POSITION PAPER ON CESR's PUBLIC CONSULTATION CONCERNING

MiFID complex and non-complex financial instruments for the purposes of the Directive's appropriateness requirements

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ALFI welcomes CESR's analysis on "MiFID complex and non-complex financial instruments for the purposes of the Directive's appropriateness requirements" published in its public consultation of May 2009. Improving further the existing solutions for classifying financial instruments in all MiFID jurisdictions via a common approach between regulators would be most helpful for market participants. However we also see a potential risk that additional guidance results in legal uncertainty and we would therefore like to make several remarks as to section 3 of the consultation paper relating to investment funds.

ALFI is the representative body of the 1.6 trillion Euro Luxembourg fund industry. It counts among its members not only investment funds but a large variety of service providers of the financial sector. As such ALFI also represents next to the fund industry's direct participants key players in the distribution of fund products.

I. GENERAL COMMENT

As mentioned above ALFI is of the opinion that the approach taken by CESR in its consultation paper is a reasonable one. We welcome the support given by CESR to the interpretation according to which not all undertakings for collective investment should be considered as complex instruments. However we are of the opinion that some criteria mentioned by CESR for the purpose of the assessment of the complex or non-complex status of investment funds are not contained in the MiFID provisions and should therefore not be used. We would also challenge the suggestion that not all UCITS are non-complex. We finally have a concern as to the diverging interpretation given by CESR as to the MiFID when it states that UCITS marketing documents are outside the scope of this Directive. A coherent approach by the European legislator as to the division between the UCITS and the MiFID directives would therefore be desirable.

II. SPECIFIC COMMENTS

Paragraph 72: CESR indicates that some non-UCITS may be less likely to satisfy all the criteria set out in article 38 of Directive 2006/73/EC if they are not authorised or regulated. It should be stressed that article 38 of the abovementioned directive does not require, in order to assess whether a financial instrument is complex or not, that such instrument be regulated or authorized. It must be noted that the purpose of article 19(6) of MiFID and article 38 of its implementing directive is to ensure that complex products are well understood and are appropriate for an investment firm's clients, but it is not to ensure that these clients do not invest in products that bear a certain risk. Therefore a reference to the fact that a product is or not regulated and authorized should not be used as a criteria for determining the complexity of a financial instrument for the purpose of article 19(6) of MiFID.

Similarly, under ***paragraph 82*** it is provided, in respect of the qualification of a hedge fund for the purpose of article 19(6) of MiFID that "since it is likely that in some cases such an undertaking will not itself be authorized or regulated and that it will not be permitted to market to the public without restrictions, it seems reasonable to consider that it may not readily satisfy the criteria in article 38 of the Level 2 Directive where this is the determining factor". Here again a criteria is added to article 38 of the implementing Directive. ALFI is of the opinion that any clarification should be based only on the criteria set out in that article and which are relevant for UCIs, i.e. the possibility to redeem at publicly available and independently valuated prices, the fact that the client may not incur a liability exceeding the cost of the acquisition of the UCI share, and the availability to the public of adequately comprehensive information on the characteristics of the UCI, so as to enable the client to make an informed judgment before entering into a transaction.

Furthermore, with regard to the question raised in the paragraph 72 of the consultation relating to which types of non-UCITS collective investment undertakings might be particularly relevant for the purpose of the *appropriateness requirement*, CESR refers again to the level of regulation of UCIs, and to the classification in respect of retail exposure provided in the PWC report on the retailisation of non-harmonised investment funds in the European Union of October 2008. Whilst ALFI agrees that UCITS are usually subject to more stringent requirements in terms of public disclosure than non-regulated UCIs, we are of the view that the information provided by non-regulated UCIs can be as comprehensive as that provided by regulated ones. This should therefore be assessed on a case-by-case basis. It should also be taken into account that non regulated UCIs can bear non complex investment strategies, while regulated UCIs can bear highly complex ones. Trying to assess the complexity of UCIs by referring to their level of regulation, and in particular on the basis of the type of underlying investment is thus not relevant and may cause confusion.

