ASSOGESTIONI
associazione del risparmio gestito

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Our ref: N. 204/09

Comments to CESR "Call for evidence on possible implementing measures concerning the future UCITS Directive"

Assogestioni[1] welcomes the opportunity to comment on CESR's call for evidence on the implementing measures concerning the future UCITS IV Directive; we deem particularly useful the involvement of stakeholders in the definition of such measures, especially considering that they will directly affect asset management industry.

Preliminary to our specific considerations, we wish to underline that the present call for evidence should be followed by a public consultation on the advice that CESR will submit to the European Commission, in order to have the chance to express our views on the specific solutions that CESR will suggest in the aforementioned advice.

Part I – Request for technical advice on the level 2 measures related to the management company passport

1. General introduction. We agree with the European Commission suggestion of adopting, where possible, level 2 implementing measures that aim to the maximum harmonisation with the existing legal framework drafted by MiFID; however, such approach should not imply the adoption of a legislation which goes further MiFID regulation.

Management companies can provide collective portfolio management, which will be ruled by UCITS IV Directive, and portfolio management and investment advice, which are already subject to MiFID. Therefore, with reference to specific issues, such as those relating to organisational requirements, it is necessary to avoid that management companies apply different rules depending on the specific service

[1] Assogestioni is the Italian association of the investment fund and asset management industry and represents the interests of 162 members who currently manage assets whose value exceeds 800 billion euro.

provided. Otherwise, management companies would be burdened by unnecessary costs and would be bound by potentially conflicting regulations. This harmonisation should in any case take into account the peculiarities of the collective portfolio management activity.

The aforementioned approach is in force in Italy: the competent authorities have already extended MiFID rules to the collective portfolio management activity as regards a number of issues, such as organisational requirements, outsourcing, best execution and inducements, thus adapting the MiFID legislation to the characteristics of management companies and their activities.

2. Prudential rules and conflict of interests. We deem important that, according to the "Provisional request to CESR for technical advice on possible implementing measures concerning the future UCITS Directive" of the European Commission, the principle of proportionality should always apply. In particular, CESR should expressly state that rules on organisational requirements should be enforced in a proportional manner, taking into account the nature, the scale, the complexity and the range of the activities provided by the management company.

With reference to the definition of procedures and arrangements that should be adopted, management companies should apply rules which take into account MiFID level 2 implementing measures, at least, on the following topics:

- general organisational requirements;
- internal control mechanisms (compliance; risk management; internal audit);
- responsibility of senior management;
- personal transactions;
- outsourcing;
- record keeping.

In order to consider the distinctive features of management companies, rules on outsourcing should distinguish the outsourcing of critical and important operational functions, which should be aligned to MiFID, and that of the management activity, which should be regulated separately, considering the principles already stated in article 13 of the UCITS IV Directive.

As regards the structure and the organisational requirements necessary for minimizing conflict of interests, we suggest to draft a discipline in line with the relevant MiFID provisions, taking into due account the differences existing between investment services and collective portfolio management. Such issue can deeply influence the structure and the activity of the management company, especially when it provides both individual and collective portfolio management.

All the measures suggested above should be defined independently from the nature of the UCITS managed by the management company, given that the latter will, according to the principle of proportionality, adapt those measures to the specific characteristics of its UCITS, as already provided in Italian legislation.

3. Rules of conduct including conflict of interests. In order to identify the steps that management companies might reasonably be expected to take to identify, prevent, manage and/or disclose conflict of interests as well as to establish appropriate criteria for determining types of conflict of interests whose existence may damage the interest of the UCITS, management companies should implement and maintain an effective conflicts of interest policy, set out in writing, that respects the principal of proportionality, as investment companies must do according to MiFID level 2 relevant implementing measures. It should also be important to extend to management companies the specific rules regarding conflict of interests that should be taken into account when the company is a member of a group.

Furthermore, according to article 14(2)(b) of UCITS IV Directive, management companies should respect conduct of business obligations similar to those imposed by MiFID in article 19 and detailed in 2006/73/EC Directive such as, for example, rules concerning inducements, information to investors and assessment of appropriateness when management companies sell UCITS directly, best execution, reporting obligations to investors, UCITS order handling.

