

## New Regulations in France Prohibit Kickbacks of UCITS's Fees

*On April 15, 2005, the General Regulation of the Autorité des Marchés Financiers ("AMF") adopted new provisions on the payment of management, subscription and redemption fees, as well as various costs, in connection with an investment by a UCITS (i.e., the investing UCITS) in another UCITS (i.e., the target UCITS). The AMF recently published its interpretation of these new provisions. The new rules apply to all UCITS being commercialized in France, both French and foreign alike.*

The new rules follow upon guidelines provided in a report published in November 2004 by the International Organization of Securities Commissions, which made it clear that fee-sharing arrangements should exclusively benefit the top-tier UCITS.

Prior to the change, these rules applied only to French UCITS commercialized<sup>1</sup> in France, as well as to their French management companies. 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 the target UCITS's fees to an investing UCITS's management company or to a third party. The idea is that any payment 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 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 investing 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 not permitted to engage in such arrangements and were thereby disadvantaged.

While the scope of the rule has been extended to foreign UCITS registered and commercialized in France (Article 411-61 of the AMF), the rule's restrictions were relaxed in order to allow a UCITS to remunerate third parties for their efforts in commercializing the UCITS. The new regime, codified under Article 411-53-1 of the General Regulation, states that payment of fees by a target UCITS to the management companies of either French or foreign investing UCITS registered and commercialized in France is generally prohibited.

However, the new rule does permit some exceptions, including the following:

- The payment of fees by the target UCITS to the investing UCITS itself;
- In the specific case of a master/feeder UCITS, the payment of fees by the management company of a master UCITS to remunerate the distributor of its feeder UCITS;
- The payment aimed at remunerating distributors of a UCITS if these distributors are independent from that UCITS's management company

<sup>1</sup> *Commercialization* is a French term that is somewhat broader than *marketing*.

In its statement of April 22, 2005, the AMF takes the view that a distributor is deemed to be 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 it is able to show that (i) it adheres to a code of good conduct, and (ii) a significant number of sales have been made to entities not related to the management company's group.

In order 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 the UCITS complies with the new rules on the payment 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).

Open questions remain as to the sanctions available to the AMF to enforce 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 by imposing a fine or by prohibiting the management company from undertaking 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 is not active in France, one may question how the AMF could effectively impose sanctions on 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 sanctions could be imposed on the bottom-tier UCITS (or its management company) if it were to pay a fee to the top-tier UCITS's management company.

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## Practice group contacts

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