Luxembourg, September 10, 2009

ALFI Response to CESR consultation paper 09-624

Technical advice to the European Commission on the level 2 measures related to the UCITS management company passport

Executive summary

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 30 June 2009, total net assets of undertakings for collective investment were 1,631 trillion euros.

There are 3,435 undertakings for collective investment in Luxembourg, of which 2,057 are multiple compartment structures containing 10,794 compartments. With the 1,378 single-compartment UCIs, there are a total of 12,172 active compartments or sub-funds based in Luxembourg.

According to December 2008 EFAMA figures, Luxembourg's fund industry holds a market share of 29.1% of the European Union fund industry, and according to 2008 Lipper data, 75.2% 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 therefore welcomes the opportunity to comment on the Level 2 measures related to the UCITS management company passport and would like to make the following general comments:

1) Organisational requirements, conflicts of interest and rules of conduct

ALFI welcomes CESR's recommendation to seek maximum alignment of UCITS with the MiFID rules in this area. In order to take into account the specificities of the UCITS sphere as (also) recommended by CESR, ALFI wishes to submit for consideration the complexity of the UCITS set up as it exists in the various member States with the need to have in mind and to give consideration to several operating models. In particular, ALFI wishes to underline that, in addition to the operating model whereby a management company exercises itself several functions (portfolio management, administration, fund distribution) operating models exist whereby several or all of these functions are outsourced (the outsource model) and delegated to experienced professionals. Recognition that one model cannot fit all situations needs to be taken into account and the impact of any proposed Level 2 provisions on all operating models assessed. Furthermore, considering the (necessary) diversity of the market, the diversity of operating models and the considerable differences in size and organisation in the UCITS sphere and market, ALFI deems it of utmost importance to give also due consideration to the principle of proportionality. The MiFID principles should therefore be adapted to the very specific nature

of the characteristics of the UCITS model. This is a matter of consistency of the global UCITS legal framework but also a matter of achieving real efficiency gains for the benefit of investors.

Moreover ALFI would like to underline that CESR's approach often goes beyond the spirit and the requirements of MiFID. In some cases the application of all MiFID rules to UCITS to the same extent as to entities within the scope of MiFID would be impractical and very costly. The expected benefits will, in those cases, have to be weighted against added cost.

In ALFI's view there is a need for more care to be given to distinguishing, throughout the consultation, between the distribution function and the management function, as it is not always clear as to the applicability of certain MiFID rules in specific situations. ALFI would like to highlight that, in order to leverage expertise and specialised professional skills, a wide use of the delegation possibilities granted to management companies by the UCITS Directive, both in terms of distribution and management, is required and often advisable. It is ALFI's understanding that the proposed rules do not prevent or in any way aim at reducing the ability for management companies to delegate and outsource functions to specialist third parties. As mentioned, due consideration needs be given to all operating models and in case of delegation management companies should not be subject to all MiFID obligations but should rather be entrusted with a duty of oversight in respect of the delegated functions.

We would also like to underline that if a UCITS management company delegates functions to a MiFID firm there should be no need for that management company to ensure that firm's compliance with MiFID. This can be presumed if the delegation is made to a regulated entity in the EU or an entity subject to equivalent supervision in its jurisdiction. ALFI would recommend that an equivalence based approach be adopted by CESR in this regard, whereby a presumption of equivalent supervision would be established concerning entities located in OECD countries. ALFI wishes to refer in that respect among others, to the work currently undertaken in this field by the European Commission.

2) Depositary issues

As to depositary issues, it is difficult to take a final stance on the practical impact of future legislation not knowing the outcome of other consultations at the European level.

The proposed harmonised arrangements between the depositary and the management company will create benefits by enhancing the orderly cooperation between these two entities in relation to clearly establishing all the relevant information / communication flows needed to perform their respective duties. Considering the evolving financial environment coupled with the specificities of the arrangements between each management company and depositary, any regulation in relation to the compulsory content of the information flow agreement should be subject to a flexible and adaptable legal regime. Level 3 guidelines should hence and as a matter of principle be privileged.

ALFI strongly agrees that the agreement between the management company and the depositary should be governed by the national law of the UCITS.

Finally, ALFI is of the view that it is not the management company's supervisory authority who should be able to request the co-operation of the competent authority of the depositary to carry out on-the-spot verifications or investigations of the depositary but rather the opposite.

3) Risk management

In light of the ever increasing importance of risk management for a UCITS, ALFI welcomes CESR's recommendations on risk management. ALFI agrees that on the one hand regulation cannot be designed with a 'one size fits all needs' approach but on the other hand it will be

crucial that there is a consistent understanding and application of the rules, coupled with a deep technical knowledge regarding risk management within the EU member states.

It must be noted that differences exist between management companies regarding the use of global exposure calculation methods (or the models included therein) and the scope, the content and periodicity of the reports in relation thereto. ALFI is of the view that CESR is proposing risk management principles which fairly consider that not all funds do have similar risk profiles and that thus not all funds need the same standards concerning risk management – i.e. the related costs may already vary significantly between management companies (even within one jurisdiction).

On cost, ALFI considers that cost incurred by the implementation of the new rules are unlikely to be material in comparison with the cost already incurred, i.e. to implement VaR and associated processes. Regarding the valuation of OTC counterparty risk exposure, the proposal which, in ALFI's view is less complex and more transparent will lead to some relief, while the new sensitivity approach and the proposed modification of the commitment approach calculations will in ALFI's view generate additional costs.

4) Supervisory Cooperation

In respect of supervisory cooperation ALFI has no specific comments and wishes to leave it to CESR to find effective solutions. ALFI would just like to emphasize that given UCITS are largely product based the supervisory authority of the UCITS should continue to have the necessary information and authority to be in a position to properly discharge its duties and to be able to assume its responsibility to the markets, the investors and their fellow regulators.

SECTION I: ORGANISATION REQUIREMENTS AND CONFLICTS OF INTEREST

CHAPTER 1: Organisational requirements

Question 1, page 10: Do you agree with the general approach proposed by CESR?

As mentioned in the executive summary above, overall ALFI agrees with CESR's recommended approach to apply the MiFID principles to Management Companies whether or not they utilise the passport to provide services outside their jurisdiction. However, as highlighted when responding to the specific questions asked and more generally as stressed in the above Executive Summary, there are areas which exceed the requirements stipulated in MiFID (2004/39/EC) as well as areas where several operating models need to be considered and the principles of proportionality and of subsidiarity applied.

Question 2, page 14: In your view, does aligning the organisational requirements for UCITS management companies with the relevant MiFID requirements in the areas of:

- **General organisational requirements;**
- **Compliance;**
- **Internal Audit;**
- **Responsibility of senior management;**
- **Complaints handling;**
- **Personal transactions; and**
- **Electronic data processing and recordkeeping**

Impose additional costs on UCITS management companies? If so, please specify which areas are affected. If possible, please provide quantitative cost estimates of the additional costs for UCITS management companies.

Question 3, page 14: In your view, what are the benefits of aligning the organisational requirements for UCITS management companies with the relevant MiFID requirements?

See above.

BOX 1, page 15 – General organisational procedures and arrangements for management companies.

Question 4, page 16: Do you agree with CESR's proposals on organisational procedures and arrangements for management companies? If not, please suggest alternatives.

ALFI agrees to some of the MiFID principles being applied to UCITS IV management companies or self-managed UCITS in terms of organisational requirements. However rules of proportionality should be applied in order to avoid significant inappropriate organizational requirements and related costs. Moreover, ALFI's understanding of CESR's proposals is that the rules regarding general organisational procedures and arrangements for management companies do not prevent and will, going forward, not significantly impact the delegation by management companies of functions to specialist third party providers (at all levels of the value chain). In case of delegation management companies should not be subject to all the criteria defined in Box 1 but should merely be entrusted with a duty of oversight.

BOX 2, page 17 – Responsibility of Senior Management

Question 5, page 18: Do you agree with the above CESR proposal on the responsibility of senior management of management companies? If not, please suggest alternatives.

ALFI agrees with the proposals made in Box 2 with regard to the responsibility of senior management. It should be the responsibility of the senior management of the management company or UCITS to ensure that reporting is sufficiently complete and timely.

BOX 3, page 18 – Remuneration Policy

Question 6, page 19: Do you agree with the above CESR proposal on the remuneration policy of management companies? If not, please suggest alternatives.

ALFI understands Box 3 to concern investment management activities only and not conflicts of interest which are dealt in another Section of the consultation paper. As mentioned, management companies often delegate their functions to third party providers which are regulated entities subject to their group's rules regarding remuneration. This should be a guarantee that such remuneration rules are complied with. In practice management companies may of course wish to include the remuneration policy of the delegate as a criteria in the investment manager's selection process.

It must also be underlined that remuneration issues are part of the risk management sphere, whose monitoring the management company is responsible for. If a management company performs investment management itself, and senior management officers are remunerated directly on the management company's profits, the establishment of a remuneration policy along the lines of Box 3 should in our view be established. However the policy should be

restricted to the senior management, compliance and internal audit level. Further, the policy should apply to the management companies' own staff and not to the staff of delegated functions in those cases where the entity is regulated by the same or equivalent regulation.

