European Fund and Asset Management Association

EFAMA REPLY TO CESR'S CONSULTATION PAPER TECHNICAL ADVICE TO THE EUROPEAN COMMISSION ON THE LEVEL 2 MEASURES RELATED TO THE UCITS MANAGEMENT COMPANY PASSPORT

EFAMA[1] welcomes CESR's consultation paper and congratulates CESR for the excellent work, which our members support to a very large extent.

Section I – Organizational requirements and conflicts of interest

Q1: *Do you agree with the general approach proposed by CESR?*
Q2: *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.
Q3: *In your view, what are the benefits of aligning the organisational requirements for UCITS management companies with the relevant MiFID requirements?*

Almost all EFAMA members fully agree with the pragmatic approach based on consistency with the MiFID regime, while taking into account the specificities of collective investment management. The vast majority of investment managers have already implemented MiFID, at least for the discretionary portfolio management part of their activities. Consistency will help simplify organizational structures, and differences (or "MiFID goldplating") should be avoided.

We wish to reiterate the importance of the principle of proportionality in regulation, and appreciate very much that CESR has clearly taken it into account in its advice.

[1] EFAMA is the representative association for the European investment management industry. It represents through its 26 member associations and 44 corporate members approximately EUR 11 trillion in assets under management of which EUR 6.1 trillion was managed by approximately 53,000 funds by the end of 2008. Just over 37,000 of these funds were UCITS funds. For more information about EFAMA, please visit www.efama.org.

18 Square de Meeûs • B-1050 Bruxelles
☎ +32 2 513 39 69 • Fax +32 2 513 26 43 • e-mail : info@efama.org • www.efama.org

We appreciate very much CESR's questions asking for input on costs, but unfortunately it is very difficult for our members to provide them. A large majority of EFAMA members is of the opinion that whether extra costs will be generated depends on whether MiFID has already been applied to Management Companies at national level, and how far. In some areas, however, such as recordkeeping or transaction reporting, there could be significantly higher costs as the requirements would be entirely new.

EFAMA agrees that self-managed investment companies should follow the same rules as Management Companies.

We also agree that direct sales by Management Companies to investors should be subject to regulation consistent with MiFID, although at the moment it is only a very small portion of fund unit sales.

Q4: *Do you agree with CESR's proposals on organisational procedures and arrangements for management companies? If not, please suggest alternatives.*
EFAMA agrees with CESR's proposals in BOX 1, but in Para. 1 (d) we suggest to replace the word "employ" with "have available", as it might be possible to acquire the necessary skills and knowledge through delegation without directly employing the people.

Q5: *Do you agree with the above CESR proposal on the responsibility of senior management of management companies? If not, please suggest alternatives.*
EFAMA agrees.

Q6: *Do you agree with the above CESR proposal on the remuneration policy of management companies? If not, please suggest alternatives.*
Q7: *In your view, should the requirements set out above in relation to senior management be extended to cover all employees of UCITS management companies?*
EFAMA agrees with CESR's proposals in BOX 3, but believes that it would be disproportionate and excessively bureaucratic to extend the policy to <u>all</u> employees of the Management Company. It should be sufficient to have a policy to cover the staff whose activities materially impact the risk profile of the Management Company (in line with the Commission Recommendation of remuneration), and this should be specified in BOX 3. However, some EFAMA members disagree with Para. 5, as it should be up to the Management Company to decide on the disclosure of the remuneration policy.

The policy could also be at group level, applying to the Management Company as a subsidiary.

Many EFAMA members regret the "piecemeal approach" taken at EU level to remuneration regulation, and believe that a horizontal one would be preferable (however, we understand CESR's restrictions).

Q8: *Do you agree with the above CESR proposal on the compliance function of*

management companies? If not, please suggest alternatives.
EFAMA agrees.

***Q9:** Do you agree with the above CESR proposal on the internal audit of management companies? If not, please suggest alternatives.*
EFAMA agrees.

***Q10:** Do you agree with the CESR's proposal on complaints handling procedures for management companies? If not, please suggest alternatives.*
EFAMA agrees, but the language requirement to be modified in the last sentence of BOX 6 from "*in an official language of his Member State*"to "*in an official language of the Member States where the UCITS is authorized or notified*". The language requirements should be limited to the official languages where the Management Company actually chooses to do business, to avoid the potential requirement to deal with all EU languages.

