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The Committee of Securities Regulators
11-13 Avenue de Friedland
75008
PARIS
France

By e-mail

Dear Sirs

Call for evidence - possible implementing measures of the future UCITS directive

We have the following comments on the call for evidence.

Part I Management Company Passport

Section 1.2.1 & Section 1.2.2 (Prudential rules, rules of conduct, conflicts of interest)

We believe CESR should consider the two questions relating to Articles 12 1(a) and (b) in section 1.2.1 alongside the questions referred to in section 1.2.2 relating to Article 14 2 (a) and (b). The language of the relevant articles corresponds closely to the relevant articles relating to MIFID. As MIFID is a service-based passport it would seem prudent to follow as closely as possible the wording contained in the MIFID implementing Directive. Such an approach would ensure a level playing field with MIFID investment firms in terms of the rules relating to conflicts of interest and operational requirements and avoid any tendency to gold-plate the UCITS regime.

We attached, at Annex A, an analysis of the relevant provisions of UCITS and those of MIFID which also covers the area of risk management.

Section 1.2.3 (Measures taken by depositaries)

We point out the typo in the Directive. The reference in Article 23(6) to paragraph 4 should be to paragraph 5.

The specific conditions that a depositary must meet are laid down in the UCITS Directive, specifically proposed Articles 22 to 26 for depositaries of common funds and proposed Articles 32 to 36 for depositaries of investment companies. Whilst similar, the duties are not the same, and CESR's must take this into account in its advice to the Commission.

In terms of content, we hope CESR will not suggest detailed level 2 implementing requirements. Clearly the agreement needs to reflect the duties the Directive imposes on the depositary as mentioned above. It will also need to reflect any additional duties imposed by UCITS home State's national law that is in addition to the Directive's minimum harmonised requirements. For example a UCITS home member State may have applied the rules relevant for depositaries of common funds to depositaries of companies. There may also be certain additional duties imposed by local law – such as trust law in the UK. To ensure

these matters are appropriately dealt with agreements will need to state clearly that the rules of the UCITS home State must be respected, but we do not see that this needs to be included as level 2 implementing measures.

Section 1.2.4 (Risk Management)

We believe that CESR should advise the Commission to look at the existing MIFID implementing measures to set the level of prescription for any level 2 UCITS implementing rules. First and foremost MIFID recognises that risk management is a subset of the principle-based rules on organisational requirements in MIFID Article 13. There is also a general requirement on competent authorities to assess compliance with the operating conditions contained within MIFID and to obtain relevant information to assess compliance (MIFID Article 17). MIFID implementing Directive, Article 7 then provides more details on risk management processes.

CESR has recently produced Level 3 guidelines on risk management principles. In many areas the wording used by CESR mirror that of MIFID's Level 2 implementing measures. Compare, for example, MIFID Article 7 1 (a) and 2 to Box 2 paragraph 1 when referring to adequate risk management procedures and the need for them to be proportionate. We would therefore suggest that CESR advises the Commission to introduce equivalent standards into any UCITS implementing measures as it has done so in MIFID.

Clearly the CESR principles go over and above the MIDIF level 2 requirements. In some areas this is a result of CESR gold-plating the UCITS requirements (for example Box 1 of the CESR principles requires competent authorities to consider the adequacy of the risk management process whereas this is not a requirement of the Directive) albeit it for good reason (to provide additional comfort to host State regulators and smooth the operation of the passporting provisions). In other areas this is due to the nature of the rules being based on the product rather than the service. We would suggest CESR advise the Commission that any additional requirements in the principles should be retained at level 3.

We suggest CESR advise the Commission that the risk management principles it has already produced at level 3 should be considered to meet the request to determine the criteria that a competent authority needs to take into account when considering the adequacy of the system in measuring risks and their contribution to the overall risk profile. There does not seem to be a need to make this level 2 implementing provisions at the current time (particularly given a review of level 3 powers by the Commission).

In response to the question on OTC derivative valuation we refer to the existing level 2 rules and CESR level 3 guidance contained in Commission Directive 2007/16/EC. We doubt that more is required here.

In terms of communication to competent authorities, the Directive is clear that the management company must send the competent authorities details of its risk management process. This has been a requirement since implementation of Commission Directive 2001/108/EC and the lack of complaint/comment from competent authorities suggest that the "detailed rules"[1] that they have with regard to communication do not need harmonisation at level 2 or 3.

