ALFI contribution to the CESR call for evidence on possible implementing measures concerning the future UCITS directive

Introduction

ALFI represents the Luxembourg investment management and fund industry. It counts among its membership over 1 300 funds and asset management groups from around the world and a large range of service providers. According to the latest CSSF figures, on 31 January 2009, total net assets of undertakings for collective investment were 1.571 trillion euros.

There are 3,398 undertakings for collective investment in Luxembourg, of which 2,034 are multiple compartment structures containing 10,914 compartments. With the 1,364 single-compartment UCIs, there are a total of 12,278 active compartments or sub-funds based in Luxembourg.

According to December 2008 EFAMA figures, Luxembourg's fund industry holds a market share of 25.4% of the European Union fund industry, and according to 2008 PWC/Lipper data, 75.4% of UCITS that are engaged in cross-border business are domiciled in Luxembourg. As one of the main gateways to the European Union and global markets, Luxembourg is the largest cross-border fund centre in the European Union and, indeed, in the world.

ALFI would like to thank the CESR for the opportunity to participate in this call for evidence and ALFI welcomes CESR's involvement in this matter.

ALFI has since the coming into force of UCITS I supported the UCITS product as a main and highly regulated savings product that has been particularly designed for retail investors. ALFI is of the opinion that the currently undertaken changes to the UCITS legislative framework will have positive effects on the overall efficiency of the UCITS investment product. Especially ALFI expects great benefits in terms of investor protection and investor information, from the KID that will replace the simplified prospectus. ALFI also supports the efforts undertaken in order to further streamline the distribution process and welcomes the improvements brought to the notification process for cross border fund registration and distribution.

ALFI considers that some outstanding issues that require further attention. These are i.e.:

- The level of involvement of competent authority authorising the investment fund especially as regards the adequacy of the organisation and risk management processes employed by the management company in respect of the fund's investment policies and strategies,
- The access to information about the management company by the competent authority of the investment fund in order to ensure that the fund complies with the rules in force. Level 1 rules need to be complemented in order to provide the competent authority of the investment fund with an effective and direct right of access to all the information relevant to the on-going supervision of the fund,
- It is of the great importance that all Level 2 provisions can be implemented in parallel with the Level 1 rules. It would significantly delay not only the realisation of efficiency

gains, but also the further expected integration of the internal market if measures relating to the notification procedure, mergers or master-feeder structures were adopted after the implementation of the framework directive,

- ALFI also considers that possible Level 2 measures should not go beyond what is necessary to achieve the objectives of the new directive. With regard to the timely implementation of both Level 1 and Level 2 measures, CESR may wish to consider where Level 3 guidance can usefully supplement Level 1 and replace Level 2 measures, not only but essentially with regard to the upcoming deadlines for the implementation process of UCITS IV.

The views that ALFI would like to share with CESR relate to the various parts composing the request for assistance that the Commission has addressed to CESR. Although ALFI is largely supportive of the approach chosen by the call for evidence, it would wish to stress that implementing measures relating to the notification procedure, although highlighted as a particularly important complement to the Level 1 provisions, are only part of Part III package of the call for evidence. There is furthermore, it would seem, no strict timetable for any such possible measures, nor is there a legal obligation for the Commission to come up with Level 2 measures should they be necessary (e.g. with regard to the standard notification letter and to the electronic exchange of information). ALFI believes that the improvements made to the notification process are largely non contentious, and should be considered with the same priority as the measures where the Commission either has a legal obligation to come up with Level 2 measures or has to comply with a strict timetable or both.

REQUEST FOR TECHNICAL ADVICE ON LEVEL 2 MEASURES RELATED TO THE MANAGEMENT COMPANY PASSPORT (PART I OF THE MANDATE)

There are 6 issues mentioned in the CESR call for evidence on which ALFI would wish to comment upon in their order of appearance. Before doing so, ALFI would like to make the following general observations:

- ALFI strongly shares the views expressed in the background statements under part one of the call for evidence whereby Level 2 provisions on the management company passport must ensure that investors in funds managed on a cross border basis are not exposed to additional operational risk or to lower standards of investor protection in comparison to domestically managed investment funds,
- ALFI agrees that an appropriate level of harmonised rules allows building up mutual trust and confidence between competent authorities,
- ALFI does also share the view that organisational requirements attached to the management company and in particular those relating to risk management processes are essential to the strengthening of the current regulatory framework as well as they are essential in the context of the current financial crisis and market environment.
- Finally, ALFI fully shares the view that when dealing with conflicts of interest and rules of conduct issues existing MiFID implementing measures should be considered, giving however due consideration to the specificities attaching to UCITS and to the UCITS set up.

1.2.1. Prudential rules and conflict of interest (article 12)1

Questions

CESR is invited to advise the Commission on the content of the rules that are proportionate and necessary for specifying the general obligations placed on management companies by Article 12(1)(a) and (b).
In particular CESR is requested:

a) to define procedures and arrangements to be implemented by the management company, having regard to the nature of the UCITS managed by the management company (its characteristics and complexity), that meet requirements of Article 12(1)(a),

b) to define the conditions for the structure and organisational requirements of a management company that are necessary for minimizing conflicts of interests as referred to in paragraph 1(b).

For ALFI's position, please refer to point 1.2.1 hereunder.

1.2.2. Rules of conduct including conflicts of interest (article 14)2

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1 **Scope of the Commission's implementing powers (Article 12(3))**

"***3. Without prejudice to Article 116, the Commission shall adopt by, 1st of July 2010, implementing measures specifying procedures and arrangements as referred to under point (a) of paragraph 1 and the structures and organisational requirements to minimize conflicts of interests as referred to under point (b) of paragraph 1.***
…"

2 **Scope of the Commission's implementing powers (Article 14(2))**

"2. Without prejudice to Article 116, the Commission shall adopt, by 1 July 2010, implementing measures, with a view to ensuring that the management company complies with the duties set out in paragraph 1, in particular to:

(a) define the steps that management companies might reasonably be expected to take to identify, prevent, manage and/or disclose conflicts of interest as well as to establish appropriate criteria for determining the types of conflicts of interest whose existence may damage the interests of the UCITS;

(b) establish appropriate criteria for acting honestly and fairly and with due skill, care and diligence in the best interests of the UCITS;

Questions

CESR is invited to advise the Commission:

a) on the rules that should specify the steps management companies should be expected to take pursuant to Article 14(2)(a),

b) on the criteria according to which the conduct of its business by a management company should be assessed by the competent authorities (according to Article 14(2)(b)),

c) on the conditions and principles that will ensure that a management company employs effectively the resources and procedures necessary for the proper performance of its business activities.

ALFI observations on points 1.2.1. and 1.2.2 on prudential rules and conflicts of interest as well as rules of conduct including conflicts of interest - both referring to a large extent to the MiFID concepts as laid down in MiFID Level 2 measures, are stated hereunder with regard to both points of the CESR call for evidence.

ALFI carefully considered whether the application of MiFID rules in respect of areas covered in the CESR Call for Evidence (CESR/09-179) on organisational requirements and conflicts of interest for management companies would be appropriate.

Executive Summary

For those management companies which conduct activities over and above the activities of a management company, and are subject in any event to MiFID rules on segregated asset management and advice, the adoption of MiFID-equivalent standards is likely to be broadly appropriate.

For those management companies which are part of groups with several MiFID firms, the adoption of MiFID-equivalent standards is also likely to be appropriate.

However, the following areas should be approached with caution:

Several activities undertaken by a management company (such as maintenance of the shareholder register) have no obvious equivalent activity in the MiFID world and so experience from MiFID does not provide any strong indicators. In this case we would suggest relying upon the overarching governance and organisation principles rather than creating specific codes (see Part 3).

(c) specify the principles required to ensure that management companies employ effectively the resources and procedures which are necessary for the proper performance of their business activities"
…"

Using MiFID as a starting point, allowing for the issues above, seems most appropriate as providing for a degree of harmonisation across activities often undertaken within the same control and management environment. It may also have the effect of stymieing attempts to retro-fit enhanced regulation post-Madoff and post-credit crunch.