***Q11:** Do you agree with CESR's proposals on personal transactions? If not, please suggest alternatives.*
EFAMA agrees, but some clarifications are needed.
In the "Meaning of personal transaction" section, Point (b) (ii) is undefined and potentially very broad. In Para. 3 (b) "*any person … involved in the management of that undertaking*" is too broad and is not defined. Clear definitions are needed in both cases.

***Q12:** Do you agree with CESR's proposals on electronic data processing and recordkeeping requirements? If not, please suggest alternatives.*
We have strong concerns regarding the section "*Recording of subscription and redemption orders*".

In most Member States the Management Company does not have the information required by CESR in this part of Box 8, particularly the identification of the unitholder. The orders are mostly aggregated by the distributors and the units are held in the name of nominees. Given the variety of structures and distribution channels in different Member States, meeting this requirement would entail huge changes in most countries. Not even the depositary usually has such information.

Before any alternatives are considered, we believe the rationale for such measures should be clarified. We do not believe that such recordkeeping can be justified to prevent late trading of market timing. For late trading, it is sufficient that a cutoff time be established by the Management Company for orders received from distributors. For market timing, appropriate cutoff times for NAV calculation should be established. To prevent frequent trading/short-term trading, a minimum time span should be established between two reverse transactions in units of the same fund or compartment.

A further concern is that collecting the information required by CESR could imply new obligations for the Management Company under Anti-Money Laundering legislation, potentially requiring a complete overhaul of existing practices.

Should it be the case that the Management Company already receives such information (probably only in case of direct sales), then recordkeeping would be appropriate and possible, although we fail to see the benefits due to the lack of rationale. In any case, the requirements should not be imposed where there are intermediaries and the Management Company does not currently receive the information.

Lastly, EFAMA strongly objects to Para. 57 (reciprocal access to information in IT systems and databases), which is very unclear and likely to breach confidentiality towards clients, as well as give rise to data protection issues.

Q13: *Do you agree with CESR's proposals on UCITS accounting principles? If not, please suggest alternatives.*
Q14: *Does this proposal lead to additional costs for UCITS management companies? Please quantify your cost estimate. What are the benefits of this proposal?*
EFAMA agrees, but wishes to point out that CESR lays out requirements for the Management Company, while in some countries the accounting is done by the depositary, and such national specificities should be taken into account.

Q15: *Do you agree with CESR's proposals on investment strategies? If not, please suggest alternatives.*
Q16: *Does this proposal lead to additional costs for management companies? If possible, please quantify your estimate. What are the benefits of this proposal?*
EFAMA agrees, but it is unclear what the difference is between the general investment policy and the investment strategies. If CESR by investment strategies means the day-to-day implementation of the investment policy, then they are implemented by portfolio managers, not the senior management, and their implementation would be verified by the risk management and/or compliance function. The text should therefore be modified. Some of our members see a clear danger of increasing administrative costs arising from this proposal.

Q17: *Do you agree on the proposed requirements relating to the exercise of voting rights?If not, please suggest alternatives.*
Q18: *What are the additional costs of this proposal for management companies? If possible, please quantify your estimate. What are the benefits of this proposal?*
EFAMA disagrees with the introduction by CESR of rules related to the exercise of voting rights. There is no legal basis in the Level 1 text, and the drafting is such that it might even be seen as introducing an obligation to vote (how could the management company otherwise prove that the voting rights are exercised "to the exclusive benefit of the unit-holders"?).

We fail to see the link to investor protection, and since CESR itself states that Member States could apply more stringent rules, no harmonization is to be expected. We recommend deleting the provisions in Para. 1 and 2. The exercise of voting rights is anyway covered by the fiduciary duty of Investment Managers towards the UCITS, and

Para. 1 and 2 are superfluous. The Management Company should be free to decide not only how best to exercise the voting rights, but also whether exercising these rights is in the interest of the UCITS. That decision will depend on the size of the position, on the costs involved, on the resources and size of the management company, on the type of decision at hand, and potentially other factors.

Para. 3: EFAMA agrees with the publication of a voting policy (on the Management Company's website or in the annual report of the UCITS), but not with the requirement to disclose the actual votes cast.

CHAPTER 2 - CONFLICTS OF INTEREST

Q19: *Do you agree with the proposed approach? Is there any additional adaptation you would suggest?*

Q20: *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 the 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.

