

EFAMA response to the CESR call for evidence on possible implementing measures concerning the future UCITS Directive

EFAMA¹ is grateful for the opportunity to comment on CESR's call for evidence on possible implementing measures concerning the future UCITS Directive at this early stage. We are very pleased that regulators have initiated the dialogue with the industry and we look forward to commenting on CESR's draft advice in the coming months. Despite the tight timetable, it is important for the industry that sufficient time is allowed for the second consultation round, taking into account the summer recess, in order to properly assess CESR's recommendations and provide useful comments.

In view of the forthcoming draft advice, EFAMA limits itself to highlighting some general principles and indicating where Level 3 guidance should replace Level 2 measures, thus alleviating CESR's workload and making it easier to meet the October deadline. For the industry, it is of the utmost importance that those Level 2 provisions that allow for the realisation of the intended efficiency gains resulting from all five measures of the UCITS IV "Efficiency package" are implemented in parallel with the Level 1 rules. In other words, some Level 2 measures are not needed at all or could be added at a later stage as a result of practical experience in the functioning of the Directive. It would, however, significantly delay the further integration of the internal market if crucial measures relating to the notification procedure, mergers or master-feeder structures were to be adopted after the implementation of the framework directive.

¹ The European Fund and Asset Management Association (EFAMA) is the representative association for the European investment management industry. EFAMA represents through its 24 member associations and 44 corporate members about EUR14 trillion in assets under management of which EUR 6.1 trillion was managed by around 53,000 investment funds at end 2008. For more information, please visit www.efama.org.

Before commenting on each section separately, EFAMA members would like to reiterate the Commission's request that the **principle of proportionality** should be respected: firstly, measures must be proportionate to the size and complexity of the activities and organisation of the management company as well as to the characteristics of the UCITS. Secondly, any measure proposed by CESR should not go beyond to what is necessary to achieve the objective of the new Directive. Lastly solutions should not lead to excessive administrative or procedural burdens on UCITS and their management companies whilst maintaining a high level of investor protection.

PART I – MANAGEMENT COMPANY PASSPORT

Prudential rules and conflicts of interest (Article 12)

Rules of conduct including conflicts of interest (Article 14)

Firstly, EFAMA members believe that CESR should seek alignment between MiFID and UCITS implementing measures on conflicts of interest and rules of conduct as far as possible whilst taking due account of the **specificities of UCITS management. Consistency and coherence throughout financial market legislation** are needed, but a one-size-fits-all approach ignoring the individual characteristics of collective portfolio management must be avoided.

Secondly, the new **implementing measures for UCITS must not go beyond those already adopted for MiFID**. This means that issues such as “churning, soft commission arrangements, timely allocation of transactions/market timing, late trading, underwriting” should not be dealt with at Level 2. Any new rules that are not absolutely necessary to achieve the aim of the Directive should be avoided in order not to delay the work.

Thirdly, with regard to procedures and arrangements to be implemented by the management company (p. 7 II.a), CESR is asked to consider “the nature of the UCITS managed by the management company (its characteristics and complexity)”. This request reflects the Level 1

provision that requires the competent authority of the management company's home Member State to issue an attestation that gives "details of any restriction on the types of UCITS that the management company is authorised to manage" (Article 17 (3) last sub-paragraph). EFAMA members highlight that so far **no legal definition of specific "types of UCITS" exists**. To make the passport work smoothly, to avoid any excessive administrative burden both for regulators and the industry and to respect the timeframe, we believe that **common procedures and arrangements** should be envisaged, especially when these relate to electronic data processing and internal control mechanisms for, inter alia, personal transactions which are not influenced by a specific "type of UCITS" and should hence be dealt with exclusively at the level of the management company.

Measures to be taken by a depositary (Articles 23 and 33)

From the industry's perspective, the analysis of the implementation of the role and liabilities of depositaries in different Member State following the Madoff fraud, and the introduction of any new measures resulting thereof, are outside the scope of the present mandate. To be able to maintain its own timetable, CESR should clearly limit itself to giving advice on Articles 23 and 33 of the UCITS IV Directive.