Question 7, page 19: In your view, should the requirements set out above in relation to senior management be extended to cover all employees of UCITS management companies?

The text in Box 3 does not limit the proposed remuneration policy only to senior management; this is only mentioned in point 25 of the explanatory text. If this limitation is retained and the policy does not extend to delegated function then the proposal is appropriate.

BOX 4, page 20 – Permanent Compliance Function

Question 8, page 22: Do you agree with the above CESR proposal on the compliance function of management companies? If not, please suggest alternatives.

ALFI broadly agrees with the contents of Box 4. In particular, ALFI shares the view that if a management company's size is too small no independent compliance functions should be imposed. For the sake of clarity and certainty, ALFI would recommend that points 34 to 36 of the explanatory notes be moved to Box 4.

BOX 5, page 23 – Internal Audit

Question 9, page 23: Do you agree with the above CESR proposal on the internal audit of management companies? If not, please suggest alternatives.

We broadly agree with the contents of Box 5. In particular, we share the view that if a management company is too small no internal audit function should be imposed. In case of management company which makes significant use of delegation the management company should only be required to make sure that the entity entrusted with these tasks has an internal audit function in place. Compliance should be presumed if the delegation is made to a regulated entity or an entity subject to equivalent supervision in its jurisdiction.

BOX 6, page 24 – Complaints Handling

Question 10: Do you agree with the CESR's proposal on complaints handling procedures for management companies? If not, please suggest alternatives.

ALFI is of the view maintaining a record of each complaint is impossible in practice in many cases, in particular when an extensive third-party distribution network is used for the distribution of units/shares of UCITS since complaints are usually addressed to the distributors and not the management company. The complexities and great variety of UCITS distribution models cannot be ignored. Applicable rules need take such complexities and variety (where direct sales will be an exception) into account.

As to the language of the complaints, we would suggest to modify the proposal by replacing the words "in an official language of his Member State" by "an official language of the Member State where the UCITS is marketed".

BOX 7, page 25 – Meaning of Personal Transaction

In principle, we agree that management companies implement adequate arrangements to prevent market abuse and insider trading. As mentioned above, in the case of delegation of tasks to a third party specialist provider the management company should only be required to ensure that the proposed personal transactions rules are observed by this third party. In case of a delegation to a MiFID firm this can be presumed to be the case. If the delegation is done outside of the EU and in a non-equivalent jurisdiction in the sense of MiFID due diligence in this regard should be performed by the management company.

Question 11, page 26: Do you agree with CESR's proposals on personal transactions? If not, please suggest alternatives.

In principle, we agree that management companies need to implement adequate arrangements to prevent market abuse and insider trading. However, in circumstances where certain tasks have been delegated to a regulated firm this obligation should be satisfied and not of the responsibility of the management company.

BOX 8, page 28 – Electronic data processing and recordkeeping requirements

Question 12, page 30: Do you agree with CESR's proposals on electronic data processing and recordkeeping requirements? If not, please suggest alternatives.

We understand Box 8 as concerning investment management and not the administration of UCITS, which is subject to the UCITS' home country rules. ALFI broadly agrees with CESR's proposals, but would like to draw the Committee's attention to the fact that in certain countries outside of the EU investment managers might not be subject to the same standards of recordkeeping. In case a management company delegates its tasks to an investment manager in such country it could agree contractually with such investment manager to comply with the proposed rules [but this would not solve potential problems related to the recovery of certain data]. Furthermore, in ALFI's view in case of delegation it is the delegated investment manager's responsibility to maintain records, and therefore the management company should not be obliged to maintain duplicate data.

Finally, as regards the recording of subscription and redemption orders, in particular paragraph 2, ALFI would like to make the following comments:

Sub-paragraph (ii): the text is not precise enough in the context of UCITS and should read "the identification of the entity or platform receiving the order from the unitholder".

Sub-paragraph (iii): it must be noted that under MiFID such information is meant to be given to retail investors only. Items such as the means of payment and total consideration are not relevant in a UCITS context. Moreover, the indication of each single fee and expense is not realistic since systems don't allow for it (see our comments with regard to Box 6 page 69 relating to the reporting obligations in respect of execution of subscription and redemption orders). Consequently the costs to the industry would largely exceed the eventual benefit to the unitholder.

Sub-paragraph (iv): the indication of the relevant liquidated/subscribed NAV cannot be given before the NAV is calculated and the trade completed.

BOX 9, page 31 – UCITS accounting principles

ALFI broadly agrees with CESR's proposals in respect of accounting rules. As mentioned in point 51 of the explanatory remarks however, it must be underlined that accounting rules are

subject to the UCITS' home Member State legislation. Therefore ALFI suggests to add, in paragraph 2 of Box 9, the words "and in accordance with accounting rules of the UCITS' home Member State" after the words "on the basis of the accounting".

Moreover, ALFI would suggest to add, at the end of paragraph 3, the words "in accordance with the valuation principles applicable in the UCITS' home Member State".

Question 13, page 31: Do you agree with CESR's proposals on UCITS accounting principles? If not, please suggest alternatives.

In general, ALFI agrees with the proposals. However, it should remain possible to use more than one IT application, particularly in relation to share class accounting (each application interfacing appropriately with one another) to achieve this accounting process and procedure.

We propose to delete the last sentence of point 59 which reads "In addition, if different share classes exist (e.g. depending on the level of management fees), it should be possible to extract directly from the accounting the net asset value of those different classes".

Question 14, page 31: Does this proposal lead to additional costs for UCITS management companies? Please quantify your cost estimate. What are the benefits of this proposal?

In principle there should be no change to the current requirements, and therefore no additional cost.

BOX 10, page 32 – Implementation of the general investment policy

ALFI notes that part of Box 10 overlaps to a certain extent with the risk management framework. ALFI agrees with CESR's proposals. However the adaptation of the proposed rules should be proportionate and in line with the overall nature and organisation of the management company.

Question 15, page 33: Do you agree with CESR's proposals on investment strategies? If not, please suggest alternatives.

The senior management or the Board of Directors should approve the investment strategies of each UCITS they manage in part by approving the fund's prospectus. Periodic monitoring of the controls and procedures should also be performed via ex ante and ex post due diligence and control of errors and investigation of the root cause of those errors.

Question 16, page 33: Does this proposal lead to additional costs for management companies? If possible, please quantify your estimate. What are the benefits of this proposal?

In ALFI's view no additional cost should be incurred as a result of this proposal provided that the term "regular basis" in point 3 of Box 10 (see also explanatory text 67) is proportionate to the frequency and magnitude of change in the investment strategies and procedures.

BOX 11, page 34 – Implementation of strategies for the exercise of voting rights

Question 17, page 34: Do you agree on the proposed requirements relating to the exercise of voting rights? If not, please suggest alternatives.

ALFI generally queries the need and further the implementation implications of the proposed requirements. Given the practical constraints and the objective nature of what is the best way to vote on any given resolution ALFI considers that the policy can only be high level in order to allow sufficient latitude in its implementation.

Voting rights may be cast inconsistently for the same resolution depending on the investment objective of a fund (for example within a multiple compartment UCITS). An example of this would be a fund with an ecological investment objective and a fund with a broader investment objective. Similarly, in the case of delegation of part of the investment management (as can be found in multi-manager products) the investment managers may vote in an inconsistent way, both believing that it is in the best interests of investors. Furthermore, for cost and practical reasons the voting strategies or policy nor the way they were actually implemented should not be required to be made available to investors. The number of resolutions raised for shareholder voting and the number of securities held in UCITS portfolios renders this unmanageable.

Question 18, page 34: What are the additional costs of this proposal for management companies? If possible, please quantify your estimate. What are the benefits of this proposal?

If implemented pragmatically where the voting strategy can include a de minimis level of holding and allowing for sufficient latitude in its deployment the cost would be negligible. However, if the proposal extends to every holding in the UCITS' portfolio and for every eventual shareholder resolution and requires that these would be consistently voted upon at UCITS level then the cost would rise to EUR millions. The benefit of such proposed provisions versus the costs they would create is not demonstrated.

CHAPTER 2: Conflicts of Interest

Question 19, page 35: do you agree with the proposed approach? Is there any additional adaptation you would suggest?

These measures do help to create a level playing field between UCITS management companies and MiFID regulated firms. This is achieved by adding additional regulatory requirements to the UCITS management companies which implies a commensurate cost, therefore detracting from the notion that UCITS IV is an efficiency package.

Question 20, page 36: In your view, does aligning the requirements for conflicts of interest for UCITS management companies with the relevant MiFID requirements impose additional costs on UCITS management companies?

- **Procedures for conflict identification and management;**
- **Independence of persons managing conflicts;**
- **Recordkeeping for collective portfolio management activities; and**

- **Management of non-neutralised conflicts.**

If so, please specify which areas are affected.

If possible, please provide quantitative cost estimates of the additional costs for UCITS management companies.