4. Measures to be taken by a depositary of a UCITS managed by a management company or an investment company situated in another Member State. We agree with the need of a standard agreement between the depositary of a UCITS managed by a management or an investment company situated in a different Member State and the management company itself; however, at this stage, we prefer to wait for the CESR's advice that will be submitted to the stakeholders in the future public consultation.

5. Risk management

5.1 Risk management process. In ruling risk management, CESR's advice should resort to a principle based approach which takes into account the outcomes of its document on "Risk management principles for UCITS" (CESR 09-178). This solution avoids the introduction of level 2 excessively detailed implementing rules, given the need to leave for level 3 the adoption of more specific and technical measures.

However, we believe that, in referring to the outcomes of the above-mentioned document, CESR should consider the following.

First of all, as regards the applicable law (set out under box 1 of CESR 09-178), risk management process should be governed by the law of the management company home Member State in order to avoid legal uncertainty and, even in case of use of management company passport, guarantee that the management company applies only one law irrespective of the Member States where the UCITS are located.

With reference to the supervision of the competent authorities, we would like to highlight that we consider important to clarify their relationships and duties, in order to avoid duplications of controls or uncertainty on the respective tasks

concerning the valuation of the risk management process when licensing the UCITS and the methodology of calculation of the global exposure relating to derivative instruments.

Furthermore, the risk measurement framework (set out under box 7 of CESR 09-178) should take into account the principle according to which the set of internal rules – governing the process of identification, measurement and management of the risks – should be appropriate and proportionate to nature, scale and complexity of the management company's activities and of the UCITS managed.

With reference to the link between risk measurement and asset valuation (set out under box 8 of CESR 09-178), it is important to underline that the risk management function performs tasks other than those relating to the function in charge to valuate the portfolio of the fund. Even if these functions should cooperate, the risk management function and the function in charge to valuate the portfolio of the fund have different and non-overlapping tasks.

In particular, the risk management function has, among others, the task and the responsibility of the definition of the portfolio measurement and management risk model. Therefore, such function will determine hypothesis, variables and data sources in order to provide and maintain the model coherent with the aims pursued. Given the aims of the risk management function, it is possible that the valuation of the financial instruments indicated in the model does not correspond to the one identified by the function in charge of the NAV calculation.

In our opinion, the abovementioned functions are separated and the prices used by one of them could not be always consistent with the prices used by the other, although they could be quite close.

Therefore, CESR should not consider the penultimate sentence of point 46 (of CESR 09-178) according to which "*Assumptions and models underlying pricing of assets requiring complex evaluation such as illiquid, structured financial instruments (whether or not they embed derivatives) or derivatives should be consistent with the risk measurement framework used by the Companies*."

5.2 Valuation of OTC derivatives. We suggest to refer to article 8(4)(a) of the level 3 "CESR's guidelines concerning eligible assets for investment by UCITS" (CESR 07-044) except for the reference to the UCITS responsibility for the correct valuation of the OTC derivatives. In particular, article 8(4)(a) establishes that: *For the purpose of applying Article 21(1) of Directive 85/611/EEC in conjunction with Article 19(1)(g) third indent of Directive 85/611/EEC, the criteria "process for accurate and independent assessment of the value of OTC derivatives" means:*

- *regarding the accurate assessment of the value of the over-the-counter (OTC) derivative: a process which enables the UCITS throughout the life of the derivative to value the investment concerned with reasonable accuracy at its fair value on a reliable basis reflecting an up-to-date market value;*

- *organization and means allowing for a risk analysis realized by a department independent from commercial or operational units and from the counterparty or, if these conditions cannot be fulfilled, by an independent third party. In the latter case, the UCITS remains responsible for the correct valuation of the OTC derivatives. Lastly, this organization of the UCITS implies that risk limits are to be defined.*

When the assessment of the value of the financial instruments is done by the management company or by another delegated independent entity, we deem applicable the abovementioned CESR's level 3 Guideline. However, such guideline should not apply when the calculation of NAV is done by the depositary (solution expressly admitted under Italian legislation), because, in this case, the latter (and not the management company) is the subject responsible for that calculation. As a consequence, in this case, the valuation criteria of the financial instruments are defined by the depositary and only agreed with the management company. Therefore, although the management company cooperates with the depositary, it is not liable for the valuation of the financial instruments.