1. The CESR Call for Evidence

CESR/09-179 calls for evidence in respect of several aspects of the operation of a management company in respect of detailed rules to be made under the following articles of the new UCITS Directive and which appear to have a predecessor in MiFID:

Article 12(1)(a)	❖ Sound administrative and accounting procedures ❖ Control and safeguard arrangements for electronic data processing ❖ Adequate internal control mechanisms including: ▪ Rules on personal transactions by employees and for the holding or management of investments in financial instruments in order to invest own funds, ensuring that each transaction involving the UCITS may be reconstructed ▪ Compliant management of assets
Article 12(1)(b)	❖ Conflicts of interest
Article 14	❖ Conduct of business including: ▪ Acting honestly and fairly ▪ Acting with due skill, care and diligence ▪ Necessary resources and procedures ▪ Conflicts of interest ▪ Acting in best interests of investors

2. The key relevant MiFID provisions

These are contained in the following core documents (bearing in mind that each Member State will have its own, often amended, version of these) with the key areas highlighted:

Directive 2004/39/EC	Art.13 Organisational requirements Art.18 Conflicts of Interest
Directive 2006/73/EC	Art. 5 Organisational Requirements including ▪ Clear management structure ▪ Internal control systems ▪ Recordkeeping Arts.6-8 – Compliance, Risk Management & internal Audit Arts.11-12 Personal Transactions Arts.13-15 Outsourcing

	Arts.16-19 Safeguarding client assets (only applicable to custodian banks of UCITS) Arts.21-23 Conflicts of Interest
CESR/08-733 – Supervisory Briefing: Conflicts of Interest	

3. The scope of the ongoing consultation

A management company is responsible for the activities referred to in Annex II of the Directive, i.e. collective portfolio management including segregated asset management, administration and marketing of UCITS units.

To the extent a management company carries on the activities of portfolio management based on discretionary mandates, investment advice and safekeeping and administration of UCITS, it is subject to Art. 12, 13 and 19 of the MiFID Directive as set out in Art.6 (4) of the UCITS IV Directive.

MiFID Level 1 and Level 2 regulation apply to the activities referred to in paragraph 3 of Art. 6 of the UCITS IV Directive, when performed by a Management Company, whereas the UCITS Directive applies to the activities referred to in Annex II of the UCITS Directive.

ALFI's understanding on the scope of the ongoing consultation is how to implement in Level 2 provisions equivalent to those implementing Art. 13 and 18 of the MiFID Level 1 Directive.

4. Conflicts of interest

As the Commission states in its Provisional Request, the powers given to CESR in relation to Art. 14 of the UCITS IV Directive "…are similar to those granted to the Commission under Article 18(10) of the MiFID Directive (2004/39/EC)".

Consequently, we should focus on Level 2 MiFID provisions implementing the aforementioned Article 18, i.e. Chapter II, Section 4 of MiFID Level 2 regulation (Dir. 2006/73/EC).

ALFI would like to stress that Art. 21 to 23 of Directive 2006/73/EC should be transposed into Level 2 regulation of the UCITS IV Directive bearing in mind the following:

MiFID requires the identification, recording and management of conflicts of interest. Article 21 of the Implementing Directive contains a variety of situations that constitute a conflict which can broadly be categorised as:

Firm v client
Client v client

The difficulty that might arise here is if the fund and its unit holders are separately treated as different clients. For example, in processing issues and redemptions is the management company providing a service to the fund or to the unit holder? MiFID does not have the capacity to make the necessary and subtle distinctions.

If the interests of a unit holder (say a market timer) conflict with those of other unit holders, that can be dealt with fairly straightforwardly, but on the face of it by systematically disadvantaging the market timer.

However, this could be an area of some complexity: for example, the need to retain sufficient liquidity within a fund while offering redemption on demand to clients. Sometimes it is difficult to distinguish the interest of the fund's manager from that of the fund.

It would be helpful therefore if the concept of client was limited, and if that were not possible to have some guidance from CESR of the priority that should be applied to the fund as opposed to its individual shareholders.

Organisational requirements:

As the Commission states in its Provisional Request, the powers given to CESR in relation to Art. 12 of the UCITS IV Directive "…are similar to those granted to the Commission under Article 13(10) of the MiFID Directive (2004/39/EC)".

Consequently, Level 2 MiFID provisions implementing the aforementioned Article 13, i.e. Chapter II, Section 1 to 3 of MiFID Level 2 regulation (Dir. 2006/73/EC) should be considered here.

ALFI believes the principle of separation between the depositary and the Management Company of a UCITS clearly affects the harmonisation between UCITS IV Level 2 regulation and MiFID Level 2 regulation.

In particular and given the separation existing between the depositary and the Management Company of the UCITS, Section 3 of Chapter II of MiFID Level 2 Directive should not be applicable to the Management Company, rather should it apply to the depositary of the UCITS.

1.2.3. Measures to be taken by a depositary of a UCITS managed by a management company on an investment company situated in another Member State (articles 23 and 33)3

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3 **Scope of the Commission's implementing powers (Articles 23(6) and 33 (6))**

"5. The Commission may adopt implementing measures on the measures to be taken by a depositary in order to fulfil its duties regarding a UCITS managed by a management company situated in another Member State, including the particulars that need to be

Questions

1. CESR is requested to advise the Commission on the specific conditions that a depositary must meet to fulfil its duties regarding a UCITS managed by a management company situated in another country.

The duties of the Depositary are set in articles 22 and 32 of the Directive. Irrespective of where the UCITS is managed, ALFI is of the view that these should be interpreted and implemented in accordance with the UCITS home state requirements.

The home state rules should govern the access of the depositary to the management company or its delegates' records. This may include on-line access, copies of the books and records of UCITS and potential on-sites to the management company or the appropriate delegate.

2. CESR is requested to advise the Commission on standard arrangements between the depositary and management company and identify the particulars of the agreement between them that are required under Articles 23(6) and 33(6) and the regulation of the flow of information deemed necessary to allow the depositary to discharge its duties.

ALFI suggests that a separate agreement be put in place for this and that existing agreements are not used. The agreement should give the depositary the right of access to share dealing activity, shareholder records, the UCITS registrar, access to the books and records of the fund, annual and semi annual accounts, on-site visits to the management company or its delegates, portfolio of holdings. The scope of what will be required will depend on whether the fund is a FCP (article 22) or a SICAV (article 32)

The agreement should also give the management company a right of access to the assets, including cash that the depositary holds for the UCITS.

3. CESR is invited to consider the need to regulate through level 2 measures the law applicable to the agreement in order to remove legal uncertainty (whether the agreement should be governed by law of UCITS home Member State, management company home Member State or of any other Member State).

ALFI is of the view that the governing law should be the governing law of the depositary.

1.2.4. Risk management (article 51) 4

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included in the standard agreements to be used by the depositary and the management company as referred to in paragraph 4.
…"

4 **Scope of the Commission's implementing powers (Article 51(4))**

As a preliminary observation, ALFI welcomes CESR's intervention on risk management and its inclusion in the first part of the call for evidence. ALFI believes that the future framework for the management company passport must include not only rules with regard to organisational requirements of the management companies and the resolution of conflicts of interest, but that due and sound risk management processes are of primary importance.

ALFI is of the opinion that risk management should also be discussed in the context of the other provisions mentioned in the CESR paper 09/179 and in the context of the depository bank. In particular, one could expect that the role of a depository/custodian/trustee in the absence of a local management company will change regarding risk management – i.e. there might be additional measures necessary at the level of the custodian concerning risk management (oversight function, fiduciary duty). All in all, the provisions laid down in the paper concerning the management company need to be discussed and the interdependencies analysed carefully.