In view of the above, ALFI would like to draw the attention of CESR to the fact that the condition which should probably be most carefully analysed in this context is the requirement that there be frequent opportunities to dispose of , redeem, or otherwise realize an instrument at prices that are publicly available to market participants and that are either market prices or prices made available, or validated by valuations systems independent of the issuer (i.e. para. (b) of article 38 of the Implementing Directive).

Paragraph 83: Putting forward the suggestion that not all UCITS are non-complex challenges in our view the worth of the in-built investor protection mechanisms of the UCITS product itself. The rationale behind the classification of UCITS funds as non-complex instruments under MiFID is indeed that such funds are already subject to regulations ensuring compliance with the criteria set out under article 38 of the Implementing Directive, *i.e.* appropriate liquidity, limitations of risk of losses for investors (*i.e.* investors in a UCITS may never lose more than the subscription amount), and information provided to investors which is adequately comprehensive. As a consequence thereof, it does not seem appropriate to challenge the content and

interpretation of the qualification of UCITS funds as non-complex instruments under article 19 (6) of MiFID, and CESR should restrain from doing so. It must be underlined in this context that "UCITS" has become a worldwide recognized brand especially thanks to its high level of investor protection. Modifying the current rules as to the fund classification under MiFID could give the wrong impression to investors that the UCITS investor protection provisions are not sufficient. This could harm the European fund industry as a whole, and some distributors could perhaps avoid complex UCITS given the additional workload and obligations that would be entailed by the appropriateness requirements. One could also wonder what implications the classification of a UCITS as complex have on the disclosure to be provided in its Key Investor Document. Furthermore, regarding the liquidity risk of a UCITS, CESR seems to suggest a look-through approach for the analysis of the portfolio to assess such liquidity risk. This would entail a significant burden for many players and would leave room for diverging interpretations.

Paragraph 84 of the CESR consultation states that "The European Commission's legislative proposals regarding the treatment of alternative investment funds, which will be published shortly, will provide an opportunity for some of these issues to be considered further by all stakeholders". ALFI would like to raise the concern that the current proposal for an Alternative Investment Fund Managers directive is not coherent with CESR's interpretation of the MiFID, since it provides in paragraph (10) of its preamble that "all alternative investment funds should be regarded as complex and that article 19(4) of the MiFID should be amended accordingly for the purpose of ensuring a high level of protection of clients. In order to allow some non-UCITS to be classified as non complex, preamble (10) of the AIFM should therefore not be maintained.

However, assuming the Alternative Investment Fund Managers directive was amended there could be a risk that certain products could be categorised as complex by some advisors and as non-complex by others according to their respective interpretation of article 38 of the Level 2 Directive..

With regard to *question 24*, which addresses the possible need to mention other specific types of instruments in a list for the purposes of CESR's classification exercise, ALFI is of the opinion that it would be an extremely difficult task which would not bring much value added, seen the number of different products on the market, not to mention the workload that a regular update of such a list would imply.

Finally, as concerns ***paragraph 85,*** it is interesting to note that CESR states in the consultation paper that UCITS marketing documents are outside the scope of MiFID. However most countries have inscoped fund factsheets and other documents in the MiFID rules on a national level so as to ensure that national marketing rules apply to these documents. Moreover the simplified prospectus, which is not and has not to be considered as a marketing document, is nonetheless explicitely covered by Directive 2006/73/EC implementing MiFID (see article 34(1) and (2) of this Directive which

provides that "Member States shall ensure that in respect of units in a collective investment undertaking covered by Directive 85/611/EEC, a simplified prospectus complying with Article 28 of that Directive is regarded as appropriate information for the purposes of the second indent of Article 19(3) of Directive 2004/39/EC", and that "Member States shall ensure that in respect of units in a collective investment undertaking covered by Directive 85/611/EEC, a simplified prospectus complying with article 28 of that Directive is regarded as appropriate information for the purposes of the fourth indent of Article 19(3) of Directive 2004/39/EC with respect to the costs and associated charges related to the UCITS itself, including the exit and entry commissions").

A more coherent approach and further clarification as to the division between the MiFID and UCITS legislative framework should be adopted.

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