In details, we suggest to take into account the following amendment of the abovementioned article 8(4)(a):
[...]
The criteria "process for accurate and independent assessment of the value of OTC derivatives" means:

- *regarding the accurate assessment of the value of the over-the-counter (OTC) derivative: a process which enables the* subject in charge to calculate the NAV *throughout the life of the derivative to value the investment concerned with reasonable accuracy at its fair value on a reliable basis reflecting an up-to-date market value;*
- *organization and means allowing for a risk analysis realized by a department independent from commercial or operational units and from the counterparty or, if these conditions cannot be fulfilled, by an independent third party.*

5.3 Content and procedure to be followed by the management company for communicating to the competent authorities of its home Member State details on risk management. In our opinion, management companies should transmit to their competent authorities the following information:

- whether the management company has a risk management function, specifying its role and tasks;
- the name of the person who is responsible for the risk management function and his professional experience (attaching a c.v.);
- the number of resources dedicated to the risk management activity, specifying their characteristics and professional experiences;
- whether the management company has drafted a list of the various types of risks in which it can incur considering its activities; the management

company should enclose this "map" and indicate the procedure used to monitor those risks;

- a description about the characteristics in terms of financial risk of the various funds managed (eventually grouped in "families") and of strategies adopted (with reference to hedge funds);
- an illustration of the main indicators used from the risk management function in order to control the profile of risk of the funds managed;
- an illustration of the procedures defined in order to control and to valuate the risk on financial derivatives position and the contribution of such positions to the general profile of risk of the portfolio;
- an illustration of the procedures defined in order to control and to valuate, on an ongoing basis, the risk linked to the use of financial leverage; the methodologies for the measurement and the control of the risks deriving from the use of derivatives products must be defined in relation to the degree of use of such instruments.

Furthermore, investment companies should give information on the use of derivative instruments with the indication of the aim of the management, the amounts of the global exposure and/or the assumable risk of said operations.

When the management company uses a model of risk management which indicates the sources of the data used (and the controls carried out in order to verify their reliability), management companies should communicate the verifications of backtesting and the stress test carried out, illustrating the results of such activity and the possible consequent actions.

Finally, management companies should specify sources of data adopted to simulate the impact of the operations decided by managers on the compliance with investment limits (prescribed by laws, regulations, or internal rules) and on the risk and reward profile of the managed portfolios.

6. On-the-spot verification and investigation and exchange of information between competent authorities. We agree with the European Commission's view which underlines the need of an effective on-going supervision and the importance of information sharing between competent authorities; such approach guarantees an effective supervision which is the basic requisite for the management company cross-border activity. As a consequence, we deem necessary that level 2 measures introduce efficient procedures in case of on-spot verification; at the same time, such measures should have a scope of application as broadly as possible and provide that the competent authorities exchange information to the maximum extent.

Part III – Request for technical advice on the level 2 measures related to fund mergers, master-feeder structures and the notification procedure

7. Mergers of UCITS: content of the information letter

7.1 Background and rationale of the proposed merger. In order to explain to investors the background and the rationale of the proposed merger, the merging and the receiving UCITS should inform them about aims pursued with the proposed merger, why the merger is realized in the interest of investors and why it increases the efficiency of the collective portfolio management activity.

7.2 Possible impact of the proposed merger. In addition to the information listed in article 43, paragraph 3, letter b), UCITS should disclose to investors: (i) whether the merger implies the replacement of the management company or of the depositary, (ii) the criteria used for calculating the ratio for exchange of units of the merging UCITS into units of the receiving UCITS; (iii) where applicable, if a cash payment per units will take place; (iv) whether the merger is a cross-border merger; (v) the consequences arising from the merger when it involves different types of UCITS (for example, a contractual UCITS and a corporate UCITS).