CESR should bear in mind that the implementing measures relating to the mentioned Articles only cover the case of cross-border management of a fund. In other words, **no duties should be imposed on the depositary that might lead to a different level of investor protection for funds that are managed cross-border vis-à-vis those managed domestically**. In this context, we strongly believe that it is the task of the management company, not of the depositary, to "verify continues compliance with the risk profile of the UCITS" (p. 9). According to the Directive, the depositary only has the duty to ensure that the fund is managed according to the law and the fund rules (or its instruments of incorporation). And according to CESR's own "Risk management principles for UCITS" of February 2009, it is the portfolio manager who "is responsible for taking investment decisions compatible with the risk limits system. On the other hand, measurement of the corresponding risks and monitoring of the risk limit system is assigned to the risk management function" (paragraph 18, p. 13).

Moreover, EFAMA would like to suggest that CESR should concentrate on **defining only the main elements** of a standard agreement and not go into further detail.

With regard to the applicable law, a broad majority of EFAMA members do not see the need to regulate through Level 2 measures the law applicable to the agreement between the depository and the management company. The **choice of the applicable law should be left to the two parties to the agreement**, although the contract should clearly state which law is applicable.

Risk management (Article 51)

EFAMA members acknowledge the high importance of risk management and welcome CESR's recently published "Risk Management Principles for UCITS" of February 2009. We believe that future Level 2 implementing measures should follow the same approach and should not go beyond these principles in order to grant asset managers the necessary flexibility to adapt risk management procedures to a permanent changing environment.

With regard to the supervisory role of competent authorities, EFAMA agrees that risk management should be considered by the competent authorities, but **there cannot be a re-assessment of the risk management process each time a new UCITS is authorised**. This would not only contradict the newly introduced Management Company Passport, which foresees that the competent authority of the UCITS fund relies fully on the attestation issued by the management company's home Member State, but it would also be overly burdensome for the industry. When licensing a new UCITS, the initial risk management approval for the management company should be relied upon and multiple approvals should be avoided. EFAMA members call on CESR to take this into account.

Despite our general support for CESR's risk management principles, EFAMA members recommend to CESR to complement the principle that the Board of Directors should "approve" the risk profile of each UCITS (Box 9) as well as the risk limits (Box 10) with appropriate delegation powers. We fully endorse the principle that the **ultimate responsibility for both the profile and the limits lies with the Board of Directors**. In fact, the Board endorses the risk profile of the fund by approving the Prospectus and is liable for it. However, it should be

possible to have the approval of the risk profile and risk limits delegated to an organ of the Management Company (i.e. a Risk Committee, or an Executive Committee) on a day-to-day basis. Such **delegation** is necessary to avoid undue delays in the launch or operation of funds. EFAMA members call on CESR to take this into account when proposing its advice.

Referring to point II.1.a of the mandate (p. 13), EFAMA members would like to point to the difficulty of establishing a list of material risks that are relevant for UCITS. **Any provision on categories of material risks should remain principle-based at Level 2.** Today's financial crisis is a timely reminder of how dangerous it could be for investors, funds and regulators if risk identification were restricted by static categories, ignoring changes to market conditions.

With regard to CESR's principles on risk measurement techniques (Box 6, p. 16), EFAMA members fully support the statement made in paragraph 30 (p. 17) that "measurement techniques should be appropriate and proportionate to the nature, scale and complexity of the Company's activities and of the UCITS it manages". However, we consider it totally inappropriate to prescribe which measurement methods a UCITS should use. Given the continuously changing risk environment as well as the constant development in best practices and risk measurement methodologies, a specific risk measurement methodology set in stone would be counterproductive. We therefore strongly urge CESR to **provide principle-based** advice with regard to points II.1.c and d of the mandate (p. 13).

Concerning the "detailed rules regarding the accurate and independent assessment of the value of the OTC derivatives" (II.2, p. 14), EFAMA members strongly doubt that more specific rules than those already set out in Article 8 (4) of Implementing Directive 2007/16/EC should be introduced. In addition to these binding Level 2 measures, CESR's Level 3 guidelines of March 2007 already gives sufficient guidance to the independent assessment of the value of OTC derivatives.

On-the-spot verification and investigation (Article 101)

EFAMA members fully endorse CESR's statement in its advice on the management company passport of 31 October 2008 that "the procedure to be followed in the course of on-the-spot verifications be the procedure applicable in the country of the inspected entity".