Section 1.2.5 & 1.2.6 (On the spot verification and investigation & information exchange)

We suggest CESR propose to the Commission that Articles 56, 57, and 59 of the MIFID implementing Directive are relevant here.

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1 The Directive states "It must communicate to the competent authorities regularly and in accordance with the detailed rules they shall define",

Part II Key Investor Information

We have no comment as we will be considering the latest CESR consultation on the subject.

Part III Fund Mergers, Master-Feeder Structures and Notification Procedures

Whist there is no deadline relating to the implementing measures in this area we would welcome any measures that assist in ensuring the UCITS product remains competitive in the market place. So, where necessary, any measures need to be introduced before the Directive has to be implemented in 2011. Generally speaking, we do not see the need for much level 2 implementing regulation being necessary. CESR should also consider if Level 3 guidance is necessary.

3.1 Mergers

Information letter: content

In response to question 1 we believe the level 1 text Article 43 (3) is already too detailed. Specifically the list of matters listed in (a) to (e) would better sit at Level 2. Therefore any further information requirements should be Level 3 at the most and CESR should also consider whether the industry could set standards here.

Other relevant information may include matters such as accounting dates leading to different income distribution patterns and dealing times/limits but these are likely to be provided by way of the provision of key investor information anyway. So we would suggest the Commission and CESR only consider additional rules or guidance following an appropriate period of time and post-implementation review.

In response to question 2 we believe there should be flexibility allowing a manager to provide the information as a stand alone document or bound up with other documents.

In response to question 3 and 4 we would suggest no implementing measures are necessary and the Commission and CESR should only consider action following an appropriate period of time and post implementation review.

Information letter: format

We would suggest no level 2 implementing measures are necessary and the Commission and CESR should only consider action following an appropriate period of time and post implementation review.

Information letter: provision

We would suggest no level 2 implementing measures are necessary and the Commission and CESR should only consider action following an appropriate period of time and post implementation review.

3.2 Feeder Funds

3.2.1 Contents of agreement

We do not think that the contents of the agreement need to be made as implementing level 2 measures. It would be better for the industry to produce best practice documents in this area and for the Commission and CESR to reflect by way of a post implementation review whether implementing rules are required.

In terms of internal conduct of business rules there are already requirements on the UCITS management company to act in the best interests of unit holders and for the fund to be operated within the requirements set out in the rules and fund's prospectus. We see no need to add to these requirements.

3.2.2 Market timing

Operators of UCITS schemes are responsible for ensuring unit holders entering or leaving the fund pay or receive the appropriate amount of money so that they are treated fairly and continuing unit holders are not disadvantaged,. Existing rules for UCITS has meant operators operate procedures to deter frequent trading and market timing possibilities. Are the Commission concerned there is market failure here?

We do not consider that there needs to be level 2 implementing measures in this area. The example provided seems to be outside the control of the manager of the feeder or master.

3.2.3 to 3.2.7

No comment.

3.2.8 (contributions in kind)

We suggest that it should be up to the master fund to decide, and set out in its prospectus, if it is willing to accept a contribution in kind and for the depositary of the master to accept assets as set out according to its responsibilities under the relevant law. Contributions in kind occur for other types of UCITS and the lack of market failure would suggest there is no need for implementing measures in this area.

3.3 Notification

3.2.1 Information on national law

We would request that marketing information is produced in a standard way and kept up to date.

3.2.2 Access to documents by a host State

The drafting of the proposed Directive is unfortunate as in all other areas a regulator to regulator notification is used. If such a method could be agreed by competent authorities, provision of the most up-to-date documents to the UCITS home State would suffice. In the absence of such agreement it would seem prudent for a management company to e-mail updated documents to both home and host State competent authority and to provide a link to a website where the most up-to-date documents are kept. The use of a central database does not seem to be necessary.

3.3.3 Standard model of the notification letter

We do not see why this needs to be level 2 implementing measures given that CESR agreed a model without implementing powers on the introduction of UCITS III. Any solution needs to bear in mind the need for a balanced proposal that should not make the process too complex, and so should not seek to add any material over and above what is stated in the Directive.