Question 21, page 36: In your view, what are the benefits of aligning the requirements for conflicts of interest for UCITS management companies with the relevant MiFID requirements?

It must be noted that most prospectuses will already contain disclosures on a general approach with regard to the prevention, identification and mitigation of conflicts of interest. ALFI therefore agrees with principles proposed by CESR in Chapter 2 of the consultation paper. However ALFI would wish to insist on the need to adapt the MiFID rules to the specificities of UCITS and to their set up, since certain conflicts of interest in the context of investment funds may arise in regard of end investors and cannot be resolved by the management company.

BOX 12, page 37 – Conflicts of interest potentially detrimental to a client of a management company or to an investor

Question 22, page 38: Do you agree with CESR's proposals on the criteria for identifying conflicts? If not, please suggest alternatives.

ALFI agrees that conflicts of interest between the management company and the UCITS, or between the management company and individual investors need to be identified, documented and managed. However ALFI does not consider it possible to manage conflicts arising between individual investors in the fund. Moreover, in the case of a self-managed UCITS such rule is irrelevant since the UCITS can't manage conflicts of interests with itself.

As already mentioned in ALFI's response to CESR's consultation paper 09/179, 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 arises here is if the fund and its unit holders are 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 these necessary and subtle distinctions.

It would be helpful therefore if the concept of client was clarified, 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 unitholders.

Many fund purchasers are self-advised and some potential conflicts of interest can only be mitigated by the investor. An example of this would be the choice to buy a regular A class share or a share with a contingent deferred sales charge where the optimal choice will depend on the investors holding period.

This is an area where MiFID cannot be transposed as such to the UCITS environment.

BOX 13, page 39 – Conflicts of interest policy

Question 23, page 40: Do you agree with CESR's proposals on the identification and management of conflicts? If not, please suggest alternatives.

See our comments above in responses to questions 19 to 22.

BOX 14, page 41 – Independence in the conflicts management

Question 24, page 42: Do you agree with the CESR's proposals on the independence of the persons managing conflicts? If not, please suggest alternatives.

In Paragraph 2 (c) of Box 14 the terms "revenues generated" should be clarified.

BOX 15, page 43 – Record of collective portfolio management or activities giving rise to detrimental conflict of interest

Question 25, page 43: Do you agree with CESR's proposals on records of activities giving rise to conflicts of interest? If not, please suggest alternatives.

No comment.

BOX 16, page 44 – Management of non-neutralised conflicts

Question 26, page 45: Do you agree with CESR's proposals on management of non-neutralised conflicts? If not, please suggest alternatives.

In ALFI's view, and in line with CESR's comment in point 24 of the explanatory text of Box 16, the MiFID rule imposing the disclosure of non-neutralised conflicts of interest to clients or investors does not apply to management companies authorised to provide individual portfolio management services. Therefore imposing such a rule on management companies of UCITS would go beyond what MiFID requires and should be abandoned.

The reporting to investors of conflicts of interest in a durable medium should be satisfied by general disclosures in the UCITS' constitutive documents. Such conflicts should not be documented and described on an individualised basis nor should the UCITS management company be required to explain the decisions taken to resolve potential conflicts. The principle of UCITS is the collective professional management of investments. Each individual conflict cannot be identified, resolved and applied to each investor.

Question 27, page 45: Are there any other issues you feel should be considered in addition to those already mentioned in this paper?

No.

SECTION II: RULES OF CONDUCT

Introduction:

ALFI fully shares the view that when dealing with rules of conduct issues, existing MiFID implementing measures should be considered. However due consideration to the specificities attaching to UCITS and to the UCITS set up need be given.

Paragraph 10 of the Introduction of the Rules of Conduct section provides that the delegation of functions, by a management company, to third parties entails that the management company should ensure, by means of a due diligence and on going monitoring, that such third parties are appropriate and will comply with adequate rules of conduct. CESR's concern regarding delegation of functions by management companies is understandable and legitimate.

However, in order to avoid any legal uncertainty in respect of management companies' duties in the context of such delegation, it seems necessary to provide for Level 2 outsourcing provisions that could be inspired and adapted from those contained under article 13 et seq. of MiFID's implementing Directive (the "Implementing Directive"). CESR's attention is therefore drawn to the necessity to clarify outsourcing provisions in the context of the Draft Advice. It should be kept in mind that any outsourcing provisions that would be included at Level 2 would have an impact on the delegation of investment management duties to third parties, and add requirements in this connection to the existing legal framework.

CESR confirms, under point 9 of the Introduction, that the rules of conduct set out in the Draft Advice are applicable *per se* to self-managed UCITS. In this context, CESR's attention should be drawn to the fact that some provisions of the Draft Advice may need to be amended or completed to take into account the specificity of self-managed investment companies.

Definition of the Term Client

The "Definitions" section of the Draft Advice provides for a definition of the "Client". As a preliminary comment, it should be noted that there is no reference in the Rules of Conduct Part of the Draft Advice to the word "Client", but only to the word "investor". This point should be clarified.

More importantly ALFI believes that the use of the word "client" in the Rules of Conduct Part of the Draft Advice is confusing as it could lead to an interpretation where investors in a UCITS would be considered as clients, and the asset management carried out by such UCITS would consequently be considered as services provided to such clients.

ALFI therefore suggests that reference to the word "client" be replaced as detailed below in Box 3, Box 4 and Box 6:

- Under Box 4, point 2, paragraph 2, CESR should consider replacing the reference to "a *professional client*" by "*an investor which qualifies as a professional under Directive 2004/39/CE*". In the same Box, point 3, the reference to "*the nature of the client"* should be replaced by "*the nature of the investor"*.
- Under points 21 and 23 of the Explanatory text for Boxes 3 to 6, references to the term "*client"* should, in our view, be replaced by "*investor*".

BOX 1, page 64 – Duty to act in the best interests of the UCITS and its unitholders and to ensure market integrity

Point 3: To whom should the management company demonstrate that they have accurately valued the UCITS portfolios?

Similarly, Box 1 point 4 lists a non exhaustive list of inappropriate practice and would be better removed as there are other points which more adequately relate to the conduct of business.

BOX 2, page 65 – Due diligence requirements

It is our understanding that the rules regarding due diligence requirements should be restricted to the UCITS sphere. The benefit of this proposal will be the improvement of the risk management framework of the UCITS funds. Some of the elements of CESR's proposal are closely linked to the risk management process, such as diligence procedures and effective arrangements to ensure that investment decisions on behalf of the UCITS are carried out in accordance with the risk limits of the UCITS (see Box 6 items 3 and 4). Most of the aspects of due diligence are already implicitly undertaken when the risk management process is put in place. One might consider to specifically deal with these items in the risk management process section to avoid duplication of diligence.

In general terms, it must be underlined that many management companies outsource the investment activity to an investment manager who therefore is in charge of formulating forecasts and performing analysis concerning its contribution to the UCITS' portfolio composition, liquidity as well as risk and reward profile. The management company performs monitoring of the performance of such tasks by the investment manager. Therefore, it would be more appropriate to require management companies to comply with a due diligence obligation on a regular basis.

Moreover, CESR must accept and define "plain vanilla" investments for which a thorough due diligence would not be necessary. For example:

- when the investment is in line with the investment guidelines of the prospectus;
- when the product is listed in regulated markets;
- when the liquidity of the products is proved.

Indeed, existing rules regarding the eligibility of investments do already exist and there is no need for further regulation in this respect. In ALFI's view, point 8 of CESR's explanatory text to Box 2 contains duplications since most of the items listed are actually in the notion of "eligible" investments under the UCITS Directive.

Responding to Question 2, these new due diligence requirements would certainly lead to additional costs for the management company (staff, technical tools ...). We are not in a position to quantify these costs exactly. However such costs will impact small companies greatly since they are not necessarily MiFID compliant and these will have to adapt to higher standards.

Question 1, page 66: Do you agree with CESR's proposals on the duty of management companies to act in the best interest of UCITS and their unitholders and on due diligence requirements? If not, please suggest alternatives.

In practice, investment management is often delegated to an entity close to the geographic area of investment. The proposal that the UCITS management company should perform analysis and formulate forecasts relating to the UCITS' portfolio composition should be

permitted to be delegated under the oversight of the UCITS' management company. In the event of a delegation, periodic reports should be given to the UCITS management company but no individual appraisal of each investment decision should be required. The proposals need in that respect to take due account of reality and of actual UCITs fund set-ups.

Question2, page 66: What are the additional costs of this proposal for management companies? If possible, please quantify your estimate. What are the benefits of this proposal?

If the requirement is not implemented pragmatically, the cost could be significant, and in turn leading to higher fees to the end investor.

BOX 3, page 67 – Direct Sale

Although it seems appropriate to apply the same rules to management companies as those applicable to distributors when these are acting as distributors of units of investment funds, it must be stressed that direct sales are marginal in the case of third-party distribution models, where most of the distribution to the final investors is perfomed by distributors abroad and not directly by the management company. Moreover, it appears from CESR's document that the terms "direct sale" as used as a heading for Section C and referred to in point 15 of Box 3 lead to confusion. A direct subscription in a fund without any intermediation is an investment and not a sale since it is made on the investor's own initiative. Therefore in ALFI's view the reference should be to "distribution" and not "sale".

