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A legal update from Dechert's Financial Services Group

New Regulations on Management Fees in France

New provisions of the General Regulation of the Autorité des Marchés Financiers ("AMF") concerning the rules on the retrocession of management, subscription and redemption fees as well as various costs, at the occasion of an investment by a UCITS (i.e., the investing UCITS) in another UCITS (i.e., the target UCITS), were adopted on April 15 and published on April 22, 2005. The AMF has now published its interpretation of these new provisions. The new rules follow upon the guidelines provided in a report published in November 2004 by the International Organization of Securities Commission, which made it clear that such fee-sharing agreements should exclusively benefit the top-tier UCITS.

Previous to the change, these rules used to apply only to French UCITS commercialized in France as well as to their French management companies, but under the new regime, the provisions now apply to all UCITS being commercialized in France, both French and foreign, and to their French and foreign management companies.

The regulations seek to prohibit kickbacks of part of the target UCITS's fees to an investing UCITS's management company or to a third party. The idea is that the retrocession of fees must exclusively benefit the top-tier UCITS itself and not its management company or another entity or UCITS. The new rules have been promulgated in order to protect the investors and to avoid conflicts of interests for the management company of the investing UCITS.

Under the old regime (subject to the application of foreign law), a foreign UCITS registered in France could freely transfer fees back to a top-tier UCITS's management company and the management companies of a foreign top-tier UCITS registered in France could freely receive fees from a target UCITS. However, French management companies and French UCITS were deprived of this possibility and were thereby less competitive.

While the territorial scope has been extended to foreign UCITS registered and marketed in France

(Article 411-61 of the AMF), the scope of the above-mentioned prohibition was softened in order to allow the UCITS to remunerate third parties for their efforts to commercialize the UCITS. The new regime, codified under Article 411-53-1 of the General Regulation, is now as follows:

Retrocession of fees by a target UCITS to the management companies of either French or foreign investing UCITS registered and marketed in France are prohibited.

By exception, the following retrocessions of fees are allowed:

- Retrocession of fees paid by the target UCITS to the top-tier UCITS itself;
- In the specific case of a master/feeder UCITS, the retrocession of fees paid by the management company of a master UCITS to remunerate the distributor of its feeder UCITS;
- Retrocessions aimed at remunerating distributors of UCITS if these distributors are independent from those UCITS's management companies.

In its statement, the AMF takes the view that a distributor is deemed independent in the absence of a shareholder relationship with the management company. However, when the distributor is nevertheless related to the management company by a shareholder relationship, it can still demonstrate its independence from the management company if (i) it is able to show that it adheres to a code of good conduct or (ii) shows that a significant amount of sales have been made to entities not related to the management company's group.

As a way to ensure the implementation of the new rules, Article 411-61 of the AMF's General Regulation provides that any UCITS (or sub-fund thereof) seeking approval to be commercialized in France must submit a letter from the UCITS's management company certifying that it complies with the above-mentioned rules on the retrocession of fees. This letter is not required if

such fees are paid pursuant to an agreement concluded before November 24, 2004 (Article 322-92 of the General Regulation).

Questions remain open as to how the AMF could sanction non-compliance with the new provisions. If the UCITS's foreign management company has exercised its European Passport for activities in France under Directive 85/611/EEC of December 20, 1985, as amended by Directive 2001/107/EC of January 21, 2002, the AMF's sanctioning body could sanction the violation of the new rules on management fees with a fine or by prohibiting the management company to undertake investment services activities in France for a certain period of time.

On the other hand, if the foreign management company has not exercised its European Passport for activities in France and it is not active in France, one may question how the AMF could effectively sanction the foreign management company or even on what jurisdictional basis it might act.

One should note however that the new rules leave open the possibility that the bottom-tier UCITS (or its management company) could be sanctioned if it were to pay a fee to the top-tier UCITS's management company.

Practice group contacts

If you have questions regarding the information in this update, please contact the Dechert attorney with whom you regularly work, or any of the attorneys listed. Visit us at www.dechert.com/financialservices

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