Exchange of information between competent authorities (Article 105)

EFAMA members suggest alignment of UCITS and MiFID provisions on exchange of information between competent authorities where appropriate.

PART II – KEY INVESTOR INFORMATION

EFAMA will provide detailed comments within the separate consultation on Key Investor Information. Nevertheless, the industry would like to state at this point that it clearly **prefers an implementing regulation to an implementing directive**. Information to investors will be comparable and efficiency gains possible only if the future KII is fully harmonised and does not leave any room for national gold-plating.

Content and presentation of KII (Article 78 (7))

In this context, EFAMA members stress that full harmonisation can and indeed should realistically only be achieved and envisaged with respect to the content and presentation of KII, not as to how the KII is provided or to other issues subject to national civil law. Moreover, harmonisation of content and presentation should take place at Level 2 and not Level 3 to ensure maximum coherence throughout the EU.

Concerns have been expressed by EFAMA members with regard to cross-references to other documents or "signposts" (II.2, p. 19): on the one hand, the last sentence of Article 78 (3) that "the essential elements shall be understandable by the investor without any reference to other documents" could be interpreted that KII provides exhaustive information on the essential elements of the UCITS. This is not possible per se since the KII is supposed to be a document

limited in size and reduced to the essential characteristics of a UCITS enabling investors to make comparisons. Therefore, **it is necessary to permit cross-references** to other documents (i.e. glossary, explanations of asset classes, information brochures about the underlying financial markets, information on ratings in case of bond funds etc.) as suggested in Article 78 (4) whilst respecting the translation requirements set out in Article 94 (1) (b). On the other hand, EFAMA members believe that the **option to use signposts should be left to the UCITS/its management company** to ensure that national regulators do not impose information requirements other than the KII, which in turn would undermine the original objective of having a single and fully harmonised, as well as comparable, document.

Specific conditions to be met when providing KII in a durable medium other than paper (Article 81 (2))

Rules concerning the provision of KII in a durable medium other than paper or by means of a website which does not constitute a durable medium should be aligned with respective MiFID standards, i.e. Article 3 of Directive 2006/73/EC.

Specific conditions when providing the prospectus in a durable medium (Article 75 (4))

Rules concerning the provision of the prospectus in a durable medium or by means of a website which does not constitute a durable medium should be aligned with respective MiFID standards, i.e. Article 3 of Directive 2006/73/EC.

PART III – FUND MERGERS, MASTER-FEEEDER STRUCTURES AND NOTIFICATION PROCEDURE

Merger of UCITS (Article 43 (5))

In the information² to be provided to investors, the merging and the receiving UCITS are required to explain the background to, and rationale for, the proposed merger as well as the possible impact on investors (II.1. a-c, p. 23). EFAMA members fear that implementing measures requiring lengthy explanations might lead to an overload of information which investors might not comprehend or be able to assess. Similar to the KII, information on mergers should be brief and simple in order to enable them to decide on whether to stay invested or not.

Moreover, EFAMA members have noted the absence of effective resolution mechanisms in case the competent authority of the receiving UCITS home Member State is not satisfied with the information to be provided to investors even after having indicated its dissatisfaction and having given the receiving UCITS the possibility to modify the information (Article 39 (3) fourth subparagraph). In such a scenario, the merger could not be authorised. Unfortunately, the ultimate decision-making power on the merger has not been granted entirely to the competent authorities of the merging UCITS Member State (see Article 39 (4)). In order to avoid potential conflicts, we encourage CESR to provide for appropriate resolution mechanisms.

Master-feeder structures

EFAMA members acknowledge the distinct character of the relationship between a master and a feeder UCITS as compared to the relation between a master fund and its direct retail investors, and hence the need for granting certain information rights to the feeder fund. Nevertheless,

² The term “information letter” introduced by the Commission is misleading since it implies a certain format and way of provision although these aspects are subject to CESR’s advice.

EFAMA members call on CESR to exert caution in limiting the feeder's information privileges to those needed to enable it to fully comply with its obligations under the UCITS Directive. Moreover, further unnecessary administrative burden putting master-feeder-structures at an even greater competitive disadvantage compared to funds of funds should be avoided. Finally, we recommend that CESR refer to existing national regimes as a starting point for its advice instead of introducing new provisions that have not been tested before.