ALFI believes that sound risk management systems require organisational requirements and specific safeguards and due diligence in order to ensure that all types of risk are adequately captured, particularly in the light of the current market situation and the turmoil in the financial markets.

ALFI is also of the view that risk management principles should cover not only derivative instruments, but should include the overall portfolio of the UCITS. Risk management principles should also be set out to avoid the negative consequences of pro cyclical measures or processes, such as Basel and other solvency rules. This would allow for risk management processes to operate under an approach that allows for a focus on long term risk.

The challenge will be to find measures which fit the needs of the various participants in the market and assure that regulation is flexible enough to cope with the changes in the financial markets in the future (hence a careful and balanced discussion on the regulatory approach (principles vs. rules) is necessary.

"4. Without prejudice to Article 116, the Commission shall adopt, by 1 July 2010, implementing measures specifying the following:

- criteria for assessing the adequacy of risk management process employed by the management company in accordance with the first sentence of paragraph 1;

- detailed rules regarding the accurate and independent assessment of the value of the OTC derivatives;

- detailed rules regarding the content and the procedure to be followed for communicating the information to the competent authorities of the management company's home Member State referred to in the third sentence of paragraph 1.
…"

Since the complexity of UCITS funds can vary significantly there will be no single rule which fits all funds – hence one should distinguish between non-sophisticated funds and sophisticated funds, wherein the latter should generally have more detailed risk management measures in place.

One of the key principles of UCITS is the protection of investors. Consequently, the principles of risk management can truly be seen as a subset of the overall principles to protect investors.

ALFI is of the opinion that convergence among competent regulators can be fostered by common principles as a common standard rather than having a rule-based regulatory approach at the level of European legislation.

Questions

CESR is invited to advise the Commission on the following questions:

1. What should be the conditions that govern risk management processes that can be employed by management/investment companies?
CESR is invited to establish the criteria that competent authorities should take into account when determining whether the risk management process employed by the management company is adequate for monitoring and measuring at any time the risk of a position and its contribution to the overall risk profile of the portfolio.

ALFI believes that the recently released CESR principles for UCITS risk management are a good starting point with regard to governance issues related to risk management processes that can be employed by management/investment companies. The various parameters defined therein with regard to setting up and running the risk management process are indeed very helpful.

The further integration of the European market for investment funds and the to be designed passport for management companies should be completed by well established criteria that competent authorities should take into account when determining whether the risk management process employed by the management company is adequate for monitoring and measuring at any time the risk of a position and its contribution to the overall risk profile of the portfolio.

In particular CESR is requested:

a) to advise on the categories of material risks that are relevant for UCITS (the identification of types of risks that should be addressed),

In particular with regard to the categories of material risks that are relevant for UCITS (the identification of types of risks that should be addressed), ALFI believes that all financial risks (such as market risk, credit risk, counterparty risk or liquidity risk) but also operational risks, as far as they may affect the interests of the investors through their direct impact on the

funds portfolio, should be considered. Furthermore ALFI agrees with § 7 of the chapter "Risks relevant to UCITS" of the CESR risk management principles for UCITS. Risk management processes should take into account that the overall financial exposure of an investment fund may also depend on additional specific risk drivers that only emerge at the aggregate portfolio level (e.g. concentration risk or liquidity risk when liquidity is understood as the ability of the UCITS to meet its obligations (redemptions or debt reimbursements) as they become due.

b) to advise on principles governing the identification of the particular material risks relevant for a particular UCITS related to each portfolio position and their contribution to the overall risk profile of the portfolio,

ALFI agrees with § 7 of the chapter "Risks relevant to UCITS" of the CESR risk management principles for UCITS. Risk management processes should take into account that the overall financial exposure of an investment fund may depend on additional specific risk drivers that emerge at the aggregate portfolio level (e.g. concentration risk or liquidity risk when liquidity is understood as the ability of the UCITS to meet its obligations (redemptions or debt reimbursements) as they become due.

c) to advise, to the extent possible, on requirements concerning risk measurement methods, such as the conditions for the use of different methodologies in relation to the identified types of risk and the specific criteria under which these methodologies might be used,

ALFI does not believe that there should be Level 2 measures with regard to risk measurement methods, such as the conditions for the use of different methodologies in relation to the identified types of risk and the specific criteria under which these methodologies might be used. Such methodologies might evolve over time and in order to avoid the negative consequences of the pro cyclical Basel or other solvency rules that have come under current scrutiny for being another element that might have contributed to the further acceleration of the financial crisis, methodologies should not be cast in stone and should be rather left to Level 3 policy intervention in order, should the need arise, to have them adapted and changed in an efficient and timely manner.

d) to establish principles for risk management processes to be employed in order to mitigate or otherwise manage and monitor the identified risks related to each portfolio position and their contribution to the overall risk profile of the portfolio. This could include requirements for management companies to ensure proper functioning of risk management processes, establishment of criteria for assessing the effectiveness of risk management processes, setting out principles for systems for operating risk limits, and / or the definition of reporting and monitoring obligations. This list is not intended to be exhaustive or a final indication of the necessary elements, and CESR should consider the best overall packaged of measures necessary for ensuring sound risk management processes are in place for UCITS.
In relation to derivative instruments, CESR is in particular requested to recommend principles for calculating the global exposure related to derivative instruments, and

measures that UCITS must undertake to ensure that global exposure relating to derivative instruments does not exceed the total net value of its portfolio.

ALFI suggests that a distinction be made between sophisticated and non-sophisticated funds to enable a management company to use a risk management approach which fits the complexity of the UCITS. In this context only a commitment approach is designed to ensure that derivative exposure does not exceed the total net asset value of its portfolio. ALFI believes that sophisticated funds using a VaR approach including the risk related to derivatives do not need to calculate a separate commitment considering the derivative exposures only.

Furthermore ALFI is of the view that VaR should not be specified as the only possible measure for sophisticated funds but there should be flexibility to use other 'more adequate' approaches – however – as already reflected in CSSF circular 07/308 - a specific risk management approach would require pre-approval of the competent authority.

Furthermore a key element of UCITS risk management is not to limit the fund's exposure to market risk but to limit the fund manager's ability to increase market exposure via active fund management – i.e. the potential leverage generated by the fund manager needs to be limited rather than the market risk (systematic risk) as such. ALFI believes that in the context of global exposure restrictions the main goal of the restriction should be highlighted more clearly – i.e. the limitation of leverage should be highlighted and thus the use of a VaR approach is merely a measure to limit the leverage but not the market risk.

2. What should be the content of the detailed rules regarding the accurate and independent assessment of the value of OTC derivatives as referred to in Article 51(1)?

In addition to addressing OTC valuation it is important to understand the challenges arising from the valuation of other assets as well (the current crisis e.g. MBS/ABS demonstrates this very well); European legislation asks that risk management processes have a role in the valuation of OTC derivatives. CESR´s approach - as laid down in the paper on Risk principles - is broader in terms of scope (illiquid assets, structured securities and complex derivatives). However it is not stated that the risk management function is responsible for valuation, rather that risk management "provides appropriate support". ALFI requests that CESR clarifies in its position on risk principles that not only the valuation of OTC derivatives needs to be in the scope of risk management but also the increasingly complex valuation processes for other instruments.

3. What detailed rules should govern the content and the procedure to be followed by the management company for communicating the information mentioned in Article 51(1) to the competent authorities of its home Member State?

ALFI considers that having duly accepted and elaborated common criteria by CESR and a common approach with regard to enforcing such criteria on risk management processes is of great importance for the new cross border facilities linked to the management company

passport. In this regard, ALFI would like to stress the importance for having at Level 2 the appropriate framework laid down to ensure that the authority that is responsible for authorising the fund is sufficiently involved as regards the adequacy of the organisation and risk management processes employed by the management company. ALFI welcomes clarification of the approach CESR intends to take with regard to the receipt of the risk management process by the authority responsible for the fund.

1.2.5. On-the-spot verification and investigation (article 101)5

Question

CESR is invited to define the content of the procedures to be followed when competent authorities intend to carry-out verification or an investigation on the territory of another Member State.