With respect to the density of information concerning the description of the possible merger impact on unit-holders, it could be useful to adopt a Key investor information approach, in order to communicate only the information that are deemed appropriate and essential for the investors; on the contrary, a document excessively detailed could confuse unit-holders and imply unnecessary costs. In any case, the impact of the proposed merger on investors should be described from a qualitative and not from a quantitative perspective.

7.3 Rights of unit-holders. Information provided under article 43, paragraph 3, letter c) appears exhaustive as they guarantee to unit-holders full knowledge of the rights they have in relation to the proposed merger.

7.4 Relevant procedural aspects of the proposed merger. The information letter should communicate in a short manner the essential steps of the merging procedure and, in such context, at least: (i) the consequences arising from the specific merger technique used (see article 48 of the UCITS IV Directive); (ii) whether the merger requires approval by unit-holders and whether is provided a presence quorum and/or a quorum for the approval of the relevant resolution; (iii) whether a temporary suspension will take place according to article 45, paragraph 2 of the UCITS IV Directive.

7.5 KII of the other UCITS. It is preferable that the information letter does not include a copy of Key investor information of the other UCITS involved in the merger, given that the latter contains information which are not directly related to the merger. Therefore, such document should be attached to the information letter.

7.6 Additional information. The additional information should be provided in the same way and form of the notification letter.

7.7 Format of the information letter and way to provide it. As Key investor information, the information letter should be a short document, written in brief manner and in non-technical language, presented in a way that is likely to be understood by retail investors.

Due to investor protection reasons, it is essential that CESR defines a common way to provide the information letter, recommending that the latter is addressed to each unit-holder of the merging and of the receiving UCITS in a durable medium (even different from paper). In addition, in order to assure a maximum disclosure, it could be provided that such letter is published also by means of a website.

8. Master-feeder structures

8.1 Master-feeder agreement. Given that the agreement between feeder and master should cover the documents and information necessary to meet the requirements laid down by UCITS IV Directive, such agreement should, among others, include the following topics:

- where applicable, the information that the feeder needs to comply with the investment limits stated in article 58, paragraph 2, subparagraph 2;
- the obligation of the master to give to the feeder the assurance that the master itself meets the condition set out in article 58, paragraph 3;
- if and in which terms the agreement rules a look through principle in favour of the feeder;
- the minimum time notice that master should give to the feeder before suspending temporarily the re-purchase, redemption or subscription of its units and the way such communication should be provided;
- all the information necessary to allow the feeder to draft the prospectus and the accounting documents in accordance to article 63, paragraph 1 and, respectively, paragraph 2;
- the obligation of the master to provide the feeder its prospectus and accounting documents in order to allow the feeder to comply with article 63, paragraph 5;
- when article 65, paragraph 2 is applicable, the obligation of the master to communicate to the feeder all the relevant information;
- the minimum time notice that feeder should give to the master if it decides to disinvest all its assets from the master and the way such communication should be provided;
- where a contribution in kind is allowed, the criteria to valuate the assets that the feeder will give to the master in exchange for units, the calculation method of the exchange ratio and the date in which this valuation and this calculation will take place.

Furthermore, the agreement should include an adequate flow of information in order to coordinate the timing of the net asset value calculation and publication of

the master and the feeder.

8.2 Content of the internal conduct of business rules. CESR should define a conduct of business rules which provides adequate internal procedures in order to implement the same topics listed in the above paragraph. These rules should also take into account any conflict of interests issue that may arise from the fact that master and feeder are managed by the same management company in order to avoid that such company advantages one of the funds with prejudice to the others.

8.3 Liquidation of the master. Due to the fact that the master can be liquidated only three months after it has informed all of its unit-holders and the competent authorities of those feeder's home Member State of the decision to liquidate, the two alternative procedures relating to the feeder – according to article 60, paragraph 4 – should be concluded before this time period has expired.