Similarly, ALFI suggests that the reference to "*the best interest of the client"* be replaced by "*the best interest of the investor"*. Furthermore, the reference to the term "client" could be confusing in this context, as it could be interpreted as a reference to the UCITS managed by the management company. Under points 21 and 23 of the Explanatory text for Boxes 3 to 6, references to the term "*client"* should thus, in our view, be replaced by "*investor*".

Under point 15, it is mentioned that "*management companies are allowed to distribute the units of UCITS, either directly or by delegation, without the need for an additional authorisaton under MiFID*". We assume that self-managed UCITS will not be allowed to distribute the units of other UCITS by delegation, and believe that this point should be clarified by CESR.

Question 3, page 67: Do you agree with this general approach proposed by CESR for conduct of business rules relating to direct selling? If not, please suggest alternatives.

In some circumstances the UCITS management company acts as an RTO and the investments in the UCITS are made without advice. As mentioned above, in such case subscriptions are made without the intervention of any intermediary and on the investor's initiative. Therefore, the burden of appropriateness is not commensurate with the risk profile of the UCITS product.

Question 4, page 67: What are the additional costs of this proposal for management companies? If possible, please quantify your estimate. What are the benefits of this proposal?

Costs are difficult to quantify.

BOX 4, page 68 – Appropriateness test and execution only

Under point 2, paragraph 2, CESR should consider replacing the reference to "a *professional client*" by "*an investor which qualifies as a professional under Directive 2004/39/CE*". In the same Box, point 3, the reference to "*the nature of the client"* should be replaced by "*the nature of the investor"*.

Box 4 provides for details regarding the appropriateness test and execution only. Notwithstanding the fact that such provisions may not be appropriate in the context of UCITS (see our comment in this connection under 4) below), we wonder in particular whether such provisions are relevant in the context of a self-managed UCITS. Indeed, a self-managed UCITS may only distribute its own shares, and not the units/shares of other UCIs. The necessity to carry out an appropriateness test in this context may be inappropriate.

If the management company does actually sell/market its funds then they should have to perform an appropriateness test and the same applies to a self-managed UCITS. Only where the trade is truly “execution only” or “unsolicited” would such tests not apply. For example, it can be inappropriate to sell a fund that has a five year investment fund to someone who needs their cash in three years or who are 85 years old.

ALFI wonders whether the application of the appropriateness test in the context of a UCITS is at all relevant. Indeed, the purpose of the appropriateness test is to ensure that the investor seeking to invest in the relevant UCITS has the experience and knowledge to understand the risks relating to such investment.

While the appropriateness test is obviously relevant for investment firms subject to MiFID, which may offer a variety of products to their clients, including non retail complex products, such relevance may be questioned for management companies which may only distribute UCITS, which are, by definition, retail products. Furthermore, any UCITS must provide a full set of comprehensive information to investors by means of its prospectus and, under UCITS IV, its key investor information.

In this context, by stating, under point 21 of the Explanatory text for Box 4, that "*the management company ... may assume that a client that would, under MiFID, be categorized as a professional client, has the necessary experience and knowledge in order to understand the risks involved in relation to the purchase of the units of the concerned UCITS"* confusion might be created. As mentioned above, UCITS are retail products, and the statement that professional clients may be assumed to have the adequate experience and knowledge to understand the risks related thereto may be understood as meaning that, *a contrario*, retail investors would not have such experience and knowledge whereas UCITS are specifically dedicated to such investors.

On such basis, a management company should be allowed to assume that any investor, whether professional or retail, has sufficient knowledge and experience to understand any UCITS. We are therefore of the opinion that CESR should reconsider its intention to apply the appropriateness test to management companies and self-managed UCITS.

Point 8 of Box 4 provides that "*Management Companies can provide the services of execution and/or the reception and transmission of orders **to** investors..."*. We believe that this sentence has not been properly copied from the Implementing Directive and should be adapted to read as follows: "*Management Companies can provide the services of execution and/or the reception and transmission of orders **from** investors...".* It must be underlined that, as mentioned above (Box 3), a direct subscription in a fund (direct subscription on a transfer agent’s register) without any intermediation should fall under this rule.

Finally, should some type of appropriateness assessment be imposed, it should be clarified whether such a requirement would be applied to existing direct clients. This would imply

additional costs regarding the assessment of the investments made by such clients. A grandfathering clause should be applied in this context.

As mentioned above, in some circumstances the UCITS management company acts as an RTO and the investments in the UCITS are made without advice to the investor. Therefore the burden of appropriateness is not commensurate with the risk profile of the UCITS product.

BOX 5, page 69 – Handling of subscription and redemption orders of investors

ALFI agrees with CESR's proposal regarding the handling of subscription and redemption orders for investors. Reference is however made to our comments above (for most management companies this is an execution only business).

BOX 6, page 69 – Reporting obligations in respect of execution of subscription and redemption orders

ALFI considers that CESR's proposals with regard to reporting obligations in respect of execution of subscription and redemption orders do not reflect the market practice and go beyond MiFID requirements:

The obligation provided for in clause 1.b) is based on article 40 of the MiFID Level 2 Directive (Directive 2006/73/EC of 10 August 2006), which is only applicable to Retail Investors and not Professional Clients. Moreover, from past experience, and taking into account standard settlement sequences it will be practically very difficult for a UCITS to send such a notice within one business day following execution. In particular, it should be clarified whether the execution referred to is the "material" execution, or the "legal" execution.

In ALFI's view, such obligation should be restricted to retail investors and in order to be applicable, CESR should complete the foregoing provision to refer to the date of the net asset value calculation and make a reference to the deadlines provided in the sales document.

ALFI generally agrees with CESR's approach, but CESR must provide examples of durable medium in order to help management companies to comply with the reporting requirement. Costs will be related to the setup of specific reporting.

Question 5, page 70: Do you agree with CESR's proposals on conduct of business rules relating to direct selling? If not, please suggest alternatives.

Considering the arguments developed above with regard to Boxes 3, 4 and 5 (concerning the marginal direct selling by management companies, the "non-complex" nature of UCITS under MiFID and the exhaustive character of the information contained in the fund documents), a lighter regime would be appropriate.

Question 6, page 71: What are the additional costs of this proposal for UCITS management companies? If possible, please quantify your estimate. What are the benefits of this proposal?

Potentially significant costs for IT development can be expected in order to achieve the requirements stated in Box 6 point 3. Further the client reporting requirements are not appropriate for UCITS, e.g. venue identification, total sum of commissions and expenses charged – the provision of UCITS is more akin to a service than a transaction**.**

BOX 7, page 72 – Duties of management companies to act in the best interests of the UCITS when executing the decisions to deal on behalf of the management UCITS in the context of the management of the portfolios

ALFI agrees with CESR's approach. However usually most of these activities are delegated. Therefore in such case the management company should only be required to ensure that proper reporting is made, and supervise the compliance with these rules.

In point 3, the third sentence mentions that "*Management companies should obtain the prior consent of the UCITS..."*. Here again, this provision would not make sense in the context of a self-managed UCITS, and should therefore be amended by CESR.

More generally, the "best execution" requirements detailed under Box 7 would be particularly cumbersome and difficult to implement in the context of a self-managed UCITS, as it would require infrastructures that most UCITS don't have. Consequently, in our view, the proposals on direct execution of orders should be amended, or at least rendered more flexible for self-managed UCITS.

Point 29 of the Explanatory text provides that "*The best execution requirements should not undermine the discretion of management companies in how they organize their business model and their execution arrangements"*. We agree with CESR that Management Companies should take into account their current business model and execution arrangements when applying best execution requirements, and believe that the content of the aforementioned point 29 should be included in Box 7 itself.

Furthermore, we are of the opinion that the content of point 29 would also be applicable and should be included in Box 8.

We also wonder whether CESR only considers the best execution principle for transactions realised on exchanges. What about OTC transactions? CESR must define a list of transactions which are excluded from this best execution requirement.

Finally we ask ourselves how the best execution policy will be communicated to unitholders. Is it necessary to insert it in the prospectus?

Question 7, page 73: Do you agree with CESR's proposals on direct execution of orders by management companies? If not, please suggest alternatives.

The requirement for management companies to "demonstrate that they have executed orders on behalf of the UCITS in accordance with the company's execution policy" should not necessitate a full and independent audit (Box 7, point 6 and explanatory text 34).

Question 8, page 73: What are the additional costs of this proposal for UCITS management companies? If possible, please quantify your estimate. What are the benefits of this proposal?

There could be significant cost if all deals are to be audited.

BOX 8, page 74 – Duties of management companies in the context of the management of UCITS portfolios: to act in the best interests of the UCITS when placing orders to deal on behalf of the UCITS with other entities for execution

Question 9, page 75: Do you agree with CESR's proposals on the placement of orders with or transmission to other entities for execution? If not, please suggest alternatives.