Yours faithfully,

Simon Vernon
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UCITS REQUIREMENT	EQUIVALENT MIFID?
Article 12 (1)(a) – Draw up prudential rules which shall require that each management company has: *'sound administrative and accounting procedures'*	**Level 1 Article 13(5) 2nd indent** An investment firm shall have *sound administrative and accounting procedures*…. **Level 2** For administrative systems suggest **Article 5. (1)** (ALL?) – [see also below for Article 14(1)(c0 **Level 2** For accounting. **Article 5 (4)** *Investment firms must establish, implement and maintain accounting policies and procedures that enable them, at the request of the of the CA to deliver to the CA in a timely manner financial reports that reflect a true and fair view of their financial position and which comply with applicable accounting standards.*
'control and safeguard arrangements for electronic data processing'	**Level 1 Article 13(5) 2nd indent.** An investment firm shall have…….. and effective control and safeguard arrangements for information processing systems **Level 2 Article 5 (2).** Member States shall require investment firms to establish, implement and maintain systems and procedures that are adequate to safeguard the security, integrity and confidentiality of information, taking into account the nature of the information in question.
'*adequate internal control mechanisms'*, including rules:	**Level 1 Article 13(5) 2nd indent**. An investment firm shall have…..internal control mechanisms….,
♦ for personal transactions by employees	**Level 1 Article 13 (2).** An investment firm shall establish adequate policies and procedures to ensure compliance of the firm including…. appropriate rules governing personal transactions… **Level 2 Article 11** (Meaning of personal transactions) **Article 12** (Personal transaction). Does not seem to be that relevant.
♦ or for the holding or management of investments in financial instruments in order to invest own funds	**Level 2 section 6** Client order Handling rules
♦ each transaction in UCITS can be reconstructed according to its origin, parties to it, nature, time and place effected	**Level 1 Article 13 (6).** An investment firm shall arrange for records to be kept of all services and transactions undertaken by it which shall be sufficient to enable the CA to monitor compliance under the Directive and in particular that the investment firm has complied with

	all obligations with respect to clients…" **Level 2 Directive Article 51** (Retention of Records) **Level 2 Regulation Article 8** (Recordkeeping)
♦ assets managed in accordance with fund rules etc.	**Level 1 Article 13 (2).** An investment firm shall establish adequate policies and procedures to ensure compliance of the firm…. **Level 2 Article 6** (Compliance)
Article 12(1)(b) Company structured and organised in such a way as to minimise the risk of:	
UCITS' or clients' interests being prejudiced by conflicts of interest between ♦ company and its clients ♦ one client and another ♦ one client and a UCITS ♦ between two UCITS	**Level 1 Article 13 (3).** An investment firm shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent a conflict of interest from adversely affecting the interests of its clients. See also **Article 18** (definition). **Level 2 Article 21** (Conflicts of interest potentially detrimental to clients) **Article 22** (Conflicts of interest policy) **Article 23** Record of services or activities giving rise to detrimental conflict of interest).

Article 14 (1) Member States to draw up rules of conduct … such rules shall implement at least the principles set out in (a) to (e). these principles shall ensure a management company;	**Level 1 Article 19 (1).** Member States shall require that, when providing investment services and/or where appropriate ancillary services to clients, an investment firm
(a) acts honestly and fairly in conducting its business activities in the best interests of the UCITS it manages and the integrity of the market (b) acts with due care and diligence, in the best interests of the UCITS it manages and the integrity of the market	acts honestly, fairly and professionally in accordance with the best interests of its clients and comply with principles in 2 – 8 **Level 2 Article 26** (Inducements)
(c) has and employs effective resources and procedures that are necessary for the proper performance of its business activities;	**Level 1 Article 13 (4)** An investment firm shall take reasonable steps to ensure continuity and regularity in the performance of investment services and activities. To this end the investment firm shall employ appropriate and proportionate systems, resources and procedures Level 2 Article 5. Member States shall require investment funds to comply with the following requirements: (a) to establish, implement and maintain decision-making procedures and an organisational structure which clearly and in documented manner specifies reporting lines and allocates functions and responsibilities; (b) to ensure that the relevant persons are aware of the procedures which must be followed for the proper discharge of their responsibilities; (c) to establish, implement and maintain adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the investment firm; (d) to employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them; (e) to establish, implement and maintain effective internal reporting and communication of information to all relevant levels of the investment firm; (f) to maintain adequate and orderly records of their business and internal organisation; (g) to ensure that the performance of multiple functions by the relevant persons does not and is not likely to prevent those persons from discharging any particular function soundly, honestly and professionally.
(d) tries to avoid conflicts of interest and, where they cannot be avoided,	**Level 1 Article 13 (3).** An investment firm shall maintain and operate effective organisational

ensures that the UCITS it manages are fairly treated, and	and administrative arrangements with a view to taking all reasonable steps designed to prevent a conflict of interest from adversely affecting the interests of its clients. **Level 1 Article 18** (definition). **Level 2. Article 22** (Conflicts of interest policy) **Article 23** Record of services or activities giving rise to detrimental conflict of interest).