1.2.6. Exchange of information between competent authorities (article 105)6

Questions

1. CESR is invited to define the content of the procedure to be followed when competent authorities intend to exchange information.

2. CESR is also requested to indicate if there are areas which could be more effectively regulated at level 3.

Both topics mentioned under points 1.2.5. and 1.2.6. with regard to supervisory issues are closely linked and are dealt with together in ALFI position given hereunder.

In ALFI's view, UCITS IV will only be successful if and when supervisory cooperation and convergence are efficiently put into place giving regulators the necessary and indispensable comfort of reliance on each other with trust and confidence, based and supported by common tools and prerogatives.

With regard to the territorial scope of competence of the respective supervisory authorities, and in order to allow supervisory authorities to make their reinforced cooperation a success,

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5 **Scope of the Commission's implementing powers (Article 101(9))**

"8. The Commission may adopt implementing measures concerning procedures for on-the-spot verifications and investigations. …"

6 **Scope of the Commission's implementing powers (Article 105)**

"The Commission may adopt implementing measures relating to the procedures for exchange of information between competent authorities.
…"

ALFI believes that the exchange of information should be the preferred way for strengthening the cross border supervision and cooperation.

The preferred option that should be referred to at Level 2 is the regime as recently introduced through MiFID. Although MiFID replaces the former Investment Services Directive and the associated supervisory cooperation regime, it must be noted that this regime has been considerably revisited through MiFID. The MiFID cooperation and supervisory framework could well serve as a good basis to this end. This is important as the MIFID regime is based on the principle of full home country control and mutual recognition. ALFI is of the opinion that this principle of home country control should remain unchallenged with regard to the future UCITS supervisory cooperation framework. Under UCITS IV the supervisory environment will become more complex, given there will no longer be a single competent authority in respect of funds using a management company and, as a result, coordination between the supervisor(s) of products and the supervisor(s) of service providers will be required. This should not, however, put at stake the fundamental principle of full home country control with regard to the fund passport or with regard to the management company passport.

ALFI would like to underline that when elaborating its advice, CESR is invited by the European Commission to take due account of the following:

- The high level of investor protection and supervision that are the guiding principles of the UCITS Directive. This should also guide the design of its implementing provisions. CESR is invited to keep these overarching principles in mind when elaborating its advice.

- These new implementing provisions are however not solely restricted to the situation where a management company exercises its right to manage a UCITS on a cross-border basis. Applying these new rules to all management situations (national and cross-border) could constitute an important contribution to the strengthening of the current EU regulatory framework. This is particularly important in relations to risk management processes, which can be considered essential in the context of the current financial crisis. CESR should therefore take due account of the general nature of the implementing powers conferred upon by the Commission. It shall also carefully assess the impact of these provisions on the existing business models and organisation of the European fund industry.

Hence, ALFI would like to repeat its former observation saying that in this regard, it is important to have at Level 2 the appropriate framework laid down that must ensure that the authority that is responsible for authorising the fund is sufficiently involved as regards the adequacy of the organisation and risk management processes employed by the management company.

REQUEST FOR TECHNICAL ADVICE ON THE KEY INVESTOR INFORMATION LEVEL 2 PROVISIONS (PART II OF THE MANDATE) – SUPPLEMENT TO THE COMMISSION 2007 "REQUEST FOR ASSISTANCE ON KEY INVESTORS DISCLOSURES FOR UCITS"

ALFI will provide detailed comments within the separate consultation on Key investor information.

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

Questions

CESR is invited to advise the Commission on the following questions:

1. What is the KII to contain and how should this be harmonised at level 2? How should level 2 measures fulfil the requirements of the UCITS IV Directive to specify the content and form of KII in a detailed and exhaustive manner such that the document is sufficient for investors to make informed decisions about planned investments? This should be taken to include the methodologies CESR considers necessary for delivering the information disclosures CESR proposes for the KII (e.g. the methodologies for risk, performance and charges disclosures). CESR should be clear as to the requisite degree of harmonisation it considers necessary for these supporting methodologies.

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7 **Scope of the Commission's implementing powers (Article 78(7))**

"7. The Commission shall adopt implementing measures which define the following:

a) the detailed and exhaustive content of the key investor information to be provided to investors as referred to under paragraphs 2, 3 and 4;

b) the detailed and exhaustive content of the key investor information to be provided to investors in the following specific cases:

i) for UCITS having different investment compartments (…),

ii) for UCITS offering different share classes (…),

iii) for funds of funds structures (…),

iv) for master-feeder structures (…),

vi) for structured, capital protected and other comparable UCITS (…),

c) the specific details of the form and presentation of key investor information to be provided to investors as referred to under paragraph 5.
…"

2. What sort of cross-references to other documents or "signposts" might be permitted, apart from those which are directly referred to in the Directive, given that Article 78 states that *"These essential elements shall be understandable by investor without any reference to other documents"*?

3. To what extent and in what way should level 2 measures harmonise the detailed presentation of key investor information (such as the layout of the document, its length, headings to be used for sections, etc.)? (Detailed supporting material should be provided relevant to the approach proposed; for instance if CESR considers templates should be used in the implementing measures to harmonise presentation of the KII, then CESR should provide such templates as it thinks necessary in its advice). What supporting work does CESR consider necessary at level 3? How should the measures at level 2 balance the flexibility necessary for allowing the KII to effectively cover the specific characteristics of particular funds or groups of funds, with the necessary harmonisation of the document?

4. How should the KII reflect all the characteristics of the special cases outlined under Article 78(7)(b) that are relevant for the retail investor making an investment decision, for instance the characteristics of master feeder structures?

2.2.2. Specific conditions to be met when providing KII in a durable medium other than paper (Article 81(2)) 8

Question

CESR is invited to advise the Commission on the specific conditions which need to be met when providing KII in a durable medium other than on paper or by means of a website which does not constitute a durable medium.

2.2.3. Specific conditions when providing the prospectus in a durable medium (Article 75(4)) 9

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8 **Scope of the Commission's implementing powers (Article 81(2))**

"2. The Commission may adopt implementing measures which define the specific conditions which need to be met when providing key investor information in a durable medium other than on paper or be means of a website which does not constitute a durable medium.
...."

9 **Scope of the Commission's implementing powers (Article 75(4))**

"4. The Commission may adopt implementing measures which define the specific conditions which need to be met when providing the prospectus in a durable medium other than paper or be means of a website which does not constitute a durable medium.
...."

Question

CESR is invited to advice the Commission on the specific conditions which need to be met when providing the prospectus in a durable medium other than on paper or by means of a website which does not constitute a durable medium.

REQUEST FOR TECHNICAL ADVICE ON REMAINING ISSUES: FUND MERGERS, MASTER-FEEDER STRUCTURE AND NOTIFICATION PROCEDURE (PART III OF THE MANDATE)

3.1. Merger of UCITS (article 43(5)10

ALFI shares CESR's views that it is fundamentally important that unit-holders receive accurate and appropriate information on the impact of the proposed merger on their investment. Similarly, ALFI agrees that any such impact justifies the provisions of the Directive providing for the right of unit-holders to redeem their units or, if applicable, convert their units without additional charge.

ALFI regrets however that the Directive seem to require, in all circumstances, for information to be provided to unit-holders of the receiving UCITS, regardless whether the merger has an impact or not on the receiving UCITS and it unit-holders. Similarly, ALFI regrets that unit-holders of the receiving CITS have the right to redeem or convert free of charge even if the merger has no impact at all on the receiving UCITS.

Indeed, ALFI believes that it will frequently be the case that a UCITS (or a compartment thereof) with limited size (hence the rationale for the proposed merger) will be merged into a UCITS with a significant size such that the merger will have no impact whatsoever on the receiving UCITS. Imposing, in those circumstances, a process of information (potentially through costly publications or mailing) for unit-holders which are not truly impacted by the merger, is not in line with the aim of the amended Directive to increase efficiency and reduce costs.