Question 10, page 75: What are the additional costs of this proposal for UCITS management companies? If possible, quantify your estimate. What are the benefits of this proposal?

The same comments as above (Box 7) are valid in our view. Will management companies be required to validate the best execution policy of the other entities in charge of the orders of the UCITS? There will be costs incurred for performing the due diligence on other entities (more so for non-EEA entities).

It would be useful if CESR would provide the industry with a precise guidance of elements which need to be taken into account when the transactions are handled by a non-EEA service provider.

BOX 9, page 76 – General principles – Order Handling

We also refer here to the comments made above relating to Boxes 7 and 8. Moreover, point 43, under the Explanatory text for Box 9, provides for specific rules applicable to the investment of own funds of management companies. Such provisions are obviously not applicable to self-managed UCITS, and the Draft Advice should be amended accordingly.

BOX 10, page 76 – Aggregation and allocation of trading orders

Question 11, page 77:Do you agree with CESR's proposals on the handling of orders? If not, please suggest alternatives.

Question 12, page 77: What are the additional costs of this proposal for UCITS management companies? If possible, please quantify your estimate. What are the benefits of this proposal?

The same comments as for previous boxes are applicable.

Point 3 details the conditions applicable to the aggregation of transactions carried out by management companies for own account with transactions carried out on behalf of UCITS or other clients. To our knowledge, management companies are not allowed to carry out transactions for own account, and we then fail to see under which circumstances such point would be applicable.

We believe point 3 from the Draft Advice should be deleted.

BOX 11, page 78 – Inducements

ALFI basically agrees with the introduction of inducements provisions. However, this is one of the areas where a straightforward adoption of MiFID without adaptations to the specificities of collective portfolio management is not possible.

We believe that the text currently proposed by CESR needs to reflect the three different activities in relation to which inducements could be received or paid by the management company. The current drafting does not adequately reflect it, and therefore creates significant problems. Furthermore, the proposed regime concerning the payment of distribution fees would force management companies to abandon their existing distribution systems.

CESR only refers to the "provision of a collective portfolio management activity", but even within that we can distinguish between inducements in relation to direct sales to investors of fund units (part of marketing function), and inducements in relation to other functions, in particular to the investment management function. CESR's text does cover them both, although it is slightly confusing and could be clarified, as follows, along the lines suggested by EFAMA:

1. Management companies should not be regarded as acting honestly, fairly and professionally in accordance with the best interests of a relevant client if, in relation to the provision of a relevant service, they pay or are paid any fee or commission, or provide or are provided with any non-monetary benefit, other than the following:
(a) a fee, commission or non-monetary benefit paid or provided to or by the relevant client or a person on its behalf ;
(b) a fee, commission or non-monetary benefit paid or provided to or by a third party or a person acting on behalf of a third party, where the following conditions are satisfied:
(i) the existence, nature and amount of the fee, commission or benefit, or, where the amount cannot be ascertained, the method of calculating that amount, should be clearly disclosed to the relevant client, in a manner that is comprehensive, accurate and understandable, prior to the provision of the relevant collective portfolio management activity;
(ii) the payment of the fee or commission, or the provision of the non-monetary benefit should be designed to enhance the quality of the collective management portfolio activity and not impair compliance with the management company's duty to act in the best interests of the relevant client;
(c) proper fees which enable or are necessary for the provision of the collective portfolio management activity, such as custody costs, settlement and exchange fees, regulatory levies or legal fees, and which, by their nature, cannot give rise to conflicts with the management company's duties to act honestly, fairly and professionally in accordance with the best interests of the relevant client.
2. In relation to the provision of a collective portfolio management activity, a management company should be permitted, for the purposes of point (b)(i), to disclose the essential terms of the arrangements relating to the fee, commission or non-monetary benefit in summary form, provided that it undertakes to disclose further details at the request of the UCITS and provided that it honours that undertaking.
3. A relevant client may be a UCITS, in which case the relevant service is the provision of a collective portfolio management activity to the UCITS, or it may be an investor, in which case the relevant service is a direct sale to the investor.

More importantly, however, the payment by Management Companies of distribution fees does not fall under "collective portfolio management activities" (as it is not part of their marketing function, which would be direct distribution), but should be considered for the Management Company as a necessary cost: without that payment, no service will be rendered. Distribution fees paid would not qualify under the provisions of Box 11 (2)(b) (ii), as they are not *designed to enhance the quality of the collective portfolio management activity*. In fact, they are extraneous to that activity, as distribution is usually carried out by other (MiFID-regulated) entities.

The UCITS Directive focuses on the fund production side of the fund business, while MiFID covers the distribution side. Distribution fees paid by UCITS management companies, therefore, do not fit the MiFID test.

One could argue that such costs should be included under (2)(c) as they are necessary payments, and we do agree with that view, but we understand that it could be too controversial, as the same argumentation is not acceptable for MiFID firms.

With regard to paragraph 46 of the explanatory text ALFI urges CESR to pay more attention to the characteristics of UCITS and its aforementioned distribution practices whilst transposing the MiFID inducement rules into the UCITS framework. The ideal solution would be to exempt distribution fee payments from the scope of the UCITS rules for inducements. As the acceptance of payments to the distributor is already regulated in MiFID ALFI basically regards it as sufficient to restrict the MiFID standards to the acceptance of payments by the management company. The reference to payment of fees or commissions /provision of benefits of the management companies should therefore be deleted.

Another possible solution is to leave the current text in Para. 1, and add a new paragraph before CESR's Para. 2 as follows:

> *"The payment of a fee, commission, or non-monetary benefit to a third party for the provision of the service of distribution of units of funds managed by the Management Company will be permitted if receipt by the intermediary is permissible under MiFID. Disclosure of such inducements to the final client will remain the responsibility of the intermediary, as required by MiFID."*

Question 13, page 79: Do you agree with CESR's proposals on inducements? If not, please suggest alternatives.

In the event of a direct sale where the UCITS management company conducts the sale directly with the investor, how should the UCITS management company disclose its inducement in practice? It is paid an annual management fee as disclosed in the prospectus and KID and therefore this is in full or in part the inducement, however there are several costs to be borne within this annual management fee and to quantify or attribute a proportion of this fee to the distribution activity could be inconsistently applied across the UCITS industry, leading to inconsistent investor information. We believe that the information provided in the UCITS' KID and prospectus of inducements should be sufficient disclosure of nature and method of calculating the inducements; the annual report and accounts adequately quantify the value of such inducements.

Where a UCITS management company is involved and remunerated for selling funds for which it is not the UCITS management company (i.e. third party funds) the nature and amount of inducement should be disclosed, in order to create a level playing field with other MiFID services.

Question 14, page 79: What are the additional costs of this proposal for UCITS management companies? If possible, quantify your estimate. What are the benefits of this proposal?

If the requirement is not implemented pragmatically the cost could be approximately 1 basis point on assets under management, in turn leading to higher fees to the end investor.

Section III: Technical advice to the EU Commission on 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

CESR's technical advice to the European Commission on 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 included in the standard agreements to be used by the depositary and the management company (Articles 22 and 23 of the UCITS Directive)

A. INTRODUCTION

As a preliminary comment, ALFI wishes to stress that the advice given by CESR goes clearly beyond what ALFI understands as being the scope of the Commission's mandate given to CESR. According to the Commission's mandate, CESR shall advise on standard agreements and identify their particulars "required under art. 23(6) (…) of the Directive". Such Article makes reference to Art. 23 (4) which, in turn, regulates the information flow necessary in the particular situation of a cross-border scenario.

It is understandable that CESR tries to take into account recent developments and discussions on the financial markets, as it clearly states in point 5. of its Introduction to the Section III Advice. However, certain issues mentioned in Box 2 should, in ALFI's view, be dealt with at a different level than this technical advice. Reference is made in particular to the consultation of the Commission (DG Market) on the UCITS depositary function.[1]

The purpose of the present consultation is limited to certain technical aspects of the Management Company Passport, as results clearly from its title and from the Commission's mandate. It is ALFI's view that CESR should thus advise only on technical aspects of the cooperation between Management Company and Depositary in a cross-border situation as far as the information sharing is concerned.

Where advice is given on the description of services, delegation, liability issues, termination, etc., ALFI considers that CESR goes far beyond the scope of the advice, namely in two respects: Firstly, it interferes with the aforementioned Commission's consultation on the UCITS's depositary function and its power to possibly draw consequences therefrom and take measures (or not) as it deems appropriate. Secondly, it appears that some of the suggestions made by CESR might have an impact on and could possibly conflict with national laws and regulations (including general rules of civil law, law of contract, etc.) which, in ALFI's view, requests further analysis before setting principle requirements applicable to all Member States.

Consequently, and without prejudice to ALFI commenting here below on the suggestions made by CESR, ALFI would strongly invite CESR to review the scope of its proposals under Section III and to limit its advice to the aspects for which it was mandated by the Commission.