Q21: *In your view, what are the benefits of aligning the requirements for conflicts of interest for UCITS management companies with the relevant MiFID requirements?*

EFAMA agrees as long as CESR's requirements are in line with MiFID and clearly reflect the principle of proportionality. Regarding the management of non-neutralized conflicts, please see our answer to Q26. Furthermore, we want to bring to CESR's attention that it is not always possible to reconcile the interests of each individual category of investors in a UCITS or those of one investor vs. the interests of the UCITS as a whole, a situation which is specific to collective portfolio management. For example, there are differing interests among unitholders regarding frequent trading, and the duty of the Management Company in that case should be to the UCITS, or to a large majority of unitholders, not to each one individually),.

Q22: *Do you agree with CESR's proposals on the criteria for identifying conflicts? If not, please suggest alternatives.*

EFAMA agrees, but point 1 (d) seems superfluous. Furthermore, we are concerned that CESR's statement in Para 3 of BOX 12 and in Para. 14 might breach the principle of equal treatment of all unitholders (see our comments above), and that the requirements in BOX 12 may not always be complied with "*mutatis mutandis*". We would also argue that BOX 4 of Section 2 already deals with the obligations of the management company regarding the appropriateness test.

Q23: *Do you agree with CESR's proposals on the identification and management of*

conflicts? If not, please suggest alternatives.
EFAMA agrees with BOX 13, but we do not agree with CESR's statement in Para. 17 that management companies should have a conflict of interest policy for each UCITS. A general policy is sufficient, also because the conflicts are unlikely to be specific to a single fund.

***Q24:** Do you agree with the CESR's proposals on the independence of the persons managing conflicts? If not, please suggest alternatives.*
EFAMA agrees.

***Q25:** Do you agree with CESR's proposals on records of activities giving rise to conflicts of interest? If not, please suggest alternatives.*
EFAMA agrees.

***Q26:** Do you agree with CESR's proposals on management of non-neutralised conflicts? If not, please suggest alternatives.*
***Q27:** Are there any other issues you feel should be considered in addition to those already mentioned in this paper?*
Almost all EFAMA members strongly disagree with CESR's approach, as the proposals go beyond MiFID requirements for conflicts on interest.

In MiFID, Art. 18 Level 1 requires the identification of conflicts of interest and, where the arrangements taken by the investment firm are not sufficient to prevent them or eliminate them, they have to be disclosed to the client. Here the proposals refer to a step beyond disclosure, and imply that senior management should "in any case" ensure that the Management Company acts in the best interest of the UCITS and unitholders. It is very unclear what additional activities should be carried out, and how the total elimination of all conflicts of interest could possibly be achieved. How could further reporting/disclosure to investors (Para. 1) be helpful, in the case of conflicts that cannot be resolved? EFAMA also disagrees with Para. 31.

It is not clear why disclosure under MiFID should be sufficient for example in the case of distribution activities to retail clients, but not for the activities of collective portfolio management for the same clients.

In BOX 16, it is not clear who the "relevant unitholders" are, and how a Management Company should discriminate between two different categories of unitholders (see our prior comments in the reply to Q20). The interests of the UCITS overall should have priority over the interests of a group of unitholders.

SECTION II – RULES OF CONDUCT FOR MANAGEMENT COMPANIES
EFAMA believes that the inclusion of definition of "professional investor" and "retail investor" on the basis of MiFID is needed. We prefer "investor" to "client" in this context.

Q1: *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.*
Q2: *What are the additional costs of this proposal for management companies? If possible, please quantify your estimate. What are the benefits of this proposal?*
EFAMA agrees, but in Para. 3of Box 1 it is unclear to whom the Management Company should "be able to demonstrate that they have accurately valued the UCITS portfolios". Certainly such requirement could not go further than the regulator, but it seems quite obvious, so we would like to have it deleted.

Regarding Para. 3, we wish to remind CESR that the valuation function is not carried out by the Management Company in all Member States.

Para. 4 is also very obvious (as it falls under the obligation of acting in the best interest of the client) and too broad, and could be deleted.

EFAMA disagrees with part of Para. 2 of the explanatory text, as it tries to extend the management company's fiduciary duty to the setting of its own fees, which would lead in the extreme case to the prohibition of any profit. Management fees are subject to commercial decisions and should not be restrained through regulatory intervention. Management fees are fully disclosed in the KID, therefore, if an investor judges them to be excessive, he/she can avoid investing.