If the Directive can no longer be amended or interpreted to avoid an information process in circumstances where it is clearly not justified, the scope and method of the information process of the unit-holders of the receiving UCITS should at least be kept to a minimum.

In this context, ALFI suggests that CESR considers whether it might be envisaged for the information process of the unit holders of the receiving UCITS (on which there is, in the

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10 **Scope of the Commission's implementing powers (Article 43(5))**

"The Commission may adopt implementing measures specifying the detailed content, format and way to provide the information referred to in paragraphs 1 and 3.
…"

scenario considered, no impact) to be undertaken post-merger by means that would not require a special mailing of an information letter. The relevant information could be included in the next semi-annual or annual report or in any other mailing to unit holders which is undertaken anyhow for other reasons at the time of or within a reasonable time after the merger.

In the situation contemplated, it would be up to the competent authorities of the receiving UCITS, which are competent for approving the information to be provided to unit holders of the receiving UCITS, to appreciate and agree (or disagree) (in accordance with the procedures set forth in article 39.3 of the Directive) whether, in the absence of any impact of the merger on the unit holders of the receiving UCITS, the information could be provided to the latter post-merger by any appropriate means.

Questions

- with regard to the content of the information letter:

1. With regard to the five kinds of information listed in Articles 43(3)(a) to (e) which the merging and the receiving UCITS have to provide to their investors, CESR is invited to advise the Commission:

a) which information should be considered useful and indispensable with regard to the background and the rationale of the proposed merger?

b) what could be other considerations than those already expressly mentioned in Article 43(3)(b)[3] that would be useful and indispensable with regard to the possible impact of the proposed merger?

c) which 'density' of information (amount of detail) CESR would consider useful and indispensable with regard to the considerations that should be part of the information letter in order to describe the possible impact of the merger on unit-holders?

d) what could be other specific rights than those already expressly mentioned in Article 43(3)(c)?.

e) which relevant procedural aspects should be contained in the information letter?

As there may be many reasons which may justify, and therefore constitute the background and rationale of a merger, it is difficult to specify which information is useful and indispensable in all circumstances. ALFI believes that it is mainly important that the background and rationale of the proposed merger is properly explained to unit holders and, in particular, to the unit holders of the merging UCITS. The information so provided should aim at ensuring that unit holders of the merging UCITS understand whether the proposed merger will change the nature of their investments in a manner that they should make an assessment whether it is appropriate for them to participate in the merger or to make use of their right to redeem or convert their holding or whether, alternatively, the merger will not

impact their investment and that there is therefore no reason not to participate in the merger (unless they have other reasons to disinvest).

In addition to the information listed in article 43(3)b), it might be useful to include information on the consequences which may arise for unit holders in circumstances where the legal form of the merging UCITS and the receiving UCITS show significant differences (such as conferring voting rights or not).

ALFI believes that, in general, the information should be complete and adapted to the specific features of the merger proposal on hand, but it should be ensured that the information is kept at such level of density that unit holders can easily identify those pieces of information which are truly relevant for them.

2. **With regard to Article 43(3)(e) which refers to the key investor information of the other UCITS involved in the proposed mergers, CESR is invited to clarify whether the KII of the other UCITS should be an integral part of the information letter or a standalone document attached to the information letter containing the information referred to in Article 43(3)(a) to (d).**

ALFI believes that, in light of the specific format of the KII, it would be more appropriate for the KII to be attached as a standalone document. The KII would not need to be attached to the information letter sent to the unit holders of the receiving UCITS.

3. Bearing in mind that the competent authorities cannot oblige the merging and the receiving UCITS to provide other information to their unit-holders than those listed in Article 43(3), but that the merging and the receiving UCITS are free to add, on a voluntary basis, further information, CESR is invited to advise on the form in which the information letter and the additional information should be provided.

ALFI believes that if the UCITS concerned wish to add additional information, they should be free to include this information either by including it in the formal information letter or by including it by means of a separate document.

4. CESR is encouraged to provide the Commission with a draft EU standard information letter.

- with regard to the format of the information letter:

ALFI believes that no specific format should be imposed.

CESR is encouraged to specify the format of the information letter.

- with regard to the way to provide the information letter:

1. The new UCITS Directive does not in general harmonise the way documents and information need to be provided to investors and to competent authorities. Only some

specific provisions (notably Article 81(1) for key investor information) harmonise this. The delegation clause in Article 43(5) gives the Commission the power (without obliging it) to harmonise the way the information letter needs to be provided. CESR is invited to consider the priority that should be given to this measure bearing in mind its usefulness in ensuring that investors actually become aware of the proposed merger and can easily read the information letter.

2. Article 43 does not expressly require any specific form for the information letter; it only requires such information to be provided to investors. However, by contrast to Article 81(1) the use of another durable medium than paper is not expressly permitted. CESR is requested to reflect whether the merging or receiving UCITS are obliged to use a specific form for providing the information letter and on any practical questions that need to be dealt with at level 2 in this regard.

ALFI believes that, going forward, there should be flexibility in the way to provide the information letter. Whereas presently a mailing process may still be appropriate, other more modern means of communication (such as posting the information on a website or e-mailing) should not be excluded in the future.

3.2. Master feeder structures

3.2.1. Article 60(6) regarding the content of the agreement/internal conduct of business rules between feeder and master UCITS11

Questions

- with regard to the content of the agreement

Pursuant to Article 58(1) a feeder UCITS has to invest at least 85% of its assets in one single master UCITS. CESR outlines that as a consequence the fate of a feeder UCITS is much more closely related to that of its master UCITS than the relationship between two 'ordinary' UCITS, including funds of funds and that this warrants a specific protection of the genuine interests of the feeder UCITS and its investors. UCITS IV contains a number of provisions which take account of the dependency of the feeder UCITS on the master UCITS. Article 60(1) is one of the most important of these provisions obliging the feeder and the master UCITS to enter into a legally binding and enforceable *agreement*. If the feeder and the master UCITS are both managed by the same management company, the agreement can, but does not have to be replaced by *internal conduct of business rules*. These are rules adopted by their joint management company.

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11 **Scope of the Commission's implementing powers (Article 60(6))**

"The Commission may adopt implementing measures specifying:
(a) the content of the agreement or of the internal conduct of business rules referred to in paragraph 1;
…"

ALFI is of the opinion that the master/feeder agreement should be referred to (or should be summarized) in the main prospectus of at least the feeder fund.

1. CESR is invited to advise the Commission on which elements need to be covered by the agreement between feeder and master UCITS and to clarify how certain issues need to be stipulated in order to satisfy the requirements under Article 60(1). While preparing its advice CESR should take account of certain specific circumstances (e.g. whether feeder and master UCITS are established in the same or in different Member States).

The agreement between the feeder and master aims to ensure that the feeder has access to all the information it needs from the master to allow it to fully discharge its responsibilities. ALFI believes that it is difficult to actually prescribe the detail of this agreement and would rather advocate a solution whereby a legal agreement would give the parties involved in the feeder the ability to request any information it feels it needs with the interest of complying with its own regulations and with the interests of its own investors in mind.

2. CESR is encouraged to provide the Commission with a draft model agreement.

Please see our response to the previous question 1. ALFI is doubtful that a model agreement would be practicable given the differing legal backgrounds across Member States.

3. Article 60(1) does not lay down whether and how master and feeder UCITS may choose the applicable law regarding their agreement. Given that the competent authorities of the feeder UCITS has to check the agreement, CESR is invited to advise on any restrictions regarding the choice of the applicable law.

Where master and feeder funds are in different jurisdictions the agreement should contain which applicable law should prevail and where there are differences in interpretations of the directive between the jurisdictions the agreement should state which interpretation should apply to the master.

The choice of law should be limited as between that of the Home State of master or feeder. From an investor protection viewpoint there would be an additional case for specifying it as to be the feeder's Home State Law.