[1] Working Document of the Comission Services (DG Markt): consultation paper on the UCITS depositary function issued on 3rd July 2009 for answer no later than 15th September 2009.

1. Specific conditions that a depositary must meet to fulfil its duties regarding a UCITS managed by a management company situated in another country (Box 1, page 89)

Question 1, page 89: Do you agree that no additional requirements should be imposed on a depositary when the management company is situated in another Member State?

Although there may be some practical issues (as mentioned in the ALFI responses to earlier CESR consultations on UCITS IV), ALFI considers that there should be a level playing field between the different structures and therefore agrees with CESR that there is no need for additional requirements in the context of this consultation.

Question 2, page 89: What will be the costs of imposing such requirement for the industry? What would be the implementation difficulties for regulators?

ALFI foresees additional costs associated with the implementation and the maintenance of an information flow agreement between the depositary and the management company as well as with the enhancement of the cooperation between the two parties, e.g. we expect some complementary reporting activities, including some interactions with the respective competent authorities. However, the magnitude of the expected increase in costs is difficult to quantify at this stage. In addition we would like to refer to our response to question 12 (ii).

ALFI believes that the real risk is that the UCITS directive may not be transposed in the same way across all EU countries and difficulties may come from local legislation (e.g. rules that prevent such exchange with third countries, professional confidentiality, data privacy, etc.) which would imply some additional indirect costs because of uncertainty, risks and delays.

2. The standard arrangements between the depositary and management company and identification of the particulars of the agreement between them as 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 (Box 2, page 90)

Question 3, page 94: Are the proposed requirements appropriate?

Without prejudice to our answers to the other questions below, to the extent they remain worded in general terms (so as to allow flexibility and adaptability to specific situations), elements listed under 3, 5, 6, 7 and 8.b. of Box 2 seem appropriate. Certain detailed information (see notably elements 5 and 7) might be better addressed outside of the information flow agreement, at the level of an operating memorandum likely to be regularly amended to take into consideration the evolving nature of the UCITS.

Elements listed under 1, 4, 8.a. of Box 2 should be addressed in the depositary agreement.

Elements listed under 2 of Box 2 should simply provide that the duration of the information flow agreement should match that of the depositary's function for the UCITS/management company concerned (generally the duration of the depositary agreement) and should hence be terminated in the same conditions. Parties should remain free to amend the information flow

agreement by mutual consent at any time deemed appropriate, as the case may be subject to relevant clearance from the authorities.

Other elements of Box 2 (framework agreement, electronic information, etc.) seem appropriate / acceptable, except that:

- The information flow agreement should not contain provisions regarding the possibilities and procedures for the review of the depositary by the management company.

- Precisions should be given as to the depositary's ability "to enquire into the conduct of the management company". In this regard, please consider the answer to question 5.

Notwithstanding the detailed information which the management company must convey to the depositary pursuant to specific clauses contained in the information flow agreement, the latter should contain a general clause expressly providing that the management company must provide any information which the depositary is requesting from the management company (or from its delegates) to the extent that the depositary may establish such information is necessary to fulfil its duties, failing which the depositary shall be in a position to claim exoneration of liability in relation to the duty for which the information was sought.

Question 4, page 94: Are the information flows exchanged in relation to the outsourcing of activities by the management company or the depositary relevant?

The concept of *"information flows exchanged in relation to the outsourcing of activities"* is unclear. It presumably refers to the actual flows of information exchanged among the management company and its delegates.

On that basis, actual information exchanged between management company and its delegates which must be accessible by the depositary can only be addressed on a case by case basis. A general obligation of access might not be justified and may prove burdensome for the operators.

More generally, the answer to this question might be based on the general following principle: to the extent an information exchanged in relation to the outsourcing of activities by management company (including any information situated at the "outsourced level") is necessary for the depositary to fulfil its duties, the management company should cause/procure that this information be made accessible to the depositary.

Question 5, page 94: Is it appropriate to indicate in the written agreement that each party may request from the other information on the criteria used to select delegates? In particular, is it appropriate that the parties may agree that the depositary should provide information on such criteria to the management company?

The depositary does not assume any particular responsibilities or duties in relation to the selection by the management company of its delegates. This is rather a commercial decision of the management company. ALFI therefore would not anticipate any need for a formal mechanism to allow the parties to request information on the criteria used to perform such selection.

However ALFI believes that, it is not inappropriate that management company and depositary keep each other informed about their delegation approach (i.e. policy). The extent to which the depositary is to provide information on criteria for selecting its own delegates (mainly sub-custodian) should be addressed in the depositary agreement.

In this context, we would refer also to the response to question 3 above.

Question 6, page 94: Is the split between suggestions for level 2 measures and envisaged level 3 guidelines appropriate?

Please refer to answer to question 7.

Question 7, page 94: Do you see a need for level 2 measures in this area or are the level 1 provisions sufficiently clear and precise?

Considering the evolving environment coupled to the specificities of each situation, any regulations in relation to the compulsory content of the information flow agreement should be subject to a flexible and adaptable legal regime. Level 3 guidelines should hence and as a matter of principle be privileged.

In this context Level 2 measures seem to be justified only:

(i) for the general clause referred to above, which should expressly provide that a management company must, at the depositary's request, provide any such information that the depositary requires in order to be able to fulfil its duties (including exoneration of liability for the depositary where such information is not provided); and,

(ii) to ensure that no laws or regulations in the management company's home state may directly or indirectly hinder effective transmission of information to the depositary and access to the management company's books and records (including onsite visit) pursuant to the information flow agreement.

The remainder of the requirements may be subject to Level 3 guidelines, the effective enforcement of which should be obtained via local regulators to whom the information flow agreement must be notified as part of the general clearing process.

Question 8, page 94: Do you consider that the proposed standard arrangements and particulars of the agreement are detailed enough?

Yes.

Question 9, page 94: What are the benefits of such a standardisation in terms of harmonisation, clarity, legal certainty, etc…?

The proposed harmonised arrangements will create benefits by enhancing the orderly cooperation between the depositary and the management company in relation to clearly

establishing all the relevant information / communication flows needed to perform their respective duties, notably monitoring and supervisory obligations. An orderly cooperation along pre-established lines as agreed between the depositary and the management company is essential in order to protect investors.

Since the implementation of UCITS III, the fund industry has seen the emergence of new investment strategies, products and third parties that contributed to increase the level of complexity in terms of monitoring and supervisory obligations. Rather than having different interaction models, the standardization at Level 3 will allow the depositary to have a single standard approach for all relationships. The proposed standardisation (in the form of a stand alone agreement under the law of the Member State in which the relevant investment fund is established) will formalize and clarify the roles and responsibilities of both parties, but should at the same time allow some flexibility (ie it should not be understood as a standard agreement with standard clauses).

We agree that CESR's advice should include a set of general requirements on the content of the agreement, the standard elements being recommended at Level 3. Over-regulation must, however, be avoided and it should be left to the parties to determine details, this also having regard to the fact that currently there may be differences with respect to the implementation of depositary responsibilities across Member States.

Question 10, page 94: What are the costs for depositaries and management companies associated with the proposed provisions?

ALFI considers that it is an important point to find the right balance between prescriptive and principle base law. Indeed, the more prescriptive the law is the less flexibility the industry has. This might result in a "tick the box" process for each party (the management company and the depository) based on the list of documents listed in the law. This might give the unintended impression to some extent that, due to such an exhaustive list, the parties might be relieved from some of their responsibilities, e.g. the effective control of the Fund.

Furthermore, ALFI believes that these new provisions will, notably in case of cross border situations, imply additional costs for the participants as they will require some additional involvements and reporting activities with regulators.

3. Level 2 measures on the law applicable to the agreement between the management company and the depositary (Box 3, page 95)

Question 11, page 95: Do you agree that the agreement between the management company and the depositary should be governed by the national law of the UCITS? If not what alternative would you propose?

ALFI strongly agrees that the agreement between the management company and the depositary should be governed by the national law of the UCITS' home Member State. Resorting to the UCITS law to cover the contract provides clarity and minimises room for compliance, for uncertainty.

In the case where a UCITS is a corporate entity there will also be an agreement between the UCITS and the management company. We recommend that this agreement be also governed by the national law of the UCITS' home Member State.

For reasons of consistency and legal certainty the same rule should apply to the management regulations as well as to the service agreement between an investment company that is not self-managed and the relevant management company.

Question 12, page 95: What are the benefits of such a proposal? Do you see costs associated with such a provision? In particular, is this requirement burdensome for the UCITS management company that will be subject to the law of another Member State regarding the agreement with the depositary?

Such a proposal takes into account the fact that the fund and its investors are – and should remain – at the centre of the regime and protection afforded by the Directive and its implementary measures. In particular, it is the only solution which gives sufficient legal certainty to the investors in relation to the UCITS they have invested in. As regards the depositary, ALFI expects that any costs associated with such a provision should be marginal, as the latter will be required to undertake the same duties that it currently performs in accordance with the law of the Member State in which the relevant investment fund is established.