BOX 2 – EFAMA agrees that a high level of due diligence is required, and welcomes regulatory initiatives such as the IOSCO Good Practices in Relation to Investment Managers' Due Diligence When Investing in Structured Finance Instruments. We invite CESR to carefully consider the recordkeeping requirements arising from Para. 4.

In view of their strict regulation, we believe that when investing into a UCITS it should be possible to rely to a higher degree for the due diligence on the fund's proper authorization and supervision. Should the standards for due diligence and verifications of underlying funds be raised significantly, costs will explode and make Funds of funds much less attractive (or else investment will be limited to in-house funds).

Q3: *Do you agree with this general approach proposed by CESR for conduct of business rules relating to direct selling? If not, please suggest alternatives.*
Q4: *What are the additional costs of this proposal for management companies? If possible, please quantify your estimate. What are the benefits of this proposal?*
EFAMA agrees, but would appreciate a clarification from CESR as to whether the definition of direct sale includes only sales with solicitation or also sales without client solicitation. A formal definition in BOX 3 would be helpful (now only defined in explanatory text (para. 16).

Q5: *Do you agree with CESR's proposals on conduct of business rules relating to direct selling? If not, please suggest alternatives.*

Q6: *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?*
EFAMA agrees with CESRs proposals in Boxes 4,5, and 6.

However, CESR should state more clearly that the sale by "execution only" is possible, as it is already specifically allowed under MiFID. Instead, in Para. 8 of BOX 4, CESR refers to the "*services of execution and/or reception and transmission of orders*". According to the terms of their licenses, Management Companies cannot provide such services. CESR should state that Management Companies can "*receive subscription and redemption orders for fund units***".**

CESR states that the Management Company may take into account the category of relevant client "*professional or retail client*" , but such categories are not yet defined in the UCITS Directive (and are not included in the definitions in the Consultation Paper – see our comment above). EFAMA suggests including a definition on the basis of MiFID, but using "*professional investor*" and "*retail investor*" instead of "*professional client*" and "*retail client*".

We have two comments on Box 6:

- Para. 1 (b) should only be applicable to retail investors (as per MiFID).
- Para. 3 (g) is irrelevant for non-listed UCITS.

Q7: *Do you agree with CESR's proposals on direct execution of orders by management companies? If not, please suggest alternatives.*
Q8: *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?*
EFAMA agrees with the extension of best execution rules in MiFID. However, it is impossible to obtain the prior consent of the UCITS to the execution policy (Para. 3) for contractual funds.

Regarding the requirement in Para. 3 to "*make available appropriate information to the unitholders*" and in Para.6 to "*demonstrate*" that orders have been executed in accordance with the Management Company's execution policy, we believe that such requirements should apply only towards the regulator and/or the depositary.

In Para. 5, the requirement for an "annual" review by the Management Company goes beyond MiFID requirements, which do not prescribe a specific frequency, and should be deleted.

Q9: *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.
Q10: *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?*

We agree, but please see our comments on BOX 7.

Q11: *Do you agree with CESR's proposals on the handling of orders? If not, please suggest alternatives.*
Q12: *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?*
EFAMA agrees, but most of Para. 2 is actually to be implemented by the depositary.

Q13: *Do you agree with CESR's proposals on inducements? If not, please suggest alternatives.*
Q14: *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?*
EFAMA 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 and we therefore disagree with CESR's proposals in BOX 11.

EFAMA believes that the text currently proposed by CESR needs to clearly 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.

CESR only refers to the "*provision of a collective portfolio management acti*vity", but within that activity we can distinguish between inducements in relation to direct sales to investors of fund units (part of the Management Company's 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:

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~~the UCITS or an investor (the latter in case of direct sale) if, in relation to the provision of a collective portfolio management activity to the UCITS or the investor~~, 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 ~~UCITS or an investor~~relevant client or a person on its behalf ~~of the UCITS or an investor~~;
(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 ~~UCITS or the investor~~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 ~~UCITS or investors~~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 ~~UCITS or investors~~relevant client.
2. In relation to the provision of a collective portfolio management activity, a~~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 to third-party intermediaries 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.

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."*

EFAMA members disagree with regard to Para. 49 and 50 of the explanatory text. It is not the entire content of Para. 1(b) of BOX 11 that needs to be disclosed, but only Sub-

point (i). Furthermore, as the MiFID requirement for disclosure to investors is only ex-ante, the same should apply to UCITS direct sales by the Management Company. We do not understand why the provisions should be different or more far-reaching, and – given that retrocessions are part of the management company fees and those are fully disclosed in the periodic reports – why such details should be disclosed on an ongoing basis. In the case of direct sales, there would not be any inducements paid, and in the case of third-party distribution, it should be clearly re-stated by CESR that any disclosure to the final investor must be made by the distributor, not by the UCITS or the Management Company.