- with regard to the content of the internal conduct of business rules

1. If the feeder and the master UCITS are managed by the same management company, they can replace the agreement by internal conduct of business rules.

a) given the specific circumstances of both master and feeder UCITS being managed by the same management company, CESR is invited to recommend any useful or indispensable modifications of the content of the internal conduct of business rules compared of an agreement,

ALFI has no specific comments to offer.

b) CESR is encouraged to provide the Commission with a draft of internal conduct of business rules.

ALFI has no specific comments to offer.

3.2.2. Article 60(6) regarding the appropriate measures to avoid market timing12

Since the feeder UCITS has to invest at least 85% of its assets into the master UCITS, the performance of the feeder UCITS depends to a high degree on that of the master UCITS. To avoid any forms of 'market timing' or other arbitrage opportunities Article 60(2) obliges the master UCITS and the feeder UCITS to take appropriate measures to coordinate the timing of their net asset value calculation and publication.

Questions

1. CESR is invited to advise on measures needed to avoid "market timing" or other arbitrage opportunities.

Arbitrage can be disruptive to fund management and can cause dilution in the fund to the detriment of long-term investors. It can occur when an investor is aware that the security prices upon which a fund's dealing price is calculated do not take account of the most recently available market information.

ALFI believes the feeder UCITS valuation and subscription/redemption processes should be linked to the master UCITS in order to avoid "market timing" or other arbitrage opportunities. As each case is unique, ALFI does not believe, however, that Level 2 should provide detailed guidance in this respect. ALFI would argue instead that Level 3, or even industry guidelines can more adequately deal with these potential issues.

2. While preparing its advice CESR is invited to consider a need to take into account different circumstances for master and feeder UCITS listed at a stock exchange or for whom a platform for secondary trading exists on the one side and for master and feeder UCITS whose units can only be subscribed as well as specific circumstances of certain Member States or certain markets.

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12 **Scope of the Commission's implementing powers (Article 60 (6))**

'The Commission may adopt implementing measures specifying:

(b) which measures referred to in paragraph 2 are deemed appropriate and;
…'

ALFI believes that the decision to list the feeder and/or master UCITS at a stock exchange or on another platform for secondary trading or only allow primary trading via subscriptions and redemptions should be taken at the level of the feeder and master UCITS.

In taking such decision, the feeder UCITS should take into account the trading options at the level of the master UCITS.

3.2.3. Article 60(6) regarding the procedures for approvals in case of liquidation, merger or division of the master UCITS13

Article 60(4) and (5) provides specific rules in case of a liquidation, merger or division of the master UCITS. If the master UCITS is liquidated, the feeder UCITS can no longer stay invested. As a consequence, the feeder UCITS must either find a new master UCITS, convert into an 'ordinary' UCITS or otherwise be liquidated. For both the investment into another master UCITS or the conversion into an 'ordinary' UCITS an approval by the competent authorities of the feeder UCITS is required. A merger or division of the master UCITS does not put into question the master-feeder structures, since the feeder UCITS may stay invested in the master UCITS or another UCITS resulting from the merger or division. The feeder UCITS may however come to the conclusion that the merger or division of the master UCITS is not in the best interests of its own end-investors. In that case the feeder UCITS may either find another master UCITS or convert into an 'ordinary' UCITS. As in the case of liquidation, this requires the approval of the feeder UCITS competent authorities.

Questions

- regarding a liquidation of the master UCITS

CESR is invited to advise the Commission on the elements of the procedure for approvals referred to in Article 60(4)(a) and (b) (approval of the investment of at least 85 % of the assets of the feeder UCITS in units of another master UCITS or approval of the amendment of fund rules or instruments of incorporation in order to enable the feeder UCITS to convert into a UCITS which is not a feeder UCITS). While preparing its advice CESR is encouraged to reflect particularly on the following elements:

a) time frames in which the feeder UCITS may use one of the options mentioned in points (a) or (b) of subparagraph 1,

As each case is specific, ALFI believes that timeframes should be set in the feeder UCITS prospectus and would be dependent on the UCITS master liquidation processes.

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13 **Scope of the Commission's implementing powers (Article 60(6))**

"The Commission may adopt implementing measures specifying:

c) the procedures for the required approvals pursuant to paragraphs 4 and 5 in case of a liquidation, merger or division of a master UCITS.
…".

b) conditions which should be applied in such circumstances,

The UCITS feeder should apply and respect the conditions as laid down in the UCITS feeder prospectus.

c) time periods for granting approval,

ALFI believes that a 1 to 5 day period should be applied for granting approval.

d) additional time period for cases in which the competent authorities refused the feeder UCITS' application for approval under Article 60(4)(a) and (b),

ALFI believes that a 30 days additional period should be given to the feeder UCITS to develop an alternative proposal in such cases where the approval for first proposal has been denied.

e) need for specific rules on the exchange of information between competent authorities with regard to the liquidation of the master UCITS if the feeder and the master UCITS are established in different Member States.

ALFI believes that CESR is best positioned to answer this question and chooses not to comment.

- regarding a merger or division of the master UCITS

CESR is invited to advise the Commission on the elements of the procedure for approvals referred to in Article 60(5)(a) to (c). While preparing its advice CESR is encouraged to reflect particularly on the following issues:

a) time frames in which the feeder UCITS may use one of the options mentioned in points (a) to (c),

Same as (a) to (c).

b) conditions which should be applied in such circumstances,

The UCITS feeder should apply and respect the conditions as laid down in the UCITS feeder prospectus.

c) possible ways to ensure protection of the feeder UCITS' investors and provide certainty for the master UCITS by requiring that the approval procedure for the alternative measures under Article 60(5)(b) and (c) be completed sufficiently in advance of the time period pursuant to the last sentence of Article 45(1) in order to allow the feeder UCITS to request free of charge redemption of its units before the merger takes effect,

ALFI believes that the option of a free switch should be made available starting from the date of the announcement of the merger or division of the master until 5 days prior to the effective date of the merger/division of the master.

d) time periods for requesting and granting approval,

ALFI believes that approval for the chosen option should be requested from the competent authority within the earlier of 5 days before the effective date of the merger or division of the master or within 5 days of the issue of the master fund merger/division proposal documentation whichever is later.

e) additional time period for cases in which the competent authorities refused the feeder UCITS' application for approval under Article 60(5)(a) to (c),

An additional 30 day period should be allowed by the competent authority to the feeder UCITS in order to develop an alternative proposal if approval for the first proposal is denied.

f) elements which competent authorities have to check and conditions under which they have to grant approval if the 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,

ALFI has no comments to offer.

g) need for specific rules regarding the exchange of information between competent authorities if the feeder and the master UCITS are established in different Member

ALFI believes that CESR is best positioned to answer this question and chooses not to comment.

3.2.4. Article 61(3) regarding the agreement between depositaries14

The feeder and the master UCITS can, if they are established in different Member States must, have different depositaries. The feeder UCITS must have timely access to all relevant information and documents regarding the feeder's investment into the master UCITS. Article 61(1) obliges the feeder UCITS to communicate to its depositary any information about the master UCITS required for the completion of the depositary's duties. The feeder UCITS will however not always possess all relevant information or be in a position to obtain them in due course from the master UCITS or the depositary of the master UCITS. For this purpose,

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14 **Scope of the Commission's implementing powers (Article 61(3))**

"'The Commission may adopt implementing measures specifying:

(a) the particulars that need to be included in the agreement referred to in paragraph 1.
…"

Article 61(1) obliges the depositaries of the feeder and of the master UCITS to enter into an agreement which governs the exchange of information and documents to ensure the fulfillment of their duties. Since there is no contractual relationship between both depositaries, this agreement forms the legal basis for any information requests on the part of the feeder UCITS' depositary.

