providers from consolidating their business activities in one or a few EU member states

In order to cut costs and reach economics of scale international fund providers often want to gather their funds and/or management companies in one or a few countries creating a so called fund hub and/or management hub for international distribution. After UCITS IV and AIFMD the regulatory framework for such consolidation is in place. However, the fact that the tax is not yet harmonized in the EU means that it is in practice often not possible to gather the funds and management in one or a few countries:

Re. 3 A. Tax barriers for cross-border managements of funds

Complex tax issues arise when investment funds are managed cross-border. Many EU countries define tax residency where the business is effectively managed. Accordingly, the investment funds that are managed cross-border may become liable to tax in the country where the management company is established.

Different tax issues may arise:

- Some jurisdictions may consider the transfer of management to be a liquidation of the fund in their country. This may trigger taxation of unrealized capital gains on the underlying investments etc.
- The jurisdictional separation of the management company and the fund could lead to double taxation or double non-taxation at fund level.

  The separation of the management company and the fund could lead to withholding taxes on distributions from the fund to its investor in its country of establishment and/or in the jurisdiction of the management company. If e.g. a Swedish fund is managed by a Danish management company Danish withholding taxes on any distributions from the fund may be due even though the fund is not a Danish fund. It can prevent foreign funds from being managed from Denmark because dividend taxes in general create tax problems in relation to double taxation of the investors etc. In other cases withholding taxes and tax reporting obligations may be due in both countries creating a taxable mismatch.

Certain member states have introduced rules and guidelines to eliminate the taxation risk associated with a single management company passport. However, the only way to solve the question in general in all EU member states would be to introduce a specific EU regulation.

Re. 3 B Tax barriers for cross-border mergers
Under UCITS IV all EU countries are obliged to allow cross-border mergers from a legal and regulatory point of view.

However, the tax treatment of fund mergers varies from country to country. While some countries allow tax neutrality for domestic merges, many countries impose tax on foreign and cross-border fund reorganizations at the level of the fund and/or at level of the investors. In practice this prevents the fund providers from gathering and offering their investment products from one or a few EU member states.

Introducing a separate EU directive in order to ensure and promote the further development of the EU fund market can solve these problems. This directive could be an extension of the current EU Merger Directive for commercial companies and should cover taxation issues for domestic, foreign and cross-border fund reorganizations.

Re. 3 C. Tax barriers for creating Master-feeder structures
UCITS IV allows for the pooling of assets into a master fund. Several feeder funds are allowed to invest in a single master fund, provided each of the feeders invest more than 85 percent of their assets in the master.

Setting master-feeder structures in one EU country will normally not create negative tax consequences. However, when it comes to cross-border structures negative tax consequences might occur. The main problem is that withholding taxes might be levied on profit distributions from the master to the feeder fund, cf. the section Tax barriers for outbound distribution above. The reason it that the feeder funds are normally exempt from tax in the registration country and accordingly the withholding tax in the country where the master fund is registered is an extra cost. However, the feeder funds may in many cases be able to reclaim the withheld tax on basis of the ECJ decision in the Santander case mentioned above, since such withholding taxes may discriminate foreign feeders compared to domestic feeders, but the administrative burden and cash deferral disadvantage should still remain.

Re. 4. Discriminating withholding taxes at fund level
Another main barrier to cross-border distribution of investment funds across the EU is the fact that many EU member states have discriminatory tax rules when it comes to outbound dividends. In many countries local investment funds may be subject to conditions receive local sourced dividends free of tax while foreign funds may be imposed a dividend tax. Such tax rules result in a market fragmentation since the investors will be better off from an economical view if they invest in local companies through local investment funds compared to foreign funds.

In the last recent years the European Court of Justice has in several decisions found that the withholding tax rules for foreign funds in an EU member state was an infringement of the EU treaty (the free movement of capital). In the so-called Santander cases the Court found that EU law precludes French legislation establishing different tax for nationally sourced dividends received by resident and non-resident undertakings for collective investments in transferable securities (ECJ C-339/11 to C-347/11).

Although the European Court of Justice has made similar judgements regarding other member states still there are many EU member states having withholding tax rules that discriminate foreign funds on nationally sourced dividends.