In our opinion, the option set out in article 60, paragraph 4, subparagraph 1, letter a) (investment of the feeder in units of another master) should imply the application of article 64. Such article imposes to a feeder that changes master the duty to inform its unit-holders of this circumstance, giving them the possibility to decide whether or not to maintain their investment. This requirement should be satisfied at least 30 days before the beginning of the investment into the master. At the same time, the change of the master implies that the authorisation procedure under article 59, paragraph 2 (which should last not more than 15 working days) have already taken place. In fact, according to article 64, paragraph 1, letter a), the feeder should provide to unit-holders, among others, a statement that its competent authorities have approved the investment of the feeder in units of such master. Therefore, the overall procedure should be concluded within the three month time period provided by article 61, paragraph 4, subparagraph 2.

As regards the option set out in the article 60, paragraph 4, subparagraph 1, letter b) (conversion of the feeder into a UCITS which is not a feeder), the UCITS IV Directive doesn't expressly rule the procedure in case of amendment of the fund rules or instrument of incorporation which implies the conversion of the feeder into an ordinary UCITS. However, this case imposes to solve the same kind of issues arising when an existing UCITS converts itself into a feeder. Consequently, even the conversion of a feeder into an ordinary UCITS could be ruled establishing: (i) the need to inform unit-holders about this circumstance at least 30 days before it becomes an ordinary UCITS, similarly to what provided in article 64; (ii) the granting of the approval within 15 working days, similarly to what provided under article 59, paragraph 2.

CESR should define when and for which extent of time the competent authorities can suspend and/or interrupt the procedures set out in article 60, paragraph 4, subparagraph 1 depending from the refusal of the feeder's application taking into account the terms suggested above and the fact that the entire procedure should last at maximum three months.

There is not a need of specific rules in order to manage the procedures mentioned in article 60, paragraph 4, subparagraph 1, in case of a cross-border master-feeder structure; such rules shouldn't be different from those that the European Commission would adopt pursuant to article 105.

8.4 Merger or division of the master. The options set out in article 60, paragraph 5, subparagraph 1, letters b) and c) are the same as those referred to article 60, paragraph 4, subparagraph 1, letters a) and b), respectively. Therefore, the procedures related to article 60, paragraph 5, subparagraph 1, letters b) and c) should be the same as those suggested in the above paragraph 8.3.

However, in this case, both procedures should last no more than 60 days, given that the master has to inform its unit-holders or the competent authorities of the feeder's home Member State with the information referred to or comparable with article 43 no later than 60 days before the proposed effective date of the merger or of the division.

With reference to the option set out in article 60, paragraph 5, subparagraph 1, letter a, it should be considered that a feeder that chooses such option is – *de facto* – changing master. In particular:

- if the feeder continues to be a feeder of the same master, the merger or the division may imply a substantial difference in the investment policy of the master;
- if the feeder continues to be a feeder of another UCITS resulting from the merger or from the division of the master, the new master may be completely different from the previous one.

Therefore, the procedure applicable should be the same proposed with regard to the case provided under article 60, paragraph 5, subparagraph 1, letter b).

8.5 Agreement between the depositaries. The agreement between the depositary of the master and the depositary of the feeder should rule, among others: (i) the modalities and the time frame for exchanging information; (ii) how each depositary complies with its own obligations, especially when the depositaries are not located in the same Member State and, therefore, are not subject to the same jurisdiction; (iii) the coordination between the depositaries on the control of the NAV calculation.

8.6 Types of irregularities of the master which are deemed to have a negative impact on the feeder. We agree with the European Commission's suggestion of including in the types of irregularities – that the depositary of the master should communicate according to article 61, paragraph 2 – the cases listed under article 106, adapting them to the peculiarities of a master-feeder structure. Therefore, the abovementioned communication could concern the cases where the master: (i) doesn't comply with laws, regulations or administrative provisions which lay down the conditions governing the authorisation as a UCITS and/or as a master; (ii) doesn't comply with laws, regulations or administrative provisions which specifically govern activities of the master or of the master's management company; (iii) doesn't

assure the continuous functioning of its activities.