Questions

1. CESR is invited to advise the Commission:

a) on the useful and indispensable elements to be covered by the agreement between the depositaries of the feeder and the master UCITS and, if appropriate, the way they should be stipulated in order to satisfy the requirements under Article 61(1),

The depositary of the master UCITS must provide the depositary of the feeder UCITS with all information and in an appropriate time frame that allows the UCITS of the feeder fund to discharge its duties under the relevant rules of the feeder depositary's home Member State.

A Feeder fund is potentially just one of many investors in a master fund: therefore it would be inappropriate to allow a feeder UCITS or its depositary access to information that is not available to other investors. The possibility of creating informational disparities among investors creates significant market integrity risks which should be minimized by the master fund Board's over-arching duty of acting in the best interests of all investors.

b) on a need to take account of specific circumstances (e.g. whether the depositaries of the feeder and the master UCITS are established in the same or in different Member States).

A key consideration of the specific circumstances where the feeder and the master UCITS are established in different Member States are the different roles and responsibilities of UCITS depositaries according to national law. The agreement between depositaries would need to take adequate account of these differences on a case-by-base basis, depending on the location of the funds involved.

Another important point that could change the nature of the agreement is where the depositary of the feeder UCITS and the master UCITS are part of the same group. In this case, a simpler and less detailed agreement might be sufficient.

As above, ALFI would like to argue that the details of these agreements should be dealt with at Level 3.

2. CESR is encouraged to provide the Commission with a draft model agreement.

As pointed out above, the roles and responsibilities of UCITS depositaries vary between Member States. Consequently, ALFI does not believe that it is appropriate to draft a model agreement.

3. Article 61(1) does not lay down whether and how the depositaries of the master and the feeder UCITS may choose the applicable law for the agreement. Given that the competent authorities of the feeder UCITS have to check the agreement, CESR is invited to reflect on any restrictions regarding the choice of the applicable law.

Since the competent authorities of the feeder UCITS need to check the agreement, it might be most practicable to stipulate that the law of the feeder UCITS home country should be applicable. This solution should also be preferred from an investor protection viewpoint.

3.2.5. Article 61(3) regarding the irregularities the depositary of the master UCITS has to report15

Article 61(2) obliges the master UCITS' depositary to immediately inform the competent authorities of the master UCITS, the feeder UCITS and the feeder UCITS' management company and depositary of any irregularities it detects with regard to the master UCITS which are deemed to have a negative impact on the feeder UCITS. The master UCITS' depositary is however only obliged to report on those irregularities of the master UCITS which are deemed to have a negative impact on the feeder UCITS. The Commission may, through Level 2 measures, specify which types of irregularities are deemed to have a negative impact on the feeder UCITS.

Questions

1. When carrying out its tasks, the depositary of the master UCITS may not only detect irregularities in the master UCITS' business that are directly related to the afore-mentioned tasks of the depositary (e.g. detect that the valuation is not in line with the law or fund rules), but by chance the depositary may become aware of other irregularities in the course of carrying out its tasks.[23]

CESR is invited to advise the Commission on whether also those irregularities that the depositary detected in the course of carrying out its tasks should be relevant in this context.

ALFI agrees that the irregularities which the depositary of the master detected in the course of carrying out its monitoring tasks should be relevant in this context. As a general note, however, ALFI would like to emphasize that the depositary of the master should not have an open-ended obligation. Its reporting requirement should hence be limited to those issues the depositary is made aware of. As mentioned above, the feeder UCITS may be one of

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15 **Scope of the Commission's implementing powers (Article 61(3))**

"3. The Commission may adopt implementing measures further specifying the following:

(b) the types of irregularities referred to in paragraph 2 which are deemed to have a negative impact on the feeder UCITS.
…)."

many investors into the master UCITS. Therefore, the depository of the master should apply consistent communication of irregularities to all investors. To give a depository of a feeder fund the ability to act separately with the benefit of information not available to other investors in the master fund may create an un-level playing field for investors.

In turn the depositary of the feeder should only be required to report on irregularities which it has been advised about officially by the depositary of the master, for example in the master's depositary report.

2. CESR is invited to provide the Commission with a list of irregularities the depositary of a UCITS may detect and to categorize these irregularities.

The irregularities vary across jurisdictions. ALFI believes that it should be left to the competent authority in the funds' home jurisdiction to define the reportable irregularities.

3.2.6. Article 62(4) regarding the agreement between auditors16

Questions

1. CESR is invited to advise the Commission on the useful and indispensable elements to be covered by the agreement between the auditors of the feeder and the master UCITS and, if appropriate, the way they should be stipulated in order to satisfy the requirements under Article 62(1). While preparing its advice CESR is encouraged to reflect particularly on the necessary arrangements which would allow the auditor of the feeder UCITS to take into account the audit report of the master UCITS and on other specific circumstances (e.g. whether the auditors of the feeder and the master UCITS are established in the same or in different Member States).

2. CESR is encouraged to provide the Commission with a draft model agreement.

ALFI is doubtful that a model agreement would be practicable given the differing legal backgrounds across Member States.

3. Article 62(1) does not lay down whether and how the auditors of the master and the feeder UCITS may choose the applicable law for the agreement. Given that the competent authorities of the feeder UCITS has to check the agreement, CESR is invited to advise on any restrictions regarding the choice of the applicable law.

As each case is specific, we believe that the choice of the applicable law should be determined between the master UCITS and the feeder UCITS auditors.

16 **Scope of the Commission's implementing powers (Article 62(4))**
'The Commission may adopt implementing measures specifying the content of the agreement referred to in paragraph 1 subparagraph 1.
…".

3.2.7. Article 64(4) regarding the format and the way to provide information on a conversion into a feeder UCITS or on a change of the master UCITS17

Subject to approval by the competent authorities an 'ordinary' UCITS may convert into a feeder UCITS and an existing feeder UCITS may change the master UCITS into which it invests. Article 64(1) obliges the feeder UCITS to inform all its investors of such a change. The feeder UCITS has to provide this information after the competent authorities approved the conversion/change of master UCITS and at least 30 days before the feeder UCITS starts to invest into the (other) master UCITS.

Questions

- with regard to the format of the information letter:

CESR is invited to specify the format of the information letter.

ALFI believes that the letter should be free of a prescribed format. If CESR is to advise on such issues the questions should be dealt with at Level 3.

- with regard to the way to provide the information letter:

1. The new UCITS Directive does not, in general, harmonise the way documents and information need to be provided to investors and to competent authorities. Only some specific provisions (notably Article 81(1) for key investor information) harmonise this. The delegation clause in Article 64(4) gives the Commission the power (without obliging it) to harmonise the way the information letter needs to be provided. CESR is invited to consider the priority that should be given to this measure bearing in mind its usefulness in ensuring that investors actually become aware of the conversion or change of the master UCITS.

The preferred medium for the information letter should be acceptable to all investors (e.g. paper) owing to the importance of the information.

2. Article 64(1) does not expressly require any specific form for the information letter; it only requires such information to be provided to investors. However, by contrast to Article 81(1) the use of a durable medium other than paper is not expressly permitted. CESR is invited to reflect whether the feeder UCITS should be obliged to use a specific form for providing the information letter and on any practical questions which need to be dealt with at level 2 in this respect.

ALFI believes that such issues should be dealt with at Level 3.

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17 **Scope of the Commission's implementing powers (Article 64(4))**

" The Commission may adopt implementing measures specifying:

(a) the format and the way to provide the information referred to in paragraph 1;
…"

3.2.8. Article 64(4) regarding a contribution in kind18

When an existing UCITS converts into a feeder UCITS, it may be detrimental to the interests of investors to first sell the assets and then invest cash in the master UCITS. Likewise a feeder UCITS which wants or has to change the master UCITS into which it invests may want to save transaction costs by (i) requesting redemption *in specie* from the old master and (ii) by a contribution in kind into a new master UCITS. In these cases Article 64(4)(b) implicitly allows feeder UCITS to invest into the master UCITS through a *contribution in kind*, i.e. by a transfer of all or parts of the feeder UCITS' assets to the master UCITS in exchange for units, should the master UCITS agree with it. The particulars of the contribution in kind need to be stipulated in the agreement between the feeder and the master UCITS.