SECTION III – 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

Q1: *Do you agree that no additional requirements should be imposed on a depositary when the management company is situated in another Member State?*
Q2: *What will be the costs of imposing such a requirement for the industry? What would be the implementation difficulties for regulators?*
EFAMA agrees with BOX 1.

Q3: *Are the proposed requirements appropriate?*
Q4: *Are the information flows exchanged in relation to the outsourcing of activities by the management company or the depositary relevant?*
Q5: *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?*
Q6: *Is the split between suggestions for level 2 measures and envisaged level 3 guidelines appropriate?*
Q7: *Do you see a need for level 2 measures in this area or are the level 1 provisions sufficiently clear and precise?*
Q8: *Do you consider that the proposed standard arrangements and particulars of the agreement are detailed enough?*
Q9: *What are the benefits of such a standardisation in terms of harmonisation, clarity, legal certainty etc.?*
Q10: *What are the costs for depositaries and management companies associated with the proposed provisions?*
A large majority of EFAMA members disagrees with the proposals in BOX 2 and believes that CESR's advice on one hand goes well beyond what is necessary to define the content of the agreement, while on the other it is not specific enough on such content. In their opinion, the agreement should only cover the flow of information required to allow the depositary to perform its duties when the Management Company of the UCITS is situated in another Member State. It should be remembered that a standard agreement already exists between depositary and Management Company, and there is no need to

have the entire contents of the standard agreement regulated by Level 2 measures. We are not aware of market failures that would require regulation in this area.

The scope of CESR's proposal should be substantially reduced, and more key elements of the agreement should instead be included in the text of BOX 2. EFAMA believes they should be included in Level 2 (not Level 3) to ensure harmonization.

In para. 3 CESR states that confidentiality obligations "*should not impair*" the ability to access information. We encourage CESR and the Commission to verify that Level 2 provisions would indeed supersede any other law and regulation (for example bank secrecy regulations or data protection legislation).

At the end of Para. 6 "*if required by national law*" should be added.

Regarding the second to last paragraph of BOX 2 on page 91, EFAMA does not see the need for depositaries to perform on-site visits, which should be reserved to regulators and auditors. In case of suspected violations, the depositary should request written information from the Management Company and, if the reply is not satisfactory, it should report the incident to supervisory authorities.

Furthermore, the CESR text in the said paragraph does not seem to grant the same rights to the depositary and the management company. Most EFAMa members believe that the following new text should replace the second-to-last paragraph in Box 2: "*The agreement shall include provisions regarding the possibilities and procedures for the review of the depositary by the management company and vice-versa.*"

Some of our members, however, are of the opinion that the depositaries have a duty of oversight of the management company, but not vice-versa. The sentence "*It shall also include a provision regarding the possibilities and procedures for the review of the depositary by the management company*" should therefore be deleted.

Q11: *Do you agree that the agreement between the management company the depositary should be governed by the national law of the UCITS? If not, what alternative would you propose?*
Q12: *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?*
Almost all EFAMA members do not agree with CESR's proposal. We would prefer the parties to the agreement to be able to freely choose the applicable law.

Q13: *Do you agree that investment companies should not be treated differently from common funds in respect of CESR's proposals?*
Q14: *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?
EFAMA agrees.

***Q15:** 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?*
***Q16:** 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?*
***Q17:** 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?*
A large majority of EFAMA members does not see a need to extend the provisions to purely domestic situations, and there is no legal basis for such an extension. As we already explained in our reply to BOX 2, the content of the agreement should exclusively reflect the additional provisions necessary due to the fact that the Management Company is located in another Member State. The provisions should therefore be quite limited in scope, not cover the content of a standard agreement, which already exists, works well in practice, and will not be at all affected if the Management Company is located in the same Member State as the depositary.

SECTION IV – Risk Management
***Q1:** 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?*
EFAMA is unfortunately unable to quantify the costs.

***Q2:** 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.*
***Q3:** 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?*
EFAMA agrees with CESR's proposals in Box 1.