Article 60 (6) regarding the content of the agreement/internal conduct of business rules between feeder and master UCITS

EFAMA members understand the benefits of providing a draft model agreement or a draft of internal conduct of business rules (II.2 and II.1.b, p. 27). For reasons of timing and flexibility, CESR should, however, confine itself to advising on the basic principles and main elements of the agreement/internal conduct of business rules and leave it to the two parties to negotiate the details.

Moreover, a broad majority of EFAMA members believe that the applicable law should be chosen by the master and the feeder fund, and the contract should clearly state which law is applicable (II.3, p. 27). Others favour CESR's advice stating that the applicable law should be that of the master UCITS since it would be easier to manage a master-feeder structure where the feeder funds are located in different jurisdictions.

Article 60 (6) regarding the appropriate measures to avoid market timing

Regulating market timing in detail is a highly complex, if not impossible task because of the different practical situations arising for example from time differences in fund jurisdictions, from existing provisions regarding NAV calculation and cut-off times in the funds' prospectuses, and from very different trading models across the EU. For example, funds are often listed on an exchange, but the pricing mechanism is very different from country to country. Moreover, secondary trading of UCITS is often initiated by third parties without consent by the

management company and thus remains outside the scope of influence of management companies. Instead of suggesting regulatory measures, CESR should consider leaving to the prospectuses or – possibly – to the agreement between the master and the feeder the measures to avoid market timing whilst taking into account specificities of cut-off times and NAV calculation.

Article 60 (6) regarding the procedures for approvals in case of liquidation, merger or division of the master UCITS

Where a feeder UCITS applies for approval in order to stay invested in the master UCITS or to become a feeder UCITS of another UCITS resulting from the merger or division (letter f), p. 31), EFAMA members believe that the approval procedure of the master-feeder structure should be simplified. This is in line with the Commission’s own analysis that “a merger or division of the master UCITS does not per se put into question the master-feeder-structure since the feeder UCITS may stay invested in the master UCITS [footnote: In a merger, this is the case, if the master UCITS is the receiving UCITS.] or another UCITS [footnote: In a merger, this is the case, if the master UCITS is the merging UCITS.] resulting from the merger or division” (p. 28).

Article 61 (3) regarding the agreement between depositaries

EFAMA members understand the benefits of providing a draft model agreement (II.2, p. 32). Nevertheless, for reasons of timing and flexibility, CESR should confine itself to advising on the basic principles and main elements of the agreement and leave it to the two parties to negotiate the details.

A broad majority of EFAMA members believe that the depositaries of the master and the feeder UCITS should be free to choose the applicable law, and that the contract should clearly state the applicable law. No restrictions as to the choice of the applicable law should be imposed (II.3, p. 32). Others favour CESR’s advice stating that the applicable law should be that of the master

UCITS since it would be easier to manage a master-feeder structure where the feeder funds are located in different jurisdictions.

Article 61 (3) regarding the irregularities the depositary of the master UCITS has to report

Although the depositary has an oversight role and is considered as an additional safeguard for supervisors, it should not replace the supervisor. Therefore, the master fund's depositary should only be held liable for informing about those irregularities that are directly related to its tasks set out in the UCITS Directive (II.1, p. 33). Otherwise, different levels of investor protection might be created between master-feeder-structures with a master fund's depositary carrying out what could be seen as "enhanced oversight function" on the one hand, and "traditional" funds or fund structures such as funds of funds with a "simple oversight function" on the other. We therefore suggest excluding this question from the present advice.

EFAMA members welcome the invitation to CESR to draw up a list of the types of irregularities the master fund's depositary detects with regard to the master UCITS (II.2, p.33). Such a list should be exhaustive to ensure legal certainty for both the master fund's depositary as well as the feeder UCITS and its depositary that might be obliged to take own measures to protect the best interests of their investors when being informed about irregularities.

Moreover, the list should concentrate on irregularities which are material and which have a significant negative impact on the feeder UCITS. The depositary should enter into a dialogue with the master fund's management company to determine the significance of the irregularity and possibly correct it, thereby rendering a notification to the relevant authority superfluous. Such a dialogue would also accelerate the remediation of the irregularity, to the ultimate benefit of investors.