Questions

CESR is invited to advise the Commission on the elements of the procedure for valuing and auditing a contribution in kind while reflecting, in particular, on the following elements:

a) similarities between a merger and a contribution in kind which may justify modelling the procedures for a contribution in kind on Article 42,

ALFI agrees that there are similarities between a merger and contribution in kind, which are also evident in current national legislation. The main focus is – as it should be – on full disclosure to the unit-holders who should be given the opportunity to redeem their holdings prior to any merger.

With regards to the potential modelling of the procedures for a contribution in kind on the procedures for mergers, an important question that needs to be addressed is the auditing of in-specie contributions. In some member states, for instance, there is currently no requirement to have an in-specie independently audited.

b) role for the depositaries of the feeder and the master UCITS in a contribution of kind,

The duties of a depository in the context of a contribution in kind are in line with its obligations as regards to investment companies or common funds. The depository of the master shall apply its own local rules on assets received or sold in-specie, which shall include an oversight of the audit reports over the valuation of the assets.

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18 **. Scope of the Commission's implementing powers (Article 64(4))**

" The Commission may adopt implementing measures specifying:

***(b) if the feeder UCITS transfers all or parts of its assets to the master UCITS in exchange for units, the procedure for valuing and auditing such a contribution in kind and the role of the depositary of the feeder UCITS in this process*.**
…"

c) the date for valuing the assets and liabilities of the feeder and the master UCITS and for calculating the exchange ratio,

The assets to be transferred as part of a contribution in kind should be valued at the same time as the valuation point of the receiving UCITS. Depending on the scenario, i.e. feeder and master in the same Member State or feeder and master in different Member States, there would need to be the ability to align the two valuation points by having the flexibility to undertake a 'special valuation' for this explicit purpose.

d) the effective date for the contribution in kind.

The effective date for the contribution in kind should be determined in line with requirements under Article 47(1) for mergers[19].

3.3. Notification procedure

ALFI urges CESR to provide 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.

3.3.1. Scope of the information on national law to be published by UCITS host Member State 20

Question

CESR is invited to advise on the scope of information that should constitute standardised overview of non-harmonised national provisions governing arrangements made for marketing of UCITS that fall within the supervisory powers of the UCITS host Member State.

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19 "For domestic mergers, the laws of the Member States shall determine the date on which a merger takes effect as well as the date for calculating the ratio for exchange of units of the merging UCITS into units of the receiving UCITS and, where applicable, for determining the relevant net asset value for cash payments. For cross-border mergers, the laws of the receiving UCITS home Member State shall determine those dates. Member States shall ensure that, where applicable, those dates are set after the approval of the merger by unit-holders of the receiving UCITS or the merging UCITS."

20 **Scope of the Commission's implementing powers (Article 95(1)(a))**
"The Commission may adopt implementing measures specifying

(a) the scope of the information as referred to in Article 91(3).
…"
Article 91(3)
"Member States shall ensure that complete information on the laws, regulation and administrative provisions which do not fall within the field governed by this Directive and which are specifically relevant to the arrangements made for the marketing of units of UCITS established in another Member State within their territories, is easily accessible at distance and by electronic means (…)".

ALFI welcomes 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.

3.3.2. Facilities and procedures providing for the access of a host Member States to statutory documents of a UCITS and other information as referred to in Article 93(1) to (3) 21

Questions

1. CESR is invited to advise on the definition of common standards and the content of relevant procedures that will facilitate access for UCITS host Member States to documents referred to in Article 93(2) in accordance with the provisions of Article 93(7). In particular CESR is invited to assess the need for the general database at the national or EU level containing obligatory disclosures of UCITS notified for cross-border marketing.

2. CESR is invited to advise on the shape of common standards and procedures for notification by UCITS of changes to documents referred to in Article 93(2) to competent authorities of a host Member States.

ALFI agrees with the Commission that CESR should assess the need for a general database at a national or EU level, including a cost-benefit analysis. The need for compatible IT systems in case of national databases should be assesses too.

ALFI regrets 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, 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 towards the competent authority of the host Member State.

To the same extent, although not being specifically part of the CESR call for evidence, ALFI would like to raise awareness on § 8 of article 93 (that refers back to § 1 and 2 of article 93) tackling the event of a change regarding share classes to be marketed, wherein the UCITS

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21 **Scope of the Commission's implementing powers (Article 95(1)(b))**

"The Commission may adopt implementing measures specifying
(b) the facilitation of access for the competent authorities of the UCITS host Member State to the information and/or documents referred to in Article 93(1),(2) and (3) as required by Article 93(7).
…."

shall give a written notice of this change to the host competent authorities before implementing the change. ALFI believes that such UCITS to host Member State communication is, of course, what the UCITS IV notification process tries to avoid. The clarification that would be ideal to make is that is above notification should only be in the instance when a share class is being launched in a host Member State for the first time. So once a share class has been "approved" by the host Member State, any subsequent launches of funds in that "approved" share class would be notified via the 93 (1 and 2) home to host regulator procedure.

Finally, ALFI strongly believes that in line with article 93.6 of the new UCITS Directive, the establishment of a truly pan-European competitive market for UCITS funds requires all Member States to adopt a single documentation format for cross border registration. This harmonization should not allow host member states the possibility of requiring the production of any local supplementary fund documentation; e.g. supplement to the UCITS full prospectus. Failing this, ALFI fears that the timing of the notification outlined in article 93 of the Directive; i.e. ten working days after the date of receipt of the notification letter accompanied by the complete documentation provided for in article 93(2) will remain quite theoretical in certain Member States.

3.3.3. Standard model of the notification letter (Article 93(1) and the attestation (Article 93(3))22

Questions

1. CESR is invited to define the exhaustive list of particulars and elements which need to be included in the notification letter. CESR is also invited to advise on a format that would be easily adaptable for the purpose of electronic communication. The format of the letter should identify enclosed obligatory documents or translation thereof in a clear way.

As a general remark, ALFI believes that in order to bring added value to the whole registration and notification process, and in order to speed up time to market, maximum harmonisation of the form and (the exhaustive list of) contents of the notification letter could be helpful to achieve that goal.

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22 **Scope of the Commission's implementing powers (Article 95(2)(a) and (b))**
" The Commission may also adopt implementing measures specifying:

(a) the form and contents of a standard model of the notification letter to be used by a UCITS for the purpose of notification, as referred to in Article 93(1), including an indication as to which documents the translations refer;

(b) The form and contents of a standard model of attestation to be used by competent authorities of Member States, as referred to in Article 93(3).
….."

2. CESR is invited to design a model attestation that will confirm that the UCITS fulfils the conditions imposed by the Directive. Information and elements of the model attestation should be exhaustive for the purpose of the attestation as referred to in Article 93(3). The model attestation should be easily adaptable for the purpose of electronic communication

3.3.4. Procedures for the electronic transmission of the notification file and the exchange of information between competent authorities for the purpose of the notification procedure. 23

Questions

CESR is requested to advise on:

a) procedures that should be put in place to facilitate electronic communication of notification files between host and home authorities, including in particular the procedure for confirmation of transmission of the file by home authorities,

b) procedures that should be put in place to exchange information between competent authorities for the purpose of the notification procedure,

c) technical arrangements that should be put in place to facilitate electronic communication of notification files and exchange of other information related to the notification procedure between host and home authorities,

d) procedures that should be put in place to deal with situations where host authorities establish that notification file is incomplete or technical problems occur.

ALFI suggests referring to existing procedures and technicalities (such as the experiences gained i.e. under the prospectus directive) that have proven their effectiveness and robustness.

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23 **Scope of the Commission's implementing powers (Article 95(2)(c))**
" The Commission may also adopt implementing measures specifying:
(c) the procedure for the exchange of information and the use of electronic communication between competent authorities for the purpose of notification under the provisions of Article 93.
…"