In case the law of another Member State, i.e. the Member State where the management company is established, would govern the agreement, the depositary would need to be aware of how/if the rules or laws would differ from jurisdiction to jurisdiction and how these requirements could be satisfied. This would not only be burdensome and cost intensive but, moreover, based on the fact that currently the depositary duties may vary across Member States, this could likely lead to the depositary being burdened with having to cope with differences of oversight and/or possibly additional duties in the oversight involved. As a principle, a depositary should not need to fulfil any additional conditions in order to act as depositary to a UCITS managed in another Member State.

This requirement will have some impact on management companies. The management company located in another Member State than the depositary will need to be aware of all the relevant laws of the UCITS national country and also the interpretations of such laws. As well as areas where it is known that regulations amongst Member States diverge, such as IT, outsourcing, VAT, data privacy and professional confidentiality, the management company cannot assume that areas of law that have been harmonised at a European level have been applied in the same way in each Member State. It is a consequence of UCITS IV that, a management company operating funds domiciled in several Member States needs to be aware of the areas where the regulations are different or are applied differently in each of the Member States it is dealing with. Management companies are the ones most likely to have to carry the burden. This is inherent and unavoidable in a situation where a management company uses the passport.

Legal and audit fees should increase where the management company is located in a different Member State to the UCITS.

4. Need for different provisions in relation to investment companies (Box 4, 96)

Question 13, page 96: Do you agree that investment companies should not be treated differently from common funds in respect of CESR's proposals?

Yes, we agree. See answer to next question (14).

Question 14, page 96: In your view, would such an approach impose unnecessary and/or burdensome requirements on investment companies? Would equal treatment improve the level playing field between different types of UCITS?

We do not believe that investment companies should be treated differently than common funds and we do not believe that such an approach would impose unnecessary and/or burdensome requirements on investments companies.

In substance a considerable part of the flow of information as required to comply with applicable duties is quite similar, regardless of the legal form of the investment fund.

Outside this common core, the scope of what will be required will depend on whether the fund is a common fund or an investment company. When obligations are common to both vehicles an equal treatment will improve the level playing field between the two different types of UCITS.

5. Possibility to advise the European Commission to extend these requirements to domestic structures (depositary and management company / UCITS domiciled in the same Member State) – Box 5, page 97

Question 15, page 97: Do you agree with CESR's proposal that equivalent rules should apply to domestic and cross-border situations? In particular, do you agree that depositaries should enter into a written agreement with the management company irrespective of where the latter is situated?

In the present case, applying equivalent rules to domestic and cross-border situations would permit to increase legal certainty regarding the relationship between the fund and its custodian. For this reason, ALFI agrees with CESR's proposal that the same rules should also apply when the UCITS and the management company are in the same Member State as for cross-border situation. The same level of arrangements between the depositary and management company should be in place so that equivalent protection is achieved for the relevant funds and related investors. A level playing field for depositaries acting on a domestic or cross border basis is essential in ALFI's view.

For existing relationships though, one will need to consider the length of time required for the review and possible amendments to the existing contractual arrangements as well as the negotiation of the stand alone agreement between the two parties, which likely points to the need for a grandfathering period.

Question 16, page 97: Do you think that such a recommendation would increase the level of protection for UCITS investors? Do you agree that a level playing field between rules applicable to domestic situations and those applicable to cross-border management of UCITS offsets potential costs for the industry?

See our answer to questions 12 and 15. Such a level playing field offsets costs for the industry as it shall also allow for depositaries to implement a single model.

Question 17, page 97:What would be the benefits of such an extension in terms of harmonisation of rules across Europe? What would be the costs of extending rules designed for cross-border situations to purely domestic situations? In particular, would a provision stating that the management company and the UCITS depositary have to enter into a written agreement irrespective of their location add burdensome requirements to the asset management sector?

Procedures / arrangements usually already exist between a management company or an investment company and the depositary. A standardized agreement between the parties would harmonize such arrangements and flow of information.

In ALFI's view, the situation is comparable in national and cross-border scenarios and hence, if one considers that written agreements setting out rights and obligations of both parties should be imposed, such reasoning should apply as well when such parties are situated in different Member States.

As similar descriptions usually already exist, ALFI does not believe that this extension will add overly burdensome requirements to the asset management sector and we would not expect substantial costs associated with such a proposal.

ALFI rather considers that harmonization/standardisation of rules across Europe could generally help to achieve comparable levels of protection.

Section IV – Risk management

In light of the increased importance of risk management for a UCITS ALFI welcomes CESR's discussions on risk management within the debate of the implementing measures concerning UCITS IV.

ALFI has given input to CESR's paper on risk principles (CESR/09-178) as well: the technical guidance proposed by CESR (CESR/09-489), and ALFI encourages CESR to refer to these comprehensive guidelines and to assure a consistent application within the EU member states.
Since the risk management guidance given by CESR is written as principles, ALFI takes the view that it is of utmost importance that the fund market participants – including management companies, depository banks, audit firm as well as regulators – do have deep common understanding and same expectations concerning the wording 'adequate risk management'.

ALFI agrees that regulations cannot be designed in a 'one size fits all needs' approach. In ALFI's view it will be crucial to strike the right balance while at the same time creating a common and consistent understanding (and deep technical knowledge) regarding risk management within all EU member states and all the relevant market participants.

Impacts of CESR's proposals on risk management (Ref. CESR/09-490) and risk measurement (Ref. CESR/09-489)

Question 1, page 101: Do the proposals related to risk measurement for the purposes of the calculation of UCITS' global exposure (as set out in document Ref. CESR/09-489) lead to additional costs for management companies and self-managed investment companies? Please quantify your cost estimate. What are the benefits of this proposal?

Under Luxembourg law, the various rules relating to risk measurement as provided for in the CESR Risk Management Principles for UCITS are mostly already applicable by virtue of CSSF Circular 07/308. Please also refer to the overall ALFI contribution to the CESR's consultation paper on Risk Measurement for the purposes of the calculation of UCITS' global exposure (Ref: CESR/09-489).

Unlike Luxembourg, other European countries - which may not yet have comparable risk regulations in place – may need to adjust their local regulation to CESR's guidance. It is very likely that this will lead for their local management companies to a need to build up adequate risk management departments/functions which will increase the cost.

Various differences exist between management companies regarding the use of global exposure calculation methods (or the models included therein) and the scope, the content and periodicity of the reports in relation thereto. ALFI is of the opinion that CESR has designed risk management principles which fairly take into account that not all funds do have similar risk profiles and thus not all funds do need the same standards concerning risk management – i.e. the related costs may vary (even within one jurisdiction) significantly. The flexibility to have a risk management adapted to the needs of the relevant UCITS is clearly a benefit.

As a result, the proposals made by CESR relating to risk measurement may, depending on the individual cases, lead to additional costs for certain management companies. There will, inevitably, be incremental costs associated with the implementation of the revised global exposure calculations. However, ALFI believes these are not likely to be material in comparison with the original cost of implementing VaR and the associated processes. Regarding the valuation of OTC Counterparty Risk Exposure (3.) the respective proposal will lead to a relief (beneficial because less complex, more transparent), while the new Sensitivity Approach (1.6) and the modification of the Commitment Approach Calculations (1.3, Option 1) will generate additional costs.

CHAPTER I

CONDITIONS GOVERNING RISK MANAGEMENT PROCESSES

Implementation of Article 51(4)(a) of the UCITS Directive

1. Identification of risks relevant to the UCITS (Box 1, page 103)

Question 2, page 104: Do you agree with CESR's proposal on the scope and objectives of the risk management policy that should be adopted by the management companies? If not, please suggest alternatives.

ALFI agrees with CESR's proposal on the scope and objectives of the risk management policy ("RMP"). The RMP should include all risks to which the UCITS is exposed, including inter alia market risk, liquidity risk, counterparty risk. UCITS III management companies already do

have RMP in place, which should take into consideration these elements of risk. Compulsorily extending the requirements to other (additional) risks may in certain cases increase the costs incurred in establishing and operating the RMP. Finally, in order to be as exhaustive as possible, we would suggest adding the following requirements to the list defined in paragraph 5. :

- Presentation of the management company
- Organization chart
- List of UCITS
- List of financial instruments and risks associated
- CVs of persons in charge

Question 3, page 104: Do the proposals related to identification of risks and risk management policy lead to additional costs for management companies and self-managed investment companies? Please quantify your cost estimate. What are the benefits of this proposal?

ALFI generally agrees with the proposal but would like to stress that sufficient flexibility should be given to have an RMP adapted to the actual risks incurred (principle of proportionality) without originating exaggerated compliance costs. It is expected that the implementation and execution of the framework to operational risks will lead to additional costs.

2. Risk management function (Box 2, page 104)

Question 4, page 106: Do you agree with CESR's proposal on the organisational requirements which should apply to the risk management function? If not, please suggest alternatives.

ALFI agrees. The organisational requirements of the risk management function as described correspond to current practice and requirements in Luxembourg.

Question 5, page 106: Do the proposals related to the risk management function lead to additional costs for management companies and self-managed investment companies? Please quantify your cost estimate. What are the benefits of this proposal?