8.7 Agreement between the auditors. The agreement between the auditor of the feeder and the auditor of the master should cover, among others, the following topics: (i) the modalities and the time frame for exchanging information; (ii) the time limit within which the auditor of the master should provide the auditor of the feeder with its audit report, in order to allow the latter to fulfil its duties; (iii) with reference to the auditor of the master, if the master and the feeder have not the same accounting year, the obligation to transmit an *ad hoc* report within a specific date; (iv) how each auditor complies with its own obligations, especially when the auditors are not located in the same Member State and, therefore, are not subject to the same jurisdiction.

8.8 Conversion into a feeder or change of the master: format of the information letter and way to provide it. As Key investor information, the information letter should be a short document, written in a brief manner and in non-technical language, presented in a way that is likely to be understood by retail investors.

Furthermore, due to investor protection reasons, it is essential that CESR defines a common way to provide the information letter, recommending that the latter is addressed to each unit-holder of the feeder in a durable medium (even different from paper). In addition, in order to assure a maximum disclosure, it could be provided that such letter is published also by means of a website.

8.9 Contribution in kind. CESR should recommend to the European Commission a solution which assures a clear definition of the duties of the depositary and/or the auditor of the feeder and of the depositary and/or the auditor of the master. In particular, it should be stated, among others, that:

- the depositary and/or the auditor of the feeder makes an adequate control on the criteria adopted to valuate the assets that feeder will give to the master in exchange for units and on the calculation method of the exchange ratio as well as the actual exchange ratio determined at the date when the contribution in kind takes effect;
- the depositary and/or the auditor of the master controls the same aspects verified by the depositary and/or the auditor of the feeder.

The date for valuing the assets and liabilities of the feeder and the master and for calculating the exchange ratio should be defined in the agreement between the feeder and the master.

The effective date for the contribution in kind should be the date indicated in article 64, paragraph 1, subparagraph 1, letter c), *i.e.* the date when the feeder is to start to invest into the master or, if it has already invested in the master, the date when its investment is to exceed the limit applicable under article 55, paragraph 1.

9. Notification procedure

9.1 Scope of information on national law to be published by UCITS host Member State. The information that the competent authorities of the UCITS host Member State should make available on their website should be exhaustive and updated, in order to allow UCITS to fully rely on the information published.

In particular, the scope of information relating to national marketing arrangements to be used in the host Member State should include, among others:

- whether there are specific national models for marketing arrangements and the characteristics of those models;
- whether there is a specific entity which takes care of the various obligations – which do not fall within the field covered by the UCITS IV Directive – that the UCITS has towards investors in the host Member State such as, for example: (i) take care of the administrative activity concerning the subscription, redemption and repurchase of the UCITS units or shares; (ii) send to investors the confirmation letter of the investment; (iii) help investors in exercising the rights connected to their units; (iv) make available to investors the documentation required by the national law;
- whether there are exemptions from the national rules applicable to marketing arrangements depending, for example, from the type of investors that can subscribe the units of the UCITS;
- in case of indirect distribution of the units of the UCITS, the main elements of the agreement made with intermediaries concerning the distribution;
- whether the information and the documentation transmitted to the competent authorities in order to comply with national obligations not falling within the scope of the UCITS IV Directive have to be updated regularly;
- the language and the means to be used in communications, not falling within the scope of the UCITS IV Directive, with the host Member State competent authorities;
- any rule on marketing communications (for example, format and way to represent performances and other information that could be included in the communications).

9.2 Facilities and procedures providing for the access of a host Member State to statutory documents of a UCITS and other information as referred to in article 93, paragraph 1 to paragraph 3. In order to simplify the procedure and to avoid uncertainties, CESR should usefully provide a standard notification letter concerning the changes to documents referred to in article 93, paragraph 2, which the UCITS has to notify to the competent authorities of the host Member State, specifying the language to be used. Member States should allow that the mentioned standard notification letter could be transmitted by electronic means.

9.3 Standard model of the notification letter and the attestation. We believe that the standard model of the notification letter and the attestation that confirms that the UCITS fulfil the conditions imposed by the UCITS IV Directive should be

formulated, to the maximum extent possible, as drafted by CESR in Annexes I and II to its guidelines to simplify the notification procedure of UCITS (CESR/06-120b).

We remain at your disposal for any request of clarification or further comments on the content of our reply.

The Director General