

Can hedge funds indices be classified as financial indices for the purpose of UCITS?

- 1) There is no legal obstacle to include hedge funds indices within the scope of the eligible indices for UCITS, to the extent they comply with the criteria imposed by article 22a of the UCITS directive and to the extent the UCITS directive expressly provides no look through for the investment in index based derivatives.
- 2) CESR Paper is largely based on the provisions included in a paper entitled "Hedge funds indices for retail investors: UCITS eligible or not eligible?" issued by François Serge L'Habitant, professor of finance at the HEC University of Lausanne.
We believe that this paper does express views which are not shared by other experts in that field, like the provisions contained in a document issued by the Edhec Business School in 2006, document entitled "A reply to the CESR Recommendations on the Eligibility of Hedge Fund Indices for Investments of UCITS". Therefore, one may consider that the Issues Paper might not totally reflect the position of the industry.
- 3) We would like to draw the attention of CESR to the fact that all the assets allocation schemes allocate a certain percentage of their assets in the alternative strategy industry, and in particular in hedge funds.

If retail investors could not get an exposure to the hedge funds strategies through regulated vehicles like UCITS, however, they may obtain such exposure through the purchase of a broad range of instruments including structured notes, certificates, shares, special purpose vehicles and life insurance policies or any other unregulated vehicles available in the markets which may not offer the same guarantees in terms of investor's protection, in particular, in terms of diversification, transparency (fees and underlying) and supervision.

- 4) As of today, the market trend is more emphasized on capital preservation. However, the "appetite" for the hedge funds market will be developing if the current market conditions change (i.e. in terms of increase of market volatility) and not allowing UCITS funds to have an indirect exposure to hedge fund indices would put them at a competitive disadvantage.
- 5) Whilst one should recognize that, for the time being, several hedge funds indices do not meet the criteria imposed by article 22a, one can not exclude that hedge funds indices which will be created in the future will meet such criteria.
- 6) Whilst one may recognize that the criteria imposed in Box 14 of the CESR's advice dated January 2006 provide an adequate protection against the weaknesses of the hedge funds indices and notwithstanding the fact that few existing hedge funds indices do comply with such criteria for the time being, we nevertheless believe that one additional criterion regarding the eligibility of such hedge funds indices may be considered. This does concern the necessity for the underlying hedge funds and funds of hedge funds to respect adequate specific rules and procedures ad hoc with regards the collection of regular and accurate prices. Indeed, we are of the opinion that the main difference existing between such hedge funds indices and other eligible indices is the difficulty to obtain accurate prices therefore.

In this respect, we would like to emphasize on the fact that it would be necessary to guarantee a full transparency of the composition of the hedge fund indices in order to respect the manner the hedge funds business is currently working.

- 7) We fully agree with the fact that adequate disclosure on the investment of the UCITS in hedge funds indices should be introduced in the UCITS prospectus.

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