ALFI would expect no additional costs provided the principles of appropriateness and proportionality with regard to the nature, scale and complexity of the management company's activities and of the UCITS it manages are observed.

3. Risk management activities performed by third parties (Box 3, page 106)

Question 6, page 107: Do you agree with CESR's proposals on the organisational requirements and safeguards which should apply to the risk management function in case of arrangements with third parties? If not, please suggest alternatives.

ALFI generally agrees with the organizational requirements and safeguards that should apply to the risk management function in case of arrangements with third parties. It should be stressed that the processes and responsibilities in the event of outsourcing to a 3rd party need to be clearly defined, namely i) calculation of the risk measure through an appropriate engine (i.e. RiskMetrics, StatPro, Barra, etc) ii) definition of the appropriate risk profile iii) production of exception reports iv) investigation, monitoring and escalation to authorities.

The due diligence process a management company should perform when appointing a 3rd party, should be tailored depending on the scope of delegation. In most events out of the

aforementioned list, only steps i) to ii) are delegated, possibly step iii). The management company would usually retain competence for step iv).

With regards to point 17. and the requirement for a management company to "take all reasonable steps to ensure continuity to the risk management process in case of interruptions to the risk management activities performed by 3rd parties", this requirement, albeit desirable may be very difficult to be put into practice, in particular for smaller entities. It appears appropriate to include in the due diligence process of the 3rd party an assessment of its Business Continuity Plan and to ensure the management company is duly informed on any change thereto. We also stress the importance of point 18. i.e. the effective access for the management company to all data relative to the outsourced activities and the co-operation of the 3rd party with the competent supervisory authorities. ALFI considers such precautions as sufficient to fulfill the management company's duties in this respect.

Question 7, page 108: Do the proposals related to performance of risk management functions by third parties lead to additional costs for management companies and self-managed investment companies? Please quantify your cost estimate. What are the benefits of this proposal?

In general the delegation to third parties follows economic reasons and therefore the delegation as such is not expected to lead to additional costs.

4. Measurement and management of risks (Box 4, page 108)

Question 8, page 110: Do you agree with CESR's proposals on the procedural and methodological requirements that should apply to the risk management process adopted by the management companies? If not, please suggest alternatives

ALFI generally agrees with CESR's proposals on the requirements that should apply to the measurement and management of risks.

However, it would be necessary in ALFI's views that the rule of proportionality be applied as far as the requirement that the risk limit system "should cover all risks to which a limit can be applied and should take into account their interactions with one another" is concerned. Such requirement should notably be implemented with due regard to the complexity of UCITS, and ALFI recommends to clarify the requirement that "all relevant risks" should be covered.

ALFI believes that this should apply as well to further structured financial instruments. If the UCITS invests in structured financial instruments, the risks associated with any of the components should be appropriately identified. The relevant risks should be managed in an appropriate manner.

ALFI supports the call for a periodic review of the risk management processes by the supervisor. The periodicity of such review should be triggered by significant changes, if any are carried into execution by the management company.

Question 9, page 110: Do the proposals related to the measurement and management of risks, including liquidity risks, lead to additional costs for management companies and self-managed investment companies? Please quantify your cost estimate. What are the benefits of this proposal?

Yes, the proposals related to the measurement and management of liquidity risks may lead to additional costs for management companies and self-managed investment companies as far as such controls have not been implemented yet. ALFI understands the specific requirements for

liquidity and are aware of its significance. Nevertheless, one should attach importance to the fact that liquidity risk is one of several types of risk and should be factored in the context of the entire UCITS' internal risk system.

5. Responsibility of the board of directors and internal reporting (Box 5, page 110)

Question 10, page 111: Do you agree with CESR's proposals on the requirements concerning the responsibility and governance of the risk management process? If not, please suggest alternatives.

Agreed. It is important that the risk culture of a company comes from the Board and that the senior management be actively involved in the governance of the risk management process. The selection of the specific risk management processes to be used in a particular case should be in the responsibility of the Management Company or the UCITS and not be generally prescribed.

However CESR should distinguish situations where functions are delegated to other parties and where the management company is performing a simple oversight role. By way of example most Management Companies do not perform Investment Management functions but rather delegate these to experts in various locations.

Question 11, page 111: Do the proposals related to the responsibility of the board of directors and internal reporting lead to additional costs for management companies and self-managed investment companies? Please quantify your cost estimate. What are the benefits of this proposal?

ALFI believes that a number of market participants have already increased their resources related to risk management to comply with the requirements of local regulations. However it is expected that both Management Companies and self-managed Investment Companies will need to devote additional resources to comply with all of the UCITS IV requirements. It is important that CESR particularly adheres to the concept of proportionality in drafting its guidance to the implementing measures.

6. Procedures for the valuation of OTC derivatives (Box 6, page 112)

Question12, page 114: Do you agree with CESR's proposals on the link between the risk management policy and the valuation of OTC derivatives? If not, please suggest alternatives.

Yes, in principle, ALFI agrees with the necessary link between the risk management policy and OTC-valuation at a management company risk management function level by including both activities in the "RMP". The management company should however have the possibility according of its business model to delegate both activities to different units or service providers as long as the constraints of box 6 paragraph 1 are complied with.

The link between the risk management policy and the valuation of OTC derivatives seems of utmost importance, especially for two reasons. Firstly, the risk assessment of an asset is intrinsically linked to its valuation: it is thus necessary that the valuation process is adequately captured in the computation of market risk exposure. Secondly, the valuation of an asset requires expert judgment, especially on the estimation of some pricing parameters. Risk management should provide comfort regarding this type of issues.

Question 13, page 114: Do you agree with CESR's proposal to extend the application of the requirements set out in Box 3 (concerning the risk management activities performed by third parties) to the valuation arrangements and procedures concerning OTC derivatives (regarding both the valuation and the assessment of the valuation) which involve the performance of certain activities by third parties?

ALFI agrees with CESR's proposal to extend the application of the requirements set out in Box 3 (concerning the risk management activities performed by third parties) to the valuation arrangements and procedures concerning OTC derivatives (regarding both the valuation and the assessment of the valuation) which involve the performance of certain activities by third parties.

Question 14, page 114: Do you agree with CESR's proposal to extend the application of the requirements set out in Box 6 to the valuation of other financial instruments which expose the UCITS to valuation risks equivalent to those of OTC derivatives? If not, please explain and suggest alternatives.

ALFI agrees with CESR's proposal to extend the application of the requirements set out in Box 6 to the valuation of other financial instruments which expose the UCITS to valuation risks equivalent to those of OTC derivatives. However, attention should be paid to costs and efforts incurred to obtain information on illiquid financial instruments.

Question 15, page 114: In cases where financial instruments embed OTC derivatives, do you consider it appropriate to apply the requirements referred to in Box 6 to the valuation of the mbedded derivative element of the financial instrument? Should these requirements apply to the valuation of all such instruments? Please explain your answer and, where appropriate, suggest alternatives.

ALFI considers that the requirements referred to in Box 6 should apply to the financial instrument as a whole, whether it includes OTC derivatives or not. Applying the requirement of Box 6 to the valuation of the embedded OTC derivative separately would seem rather arbitrary, and might lead to missing the global picture of such a financial asset.

Question 16, page 114: Do the proposals related to the valuation of OTC derivatives in the context of risk management lead to additional costs for management companies and self-managed investment companies? Please quantify your cost estimate. What are the benefits of this proposal?

Yes, ALFI estimates there will be an increase of costs. Whether these costs outweigh potential benefits in form of a more comprehensive and coherent view on OTC-valuation and risk management will depend strongly on each management company's business model. It should be the responsibility of each management company to set up its OTC-valuation process and integrate it in the "RMP" in an efficient way to avoid unnecessary costs.

7. Supervision (Box 7, page 114)

Question 17, page 115: Do you agree with CESR's proposals on the supervisory framework that should apply to the risk management process adopted by the management companies? If not, please suggest alternatives.

ALFI agrees with CESR's proposals on the supervisory framework. The challenge will be to have a common understanding and a consistent application of the risk management principles within the EU Member States. To achieve this, the regulators have to have enough resources

and sufficiently skilled people. This is particularly important in situations where regulators are expected to proactively detect deficiencies and address issues.

With regard to the ongoing review of the adequacy and effectiveness of the risk management process, ALFI believes that Management Companies should be given the active part of notifying any material changes to the regulators, if necessary, rather than the regulator asking for updates on a periodical basis.

Question 18, page 115: Do the proposals related to authorisation processes and the supervisory approach of competent authorities lead to additional costs for management companies and self managed investment companies? Please quantify your cost estimate. What are the benefits of this proposal?

All in all, ALFI believes that the proposals do not lead to additional costs for management companies.

Box 8, page 115 – Investment companies

Question 19, page 116: Do you agree with CESR's proposals on the application to investment companies of the risk management requirements set out in this document? If not, please explain your position.

ALFI agrees with CESR's proposals on the application to investment companies of the risk management requirements set out in this document.