Article 62 (4) regarding the agreement between auditors

EFAMA members understand the benefits of providing a draft model agreement (II.2, p. 35). Nevertheless, for reasons of timing and flexibility, CESR should confine itself to advising on the basic principles and main elements of the agreement and leave it to the two parties to negotiate the details.

A broad majority of EFAMA members believe that the auditors of the master and the feeder UCITS should be free to choose the applicable law, and that the contract should clearly state which law is applicable. No restrictions as to the choice of the applicable law should be imposed (II.3, p. 35). Others favour CESR's advice stating that the applicable law should be that of the master UCITS since it would be easier to manage a master-feeder structure where the feeder funds are located in different jurisdictions.

Article 64 (4) regarding the contribution in kind

A broad majority of EFAMA members do not see the need for further implementing measures given that both the feeder and the master fund as well as the depositaries and auditors already have to enter into an agreement according to Articles 61 and 62 and will hence ensure that the interests of their respective investors are protected.

Notification procedure

EFAMA members urge CESR to come forward with its advice on the notification procedure by 30 October 2009 in order to enable the Commission to propose and adopt the necessary implementing measures in time. The notification procedure is one of the major elements of the Efficiency Package and its harmonised implementation should not be put at risk.

In addition to the Commission's mandate, CESR should examine and clarify how fee structures will be adapted to the new regulator-to-regulator approach.

Scope of the information on national law to be published by UCITS host Member State

EFAMA members welcome the fact that Member States shall ensure that complete information on the laws, regulation and administrative provisions which are specifically relevant to the arrangements made for marketing are published (Article 91 (3)). We suggest that the information should be published in a standardised way on the regulators' websites and that the scope should include information on the laws and regulations on penalties for non-compliance with national rules.

Moreover, we consider it of the utmost importance that management companies should be able to rely fully on the information published. Therefore, a broad majority of EFAMA members believe that CESR Members should commit themselves not to apply sanctions to a management company if relevant rules pertaining to marketing are not published on the regulator's website. A management company should not have to suffer the consequences of the supervisor's failure to fulfil its disclosure requirements. Instead, supervisors should grant those companies a transitional period to remedy the situation and, in parallel, should complete/update their publication.

Facilities and procedures providing for the access of a host Member State to statutory documents of a UCITS and other information as referred to in Article 93 (1) to (3)

EFAMA members agree with the Commission that CESR should assess the need for a general database at a national or EU level. The assessment should include a thorough cost-benefit analysis and consider the need for compatible IT systems in case of national databases (II.1, p. 40).

EFAMA members regret that Article 93 (7) of the Level 1 Directive breaks with the regulator-to-regulator approach and requires UCITS to notify any amendments to the notification documents to the competent authority of the UCITS host Member State. Instead, and depending on the outcome of the cost-benefit analysis, it could be envisaged that a UCITS notifies its home Member State authority which in turn will feed the amended documents into the general

database. The upload of the new files should satisfy the notification requirement by the competent authority of the host Member State and would be fully consistent with the newly introduced regulator-to-regulator approach.

Standard model of the notification letter (Article 93 (1)) and the attestation (Article 93 (3))

As a general remark, EFAMA members call for maximum harmonisation of the form and (the exhaustive list of) contents of the notification letter. CESR's guidelines to simplify the notification procedure of UCITS of June 2006 could be used as a model.

According to Article 93 (1), the notification letter shall include information on arrangements made for marketing of units in the host Member State. EFAMA members believe that it should be sufficient to state a) whether the units will be distributed directly or indirectly (via fund platforms, independent agencies or other third parties), and b) that the UCITS will comply with the rules of the host Member State. Setting out detailed marketing plans with a complete list of distributors would be very burdensome and impractical. For instance, fund managers in most cases do not know the intermediaries linked to the fund platform or independent agency they use. Since these business relationships tend to change rather frequently, the UCITS would have to permanently update the information contained in the notification letter which in turn would incur additional costs without enhancing investor protection. Finally, it must be remembered that many areas of marketing are already subject to EU-legislation, for instance to MiFID where funds are distributed via MiFID entities, the Distance Marketing Directive or the E-commerce Directive.

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