***Q4:** Do you agree with CESR's proposal on the organisational requirements which should apply to the risk management function? If not, please suggest alternatives.*
***Q5:** 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?
The relationship between the risk management and the valuation function was already covered by CESR in its Risk management Principles for UCITS. EFAMA reiterates the position that the two functions are separate and independent – they should cooperate but the risk management function should not take on valuation duties.
Although the text of Para. 2 (d) follows the wording of the Principles, EFAMA would appreciate the inclusion in the explanatory text of the same text as Para. 45 (page 19) in the Risk Management Principles: "*Without prejudice to the difference of the objectives pursued by the risk management and the valuation processes, there should be sufficient interaction between the two functions so as to allow mutual support, where necessary. That interaction may for instance result in the participation of both functions into the Company's valuation committee*." This paragraph better expresses the independence of the two functions and their relationship.

We have the same concerns in relation to BOX 6.

Q6: *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.*
Q7: *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?*
EFAMA agrees with the proposals.

Q8: *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.*
Q9: *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?*
EFAMA agrees with CESR's approach and with BOX 4.However, the requirements in Para. 22 of the explanatory text regarding IT systems seem too detailed. Such decisions should be left to the management company.

Q10: *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.*
Q11: *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?*
EFAMA agrees with the proposals in BOX 5.

Q12: *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.*
Q13: *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?*
Q14: *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.*
We disagree with the requirement in Para. 3 of BOX 6 for the appointment of the risk management function with "*specific duties and responsibilities*" with regard to the valuation of OTC derivatives.

EFAMA agrees that the risk monitoring/measurement function should support the valuation process. This support, however, should take the form of participation in the management company's valuation committee, not of imposing its pricing assumptions and models on the valuation function. The valuation function should exercise its activities independently of the risk monitoring function, and should be responsible for choosing the most appropriate pricing source or valuation model.

With regard to Para. 5, we do not support the proposed extension, for which there is no legal basis in Level 1 and which is very ill-defined (there is no specification of what "other types of financial instruments" the requirements would apply to, and what valuation risks would be "equivalent").

We also believe that CESR's proposals should follow the Eligible Assets Directive, so as not to create inconsistencies, and suggest that the wording of Para. 1 (i) be modified to reflect Art. 8 (4) (a) of the EAD: "*the basis for the valuation is either a reliable up-to-date market value of the instrument, or, if such a value is not available, a pricing model using an adequate recognized methodology*;" The words "or meaningful" would have to be deleted in CESR's text, and "recognized" should be added.

Q15: *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 embedded 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.*
In reference to the valuation of financial instruments embedding a derivative, we neither consider it appropriate to separate the embedded derivatives from the instrument, nor to apply the requirements referred to in BOX 6 to the valuation of such derivative element. The requirements of EAD regarding embedded derivatives relate to the exposure calculation for UCITS, not to the valuation of such instruments, for which a price is available/calculated taking into account the instrument as a whole.

Q16: *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?*
The information is not available.

Q17: *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.*
Q18: *Do the proposals related to authorisation processes and the supervisory approach of competent authorities lead to additional costs for management companies and selfmanaged investment companies? Please quantify your cost estimate. What are the benefits of this proposal?*
EFAMA agrees with the content of BOX 7, but believes it should be clarified. The current text could be interpreted as referring only to situations where the UCITS and the Management Company are situated in the same Member State. In fact, Para. 2 states that "*when authorizing a new UCITS …, competent authorities shall be satisfied that the risk management process remains adequate*", and no distinction is made regarding the role of the home vs. the host (UCITS) competent authorities. The wording "competent authorities" is used throughout, although sometimes it refers to the host, and sometimes to the home competent authorities.

According to Art. 19 of the UCITS Directive, approval and supervision of risk management procedures are clearly assigned to the authorities of the management company's home Member State. The wording in Para. 45 should therefore be modified, as the host Member State's competent authorities **must rely** on (not "***may take into account***") the appraisal carried out by the home competent authorities of the management company's risk management process.

Q19: *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.*
EFAMA agrees.

SECTION V – SUPERVISORY COOPERATION
EFAMA has no comments, although we wish to stress that a clear commitment to supervisory cooperation is crucial for the implementation of UCITS IV.

ADDITIONAL REMARKS
Some EFAMA members believe that, with regard to delegation, the existence of equivalent standards in a third country is a matter which should be taken into account in

deciding whether or not an investment firm in any such third country can be appointed to act as investment manager to a UCITS fund. Where equivalence is deemed to exist, it should be sufficient for the investment manager in a third country to comply with local law requirements, except where there are no equivalent requirements.

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