Level 1 Article 50 1 (g)(iii) The OTC derivatives are subject to reliable and verifiable valuation on a daily basis and can be sold, liquidated or closed by an offsetting transaction at any time at their fair value at the UCITS initiative. **Level 2 (Article 8 2007/16/EC) (& Level 3 guidance)** 4. For the purposes of the third indent of Article 19(1)(g) of Directive 85/611/EEC, the reference to reliable and verifiable valuation shall be understood as a reference to a valuation, by the UCITS, corresponding to the fair value as referred to in paragraph 3 of this Article, which does not rely only on market quotations by the counterparty and which fulfils the following criteria: (a) 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 recognised methodology; (Level 3 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.) (b) verification of the valuation is carried out by one of the following: (i) an appropriate third party which is independent from the counterparty of the OTC-derivative, at an adequate frequency and in such a way that the UCITS is able to check it; (Level 3 The UCITS remains responsible for the correct valuation of OTC derivatives and must, inter alia, check that the independent third party can adequately value the types of OTC derivatives it wishes to conclude.) (ii) a unit within the UCITS which is independent from the department in charge of managing the assets and which is adequately equipped for such purpose. (Level 3 CESR's view is that "independent" and "adequately equipped" in this context mean a unit which has the adequate means (both human and technical) to perform this valuation. This implies that the UCITS use its own valuation systems, which can however be provided by an independent third party. This excludes the use of valuation models provided by a party- related to the UCITS (such as a dealing room with which OTC derivatives are concluded) which have not been reviewed by the UCITS. This also excludes the use of data (such as volatility or correlations) produced by a process which has not been qualified by the UCITS.)	No MIFID equivalent

Level 1 Article 51 The management company or investment company shall employ a risk management process which enables it to monitor and measure at any time the risk of the positions and their contribution to the overall risk profile of the portfolio. It shall employ a process for accurate and independent assessment of the value of OTC derivatives It shall communicate to the CA of its home Member State regularly and the types of derivatives instruments, the underlying risks, the quantitative limits and the methods which are chosen in order to estimate the risks associated with transactions in derivative instruments regarding each managed UCITS.	**Level 1 Article 13(5) 2nd indent**. An investment firm shall have…..effective procedures for risk assessment… **Level 2 Article 7** 1. . Member States shall require investment firms to take the following actions: (a) to establish, implement and maintain adequate risk management policies and procedures which identify the risks relating to the firm's activities, processes and systems, and where appropriate, set the level of risk tolerated by the firm; (b) to adopt effective arrangements, processes and mechanisms to manage the risks relating to the firm's activities, processes and systems, in light of that level of risk tolerance; (c) to monitor the following: (i) the adequacy and effectiveness of the investment firm's risk management policies and procedures; (ii) the level of compliance by the investment firm and its relevant persons with the arrangements, processes and mechanisms adopted in accordance with point (b); (iii) the adequacy and effectiveness of measures taken to address any deficiencies in those policies, procedures, arrangements, processes and mechanisms, including failures by the relevant persons to comply with such arrangements, processes and mechanisms or follow such policies and procedures. 2. Member States shall require investment firms, where appropriate and proportionate in view of the nature, scale and complexity of their business and the nature and range of the investment services and activities undertaken in the course of that business, to establish and maintain a risk management function that operates independently and carries out the following tasks: (a) implementation of the policy and procedures referred to in paragraph 1; (b) provision of reports and advice to senior management in accordance with Article 9(2). Where an investment firm is not required under the first sub-paragraph to establish and maintain a risk management function that functions independently, it must nevertheless be able to demonstrate that the policies and procedures which it is has adopted in accordance with paragraph 1 satisfy the requirements of that paragraph and are consistently effective.

1.2.6 Exchange of information between competent authorities	
Level 1 Article 101	See MIFID Articles 56,57 